IN THE SUPREME COURT OF THE STATE OF MONTANA

Supreme Court Cause No. DA 23-0289

On Appeal from the Montana 13th Judicial District Court, Yellowstone County,
The Honorable Collette B. Davies, Presiding

PHOENIX CAPITAL GROUP HOLDINGS, LLC

Plaintiff/Appellant,

v.

BOARD OF OIL AND GAS CONSERVATION OF THE STATE OF MONTANA,

Defendant/Appellee/Cross-Appellant

And

KRAKEN OIL AND GAS LLC,

Intervenor/Appellee/Cross-Appellant

Plaintiff/Appellant Phoenix Capital Group Holdings LLC's Opening Brief

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ISSUES PRESENTED

1. Whether the Board of Oil and Gas Conservation of the State of Montana (the "Board") can force pool a mineral owner's interest when the mineral owner has expressly requested to voluntarily pool their interest before the application for force pooling is submitted to the Board.

2. Whether the Board can grant risk penalties to an operator against a mineral owner based upon a mineral owner's failure to pay within a statutorily required timeframe when the operator does not send out the notice to participate in the statutorily required timeframe.

3. Whether a notice sent under Mont. Code Ann. § 82-11-202(3) constitutes a written demand for payment under Mont. Code Ann. § 82-11-202(2)(b) and negates the statutory timeframes in Mont. Code Ann. § 82-11-202(3).

STATEMENT OF THE CASE

Plaintiff/Appellant Phoenix Capital Group Holdings, LLC ("Phoenix") brought this case challenging a decision of the Board that granted Intervenor/Appellee Kraken Oil and Gas, LLC ("Kraken") force pooling of Phoenix's minerals and risk penalties against Phoenix. The Board entered its order on October 14, 2021. Dkt. 25, Ex. 20. Phoenix filed a request for rehearing with the Board, which was denied on December 1, 2021. Dkt. 25, Ex. 21. On

December 30, 2021, Phoenix filed a complaint for injunctive relief in district court pursuant to Mont. Code Ann. § 82-11-144 challenging the Board's order. Dkt. 1.

All parties agreed that the case should be determined on summary judgment and filed competing motions on September 9, 2022, pursuant to a stipulated amended scheduling order. *See, e.g.,* Dkts. 19-27. The district court held a hearing on November 22, 2022. The district court issued its Order on Motions for Summary Judgment on April 17, 2023 (the "Order"), granting the Board's and Kraken's summary judgment motions and upholding the Board's order. Joint Appendix ("JA") 1. Phoenix filed its Notice of Appeal on May 25, 2023, and Kraken and the Board filed their Combined Notice of Cross-Appeal on June 7, 2023. Dkts. 46 & 50.

STATEMENT OF FACTS

A. Pooling

State laws relating to oil and gas development "attempt to balance states' goals of resource development with landowners' rights."[1] Dkt. 25, Ex. 1 (Frank Sylvester, *Oil and Gas Spacing and Forced Pooling Requirements: How States Balance Energy Development and Landowner Rights*, 4 U. Dayton L. Rev. 47

[1] The terms "landowner," "mineral owner," and "owner" are used interchangeably throughout this brief. Although a surface owner does not necessarily own the mineral rights, the only real property ownership discussed in this brief is that of the mineral owner.

(2015)). Well-spacing and pooling are tools that help accomplish these goals. Typically, there is a pool or reservoir of oil and/or gas under several tracts of land, and each tract has different, often undivided, ownership. Dkt. 25, Ex. 2 (58 C.J.S. Mines and Minerals § 436). Because oil is fluid, all the oil in one reservoir might be removed by a single well that is drilled on only one of the tracts. *Id.* To extract oil from the reservoir, the various interests of mineral owners are "pooled" into one or more drilling units for the production of the reservoir, with each owner still entitled to a share equal to their mineral acreage in that unit. *Id.*

The goal for the state is to obtain voluntary pooling. Dkt. 25, Ex. 3 (Kemp Wilson, *Montana Oil and Gas Conservation – North Dakota Industrial Commission – Waste Prevention in the Big Sky Country*, RMMLF-INST 5G-1 (1997)). Voluntary pooling is based on agreements between mineral owners and oil and gas developers where the parties agree to the terms of development. Dkt. 25, Ex. 1, at § II. Most often, this takes the form of oil and gas leases from the owner(s). *Id.* Those oil and gas leases include a provision that allows the operator to pool the owners' minerals into a spacing unit with other owners/leaseholds.

If an operator cannot obtain leases or voluntary participation from all the minerals within a proposed spacing unit, then force pooling may be necessary. This occurs when one or more mineral owners refuse to sign leases, but the Board determines that an operator can still pool the non-consenting owners' minerals into

a unit for production. Force pooling laws "attempt to resolve the problem of non-consenting owners: landowners with oil or gas rights who refuse to voluntarily pool their ownership rights with other landowners." Dkt. 25, Ex. 1, at § II. By force pooling the unleased owners, an operator may still be able to produce oil and gas from a spacing unit.

"Typically, forced-pooled owners are given the choice of (1) agreeing to participate in drilling and pay their share of the costs, (2) agreeing to give up their operating rights in return for a bonus payment and royalty determined appropriate by the state conservation agency, or (3) electing to be 'carried' for drilling and completion costs." Dkt. 25, Ex. 4 (John S. Lowe, Oil and Gas Law in a Nutshell (5th Ed. 2010), at Chp. 2 (pp. 29-30)). In Montana, when a mineral owner refuses to participate in costs and is force pooled, the owner is allocated a 1/8 (12.5%) landowner royalty. Dkt. 25, Ex. 3, at p. 7; Mont. Code Ann. § 82-11-202(2)(c).

While the mineral owner will receive the 1/8 royalty, the operator retains the benefit of the remainder of the owner's revenue interest until the cost recovery is complete. *Id.* This remains the case until, and if, the well produces sufficient revenue to recover costs and risk penalties, discussed below. After the well reaches "payout" (the operator has recovered costs of drilling and operation), the mineral owner is entitled to full revenue for 100% of its interest (not just the 1/8 royalty). Mont. Code Ann. § 82-11-202(2)(c).

B. Risk Penalties

As an alternative to leasing their development rights to an operator in exchange for a fractional royalty, a mineral owner may participate in the drilling and development of a well. However, most mineral owners do not have the ability to contribute to well costs, nor are they willing to risk the investment if the well is not profitable. Dkt. 25, Ex. 1, at § IV(C). As a result, owners generally sign leases that provide for a royalty and do not require any cost contributions, and in return shift the risk along with the bulk of the financial responsibility to the lessor. *Id.* While leases may provide more lucrative royalties and upfront "bonus" payments, a mineral owner who is force pooled and refuses to participate in costs gets only a 1/8 (12.5%) statutory royalty. Mont. Code Ann. § 82-11-202(2)(c).

When a force-pooled, unleased owner refuses to participate in costs of development, the operator is responsible for "carrying" costs on that owner's entire interest. Dkt. 25, Ex. 1, at 6. Because the operator must cover these costs, Montana law allows an operator to recover "risk penalties" from the force-pooled owner's share of production proceeds. Dkt. 25, Ex. 3, at p. 7; Mont. Code Ann. §82-11-202 (2)(b)(i)-(ii). For certain well costs, the risk penalty is 200% in Montana. *Id.* Practically, that means that an operator gets to recover 200% of the actual costs from the force-pooled owner's production share. Thus, instead of getting paid on its full owner's share from well revenue once the well has reached

payout, the force-pooled owner will not get paid until the operator has recovered 200% of those costs from the owner's revenue. *Id.*

Not only is this a penalty to the force-pooled owner, but it is also a substantial windfall for the operator. It allows the operator to "charge" the force-pooled owner for 200% on some of the costs owed, keeping revenue that would have gone to the owner if the owner had participated in costs. These risk penalties encourage mineral owners to voluntarily participate in production, enter oil and gas leases, promote natural resource production, and protect the consenting owners' correlative rights. Dtk. 25, Ex. 1, at 7.

C. Phoenix's Mineral Interest

Phoenix owns an undivided mineral interest in the following property in Richland County, Montana:

> Township 25 N, Range 59 E
> Section 6: S1/2
> Section 8: N1/2

(the "Minerals"). Dkt. 25, Ex. 5. Phoenix acquired its interest from Steve Solis by a deed recorded on February 26, 2021. *Id.* Steven Solis acquired his interest from Katherine Solis by a deed recorded earlier that same day. *Id.* at Ex. 6. Accordingly, prior to February 26, 2021, Katherine Solis ("Solis") was the record owner of the Minerals. *Id.*

Some of the Minerals are part of a permanent 1,280-acre spacing unit which consists of Sections 6 and 7 in Township 25 North, Range 59 East. Dkt. 25, Ex. 9. Kraken drilled three wells in early 2020 on the spacing unit that are at issue in this litigation: the RKT Carda 7-6 #2H, the RKT Carda 7-6 #3H, and the RKT Carda 7-6 #4H (the "Wells"). *Id.* at pp. 7-8, Ex. 10. When Phoenix purchased the Minerals in 2021, Kraken did not have a lease for the Minerals, had not force pooled the Minerals for the Wells, and had not applied for risk penalties on the Minerals for the Wells. JA 2 - 83:10-13; Dkt. 25, pp. 7-8. In other words, with respect to the Wells, Phoenix paid for and purchased Minerals that were unleased, unpooled, and not subject to risk penalties.

D. Kraken's Prior Contact with Solis

In 2017, when Solis still owned the Minerals, Lindsey Meszaros, an agent for Kraken, had one phone conversation with Solis and one phone conversation with Solis's sister. Dkt. 27, Ex. A, at ¶¶ 6-10.[2] Kraken also sent an offer letter to Solis on October 31, 2017, offering to lease the Minerals. *Id.* Kraken's last contact with Solis was in November 2017, when an employee of Kraken contacted her via telephone. Dkt. 27, Ex. B. Solis did not respond to the offer letter and did

[2] Kraken and the Board attempted to submit Meszaros' testimony regarding what Solis and her sister said on those phone calls via affidavit and via the Board hearing transcript. The district court correctly rejected that testimony as hearsay. JA 1 - 3.

not agree to lease the Minerals in 2017. Dkt. 27, Ex. A. Kraken had no further contact with Solis between October 2017 and January 2020.

On December 23, 2019, more than two years after its last conversation with Solis, Kraken filed three applications to drill the Wells with the Board. Dkt. 28, Exs. 23-25. Kraken did not apply for or obtain an order force pooling the Minerals or imposing risk penalties prior to submitting the drilling applications for the Wells. Kraken also did not have any contact with Solis about the specific Wells in 2017, which were not even contemplated at that time. Dkt. 27, Ex. A.

Kraken sent notices dated January 10, 2020, to Solis, giving her an opportunity to participate in the Wells as a full cost bearing owner. Dkt. 25, Exs. 11-13 (the "Notices"). However, although the Notices were dated January 10, 2020, they were not "certified at the post office" until January 13, 2020. Dkt. 27, Ex. C 22:32-34 (transcript of Board hearing). Thus, the Notices were not actually mailed until January 13, 2020. The Wells were spudded on the following dates:

- RKT Carda 7-6 #2H: January 21, 2020 (8 days after the notice was sent)
- RKT Carda 7-6 #3H: January 29, 2020 (16 days after the notice was sent)
- RKT Carda 7-6 #4H: February 6, 2020 (27 days after the notice was sent).

Dkt. 27, p. 5. The Notices were returned to Kraken as unclaimed mail. *Id.*

The Notices were informational and track the exact requirements of Mont. Code Ann. § 82-11-202(3)(a) (other than being sent within the prescribed

timeframe), which allows the Board to presume that a mineral owner has refused to participate in a well if the statute is followed.[3] Specifically the Notices contained the following information: the location of each well, the projected depth of each well, estimated costs of drilling, and an estimated spud date of each well. Dkt. 25, Exs. 11-13; *see, also,* Mont. Code Ann. § 82-11-202(3)(a). According to the Notices, Solis had 30 days from the receipt of each letter "to accept or reject this well proposal." *Id.* The Notices also notified Solis, "By electing to participate, the working interest owner [Solis] agrees to tender payment to Kraken within (30) days of receipt of any joint interest billing or invoice." *Id.* The Notices did not demand any payment from Solis at that time but simply informed Solis that by choosing to participate, she would be required to tender payment to Kraken in the future upon receipt of invoices. *Id.* Kraken did not obtain force pooling of the Minerals or risk penalties before or after drilling the Wells in 2020.

[3]All statutes referenced are to those existing prior to 2023 amendments. The Board worked with the legislature in the 2023 session to revise Section 82-11-202(3)(a), removing the requirement that a notice under 82-11-202(3)(a) must be sent 30 days prior to the spud date of a well. *See* Mont. Code Ann. § 82-11-202(3) (2023); Mont. H.B. 289, 68th Leg., Chp. 441 (2023), available at https://leg.mt.gov/bills/2023/sesslaws/ch0441.pdf. This case is about the failure of Kraken to send those notices 30 days prior to the spud date under the pre-2023 statutory requirement.

E. Phoenix's Attempts to Participate

Once Phoenix acquired the Minerals in 2021, it requested multiple times to participate as a cost bearing owner in the Wells. Specifically, Phoenix emailed Kraken several times in February and March of 2021, requesting participation. Dkt. 25, Exs. 14-16. In a March 17, 2021 email to Kraken, Curtis Allen, CEO of Phoenix, specifically requested AFEs (authorizations for expenditures) and JIBs (joint interest billings) for the Minerals so that Phoenix could pay its share of costs. Dkt. 25, Ex. 16. In response, Justin Payne, a landman with Kraken, informed Mr. Allen that the Minerals were "deemed Non-Consent since Ms. Solis did not elect to participate in the wells during the election period." Dkt. 25, Ex. 17. Mr. Payne also stated that it was "ordered by the MBOGC to authorize non-consent penalties in accordance with 82-11-202(2) MCA." *Id.* Mr. Payne's statement was incorrect as Kraken had not complied with the required election period to send the Notices under § 82-11-202 (30 days before the spud date) and the Board had not authorized non-consent penalties on the Minerals for the Wells.

Phoenix filed a declaratory judgment case against Kraken in Richland County on August 4, 2021, seeking a court's determination that the Notices sent to Solis were void for failure to comply with § 82-11-202 and a judgment that Phoenix had a right to participate in the Wells (the "Richland County Case"). Dkt.

25, at Ex. 18.[4] As of the date that the Richland County Case was filed, the Minerals had still not been force pooled for the Wells, and risk penalties had not been sought by Kraken. Dkt. 25, Ex. 10, at RFA 9.

The Wells were completed on August 18, 2021. JA 2 - 65:19- 66:2. According to Kraken, until the Wells were completed, it did not know if "the frack was successful" or if Kraken "got immediate flow back" or whether the casing held. *Id.* at 65:19-24. Prior to completion on August 18, 2021, "you don't know whether the risk was a successful payoff until the wells are completed, and that was on 8/18/2021 . . . ." *Id.* Accordingly, when Phoenix attempted to participate in the Wells multiple times in the five months prior to completion of the Wells, nobody knew whether the Wells were going to be financially successful.

F. The Board's Pooling Order

On September 7, 2021, approximately one month after Phoenix filed the Richland County Case attempting to participate in the Wells, Kraken applied for an order force pooling the Minerals and for risk penalties. Dkt. 25, Ex. 19. In the Application, Kraken averred that as of the Application date, it "has been unable to establish voluntary pooling of all interests within said spacing unit with respect to" the Wells. *Id.* at ¶ 3. Kraken further affirmed that "it is anticipated that such pooling cannot be consummated prior to hearing on this application." *Id.* In its

[4] The Richland County Case is stayed pending resolution of this case.

Application, Kraken did not inform the Board that Phoenix had attempted multiple times to voluntarily pool its Minerals and participate in the Wells, rendering force pooling unnecessary. *Id.* Kraken requested that the Board force pool all interests in the Wells and authorize recovery of non-consent risk penalties. *Id.*

The Board held a hearing on Kraken's Application on October 14, 2021. Dkt. 25, Ex. 20; Dkt. 27, Ex. C. Meszaros testified at the Board hearing about her conversations with Solis and Solis's sister. Dkt. 27, Ex. C at 8:28-9:26. Solis did not testify at the Board hearing. *Id.* The Board found, based upon Meszaros's hearsay testimony, that Solis, the prior mineral owner, "did not want to participate or lease or even be contacted." *Id.* at 24:39-25:4. The Board was aware of the Richland County Case and Phoenix's attempts to participate as the current owner. *Id.* at 13:26-29; 15:37-16:9.

After the hearing, the Board entered an order force pooling the Minerals and allowing Kraken to recover risk penalties from Phoenix's interest (the "Pooling Order"). Dkt. 25, Ex. 20. As part of the Pooling Order, the Board found that "Kathryn [sic] Solis failed or refused to pay her share of costs of development or other operations after written demand under § 82-11-202(2)(b), Mont. Code Ann." *Id.* It also found that Kraken "made an unsuccessful, good faith attempt to acquire voluntary pooling" of the Minerals. *Id.* Based upon Kraken's contact with the prior mineral owner, the Pooling Order provides that Phoenix can only receive a

12.5% royalty on its Minerals and that Kraken can recover risk penalties, up to 200% of actual costs incurred, from Phoenix's interest. *Id.*

STANDARD OF REVIEW

This Court reviews a district court's grant or denial of summary judgment de novo, applying the same criteria as the lower court. *Fisher ex. rel. McCartney v. State Farm Mut. Auto. Ins. Co.*, 2013 MT 208, ¶ 11, 371 Mont. 147, 305 P.3d 861. When the standard of review is de novo, the Court will "review the district court's conclusions of law to determine whether they are correct and its findings of fact to determine whether they are clearly erroneous." *Revelation Industries, Inc. v. St. Paul Fire & Marine Ins. Co.*, 2009 MT 123, ¶ 13, 350 Mont. 184, 206 P.3d 919. The interpretation and application of a statute by the district court is a conclusion of law, which the Supreme Court reviews for correctness. *Estate of Donald ex rel. Donald v. Kalispell Regional Medical Cntr.*, 2011 MT 166, ¶ 17, 361 Mont. 179, 258 P.3d 395 (citing *Hulstine v. Lennox Indus.*, 2010 MT 180, ¶ 16, 357 Mont. 228, 237 P.3d 1277).

Mont. Code Ann. § 82-11-144, the statute under which Phoenix brought this case, allows a suit for injunction against the Board and requires a district court to try the case "de novo" and "not upon any record of any hearing before the board." Accordingly, the reviewing court is likewise not limited to the administrative record. *Ostby v. Bd. Of Oil & Gas Conserv.*, 2014 MT 105, ¶ 8, 374 Mont. 472,

324 P.3d 1155. Although the challenged order shall be prima facie valid, any "finding of fact, actual or presumed" made by the Board is not "binding on the court." Mont. Code Ann. § 82-11-144.

Under this standard, the Court "shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning and applicability of any board action." *Id.* The Court may hold unlawful and set aside Board actions, findings, and conclusions that are "in excess of statutory jurisdiction, authority, or limitations or short of statutory right" or "without observance of procedure required by law" or "unwarranted by facts." *Id.* Here, the district court improperly granted summary judgment to the Board and Kraken, holding that the Pooling Order was not unlawful and should not be set aside. JA 1. This Court should reverse the holding of the district court and set aside the Pooling Order.

SUMMARY OF THE ARGUMENT

Phoenix challenged two decisions from the Board's Pooling Order: the Board's decision to force pool the Minerals and its decision allowing Kraken to recover risk penalties from Phoenix's share of production. Phoenix attempted to voluntarily pool the Minerals and participate in the Wells multiple times before Kraken applied for force pooling of the Minerals. Mont. Code Ann. § 82-11-202(1)(b) required Kraken, the operator, to make a "good faith attempt" to

voluntarily pool the Minerals before applying for force pooling. The district court incorrectly interpreted this requirement to allow Kraken to simply ignore the multiple offers that Phoenix, the mineral owner, made to voluntarily pool its Minerals prior to Kraken's Application. Kraken was required by § 82-11-202(1)(b) to act in good faith and accept the mineral owner's offer to voluntarily pool the Minerals instead of applying for force pooling.

After minerals are force pooled, an operator is required to meet additional criteria to obtain risk penalties pursuant to Mont. Code Ann. § 82-11-202(2) and (3). Specifically, § 82-11-202(3) requires an operator to send a notice to the mineral owner 30 days prior to spudding a well. If the mineral owner does not pay or agree to pay its share of costs prior to the well spud date, then subsection (3) presumes that the mineral owner has chosen not to participate. Kraken, the Board, and the district court all agree that Kraken did not meet this requirement; the Notices Kraken sent under subsection (3) to Solis were not sent 30 days prior to the spud date of any of the Wells.

Nevertheless, the district court found that Kraken had met a separate requirement in § 82-11-202(2), which allows an operator to obtain risk penalties if the operator sent a "written demand" for payment prior to its application, and the mineral owner either refuses to pay or does not pay its share. There is no timeframe in subsection (2) for when the mineral owner is required to pay.

Phoenix, the mineral owner at the time that Kraken applied for risk penalties, had offered multiple times to pay its share of costs and participate in the Wells prior to Kraken's Application. Yet, the district court applied a statutory presumption of non-participation to the current mineral because the prior mineral owner, Solis, had "failed to pay" her share of costs after receiving the Notices.

The district court's interpretation of § 82-11-202(2)(b) was incorrect because it applied a statutory presumption to Solis and not to Phoenix. Subsection (3) is the only provision in § 82-11-202 that allows for a presumption of non-consent if a mineral owner does not pay within a certain timeframe. Subsection (2), on the other hand, has no timeframe and, by its plain language, allows the mineral owner to pay its share any time before the operator applies for risk penalties. By applying the presumption in subsection (3) to the prior mineral owner, while disregarding the operator's failure to comply with the requisite notice date, the district court misinterpreted and misapplied § 82-11-202.

The district court further misconstrued § 82-11-202(2)(b) when it determined that the Notices constituted a "written demand" for payment under that subsection. Nothing in the Notices informed Solis that Kraken was demanding payment. And, in fact, even if Solis had wanted to pay, she could not have done so because there was no actual amount for her to pay – only speculative future costs

based upon an estimated calculation of her interest. A demand for payment, at the very least, must include the payment amount required.

Finally, the district court incorrectly granted deference to the Board's interpretation of § 82-11-202, ignoring the plain language in the statute and its purpose. The statute is not meant to favor operators over real property owners. Under the district court's interpretations, Kraken was granted wide leeway to simply ignore the statutory timeframes, which was in turn strictly applied against the mineral owner. The fact that the Board did the same below, favoring the operator over the mineral owner, does not allow the district court to incorrectly apply the statute.

This Court should reverse the district court's Order and find that the Board's Pooling Order exceeded its jurisdiction, ignored the required statutory procedures, and was unwarranted by facts. Mont. Code Ann. § 82-11-144. A reversal would allow Phoenix to participate in the Wells as a full cost-bearing owner from the date that costs were first incurred.

ARGUMENT

I. THE DISTRICT COURT INCORRECTLY INTERPRETED FORCE POOLING REQUIREMENTS.

For both decisions that the Board made in its Pooling Order – to force pool the Minerals and grant risk penalties – the Board follows different subsections of

Mont. Code Ann. § 82-11-202.[5] To force pool an interest, the Board must determine that the "applicant has made an unsuccessful, good faith attempt to voluntarily pool the interest within the permanent spacing unit." Mont. Code Ann. § 82-11-202(1)(b). Only upon such a finding does the Board have statutory authority to force pool interest. The resulting pooling order "must be upon terms that are just and reasonable" and that afford the owner of any interest in a permanent spacing unit "the opportunity to recover or receive without unnecessary expenses a just and equitable share of the oil and gas produced and saved from the spacing unit." *Id.* The district court upheld the Board's decision to force pool the Minerals finding that Kraken made a good faith attempt with Solis (the prior owner), and thus additional attempts when Pheonix owned the Minerals were not required. JA 1 - 8-9.

Phoenix has not argued that Kraken was required to make additional attempts to lease the Minerals. However, "good faith" did require Kraken to accept Phoenix's offers to voluntarily pool the Minerals in the months before Kraken's Application. As the district court noted, "It is hard to imagine that Phoenix could acquire better rights in the mineral interest than what Solis herself had." JA 1 - 9. What Phoenix purchased was exactly the interest that Solis herself had – unleased,

[5] There is no case law interpreting the provisions of Mont. Code Ann. § 82-11-202 at issue in this litigation. Since that statute has been amended to remedy the exact issues in this case, this is a unique appeal.

unpooled Minerals that were not subject to risk penalties. Thus, Phoenix still had the option when it purchased those Minerals to voluntarily pool them.

That is precisely why Phoenix offered multiple times to voluntarily pool and pay its share of costs from February 2021 until September 2021. Dkt. 25, Exs. 14-16. Kraken, in turn, ignored Phoenix's attempts and applied to the Board for force pooling of the Minerals, falsely stating in its Application that it "has been unable to establish voluntary pooling of all interests within said spacing unit" and that "it is anticipated that such pooling cannot be consummated prior to hearing on this application." Dkt. 25, Ex. 19, at ¶ 3. All Kraken had to do to "establish voluntary pooling" was accept one of Phoenix's multiple offers to voluntarily pool the Minerals. The fact that Kraken refused and, instead, applied for force pooling is not a "good faith attempt to voluntarily pool" the Minerals as required by § 82-11-202(1)(b). It is the opposite: Kraken's actions were dishonest and in bad faith.

The district court determined that Kraken's attempts in 2017 to lease the Minerals were enough to meet the "good faith" requirement in § 82-11-202(1)(b). To be clear, Kraken's attempts to lease the Minerals from Solis included two phone calls to her and sending her one lease packet in the mail in 2017. Dkt. 27, Exs. A and B. At that time, the Wells were not even contemplated, only the permanent spacing unit upon which the Wells would eventually be drilled. Kraken did not

even submit drilling applications for the Wells until 2019, over two years after its last contact with Solis. Dkt. 28, Exs. 23-25.

Based upon Kraken's contact with Solis four years prior to the Pooling Order and five years prior to its Order, the district court found that Kraken made a good faith attempt to voluntarily pool the Minerals. JA 1 - 8-9. The district court incorrectly interpreted the "good faith" requirement of § 82-11-202(1)(b). At the very least, the statute required Kraken to accept Phoenix's offers to voluntarily pool the Minerals before Kraken applied for force pooling because it "could not establish voluntary pooling" of the Minerals. Dkt. 25, Ex. 19, at ¶ 3.

The district court also misstated the express timing requirements of § 82-11-202(1)(b), which contributed to its incorrect interpretation of the statute. Kraken and the Board both argued that they only needed to seek consent from Solis, the owner of the Minerals at the time the Wells were spudded. JA 1 - 9. The district court found their interpretation of the statute to be "consistent with the statutory scheme as a whole and industry practices." *Id.* According to the district court, an operator seeks voluntary pooling before a well is drilled but only seeks force pooling "*after* those wells have begun producing income that must be allocated." *Id*.[6] This interpretation of § 82-11-202(1)(b) is expressly contradicted

[6] It is unclear where the district court obtained this interpretation as nothing is cited in support of it. However, it likely came from argument by Kraken's attorneys at the hearing regarding Kraken's belief about industry practice.

by the statute itself. According to that provision, the applicant for a pooling order "must be a person who owns an interest in the oil or gas underlying the permanent spacing unit or who has drilled a well, proposed to drill a well, or proposes to conduct other operations on a well . . . ." Mont. Code Ann. § 82-11-202(1)(b) (emphasis added). Once a permanent spacing unit is created, anyone who has an interest in the oil or gas underlying it can seek a pooling order at any time according to the plain language of the statute. *Id.*

Here, the Minerals are part of a permanent spacing unit that was created on October 14, 2018. Dkt. 25, Ex. 9. Kraken could have sought force pooling of the Minerals at any point thereafter once the Wells were contemplated, including in 2019 and 2020. It did not. Instead, it waited until three years later – after Phoenix requested to voluntarily pool the Minerals and filed the Richland County Case – to seek a pooling order. The district court's determination that this timeframe and the intervening actions (Phoenix's multiple offers to voluntarily pool the Minerals) were irrelevant is wrong. That decision was based upon an inaccurate interpretation of the statute, one where Kraken's delay in applying for force pooling was just "industry practices." JA 1 - 9. The statute clearly defines the timing and practice for seeking a pooling order – any time after a permanent spacing unit is created. Mont. Code Ann. § 82-11-202(1)(b).

Kraken did not act in "good faith" when it waited several years to pool, apparently due to oversight or neglect until Phoenix offered to voluntarily pool the Minerals. It certainly did not act in good faith when it ignored Phoenix's offers, waited until the Richland County Case was filed, and then applied to the Board for pooling on the false basis that it could not obtain voluntary pooling. The actual owner of the Minerals at the time the Application was submitted was willing and ready to pool the Minerals. Dkt. 25, Exs. 14-16.

The Board's determination in its Pooling Order that Kraken could not obtain voluntary pooling of the Minerals was "without observance of procedure required by law" and "unwarranted by facts." Mont. Code Ann. § 82-11-144. The statute required Kraken to act in "good faith" and for the Board to enter an order that was "just and reasonable," affording the mineral owner the right to receive "without unnecessary expense" its equitable share of oil and gas produced. Mont. Code Ann. § 82-11-202(1)(b). Force pooling minerals of an owner who offered to voluntarily pool and only giving that owner a 1/8 royalty is not "just and reasonable," especially when based upon false statements of the operators. *Id.* The district court's decision to uphold that unjust Pooling Order was based upon an incorrect legal conclusion. *Estate of Donald*, ¶ 16.

II. THE DISTRICT COURT INCORRECTLY APPLIED THE RISK PENALTY REQUIREMENTS.

The Pooling Order also allows Kraken to obtain risk penalties payable from Phoenix's share of production from the Wells. Dkt. 25, Ex. 20. In Montana, risk penalties are 100% of some costs such as "newly acquired surface equipment beyond the wellhead connection." Mont. Code Ann. § 82-11-202(2)(b)(i). More importantly, the penalties are 200% for the most significant well costs, including "staking, well site preparation, obtaining right-of-way, rigging up, drilling, reworking, deepening or plugging back, testing, and competing the well." *Id*. at (2)(b)(ii). This 200% penalty is extremely punitive towards mineral owners who have refused to participate in costs and expenses of a well. In this case, the Pooling Order is punitive towards Phoenix, allowing Kraken to recover 200% of the actual costs for major and more lucrative expenses from Phoenix's share. Dkt. 25, Ex. 20.

a. Kraken cannot benefit from its failure to follow statutory requirements.

Obtaining a force pooling order is one of the prerequisites to obtaining risk penalties. Mont. Code Ann. § 82-11-202(2). Because Kraken was not entitled to force pooling, it was not entitled to risk penalties. However, assuming that Kraken met the requirements for force pooling, there are additional requirements for risk penalties. Subsections (2) and (3) of § 82-11-202 set forth the procedure for

obtaining risk penalties. Under subsection (2)(b), an operator is entitled to risk penalties "[i]f a well has been drilled prior to the hearing on the application and an owner, after written demand, failed or refused to pay the owner's share of the costs of development or other operations . . . ." Mont. Code Ann. § 82-11-202(2)(b).[7] Thus, if a mineral owner has "failed or refused to pay" its share of costs after an operator sends a "written demand," the operator may obtain risk penalties. Subsection (3) explains that "[a]n owner is presumed to have refused to pay the owner's share of costs if prior to the spud date of the well, the owner fails to pay or agree to pay the share of costs after notice by the well operator," that has either been (1) acknowledged in writing or (2) "sent at least 30 days prior to the spud date of the well to the owner by certified mail . . . ." Mont. Code Ann. § 82-11-202(3).

Kraken and the Board acknowledge that the Notices here were not sent 30 days prior to the spud date of the Wells. Dkt. 27, p. 16; Dkt. 21, p. 11. As explained above, the RKT Carda 7-6 #2H was spudded 8 days after the notice was sent to Solis, the #3H was spudded 16 days after the notice was sent, and the #4H was spudded 27 days after the notice was sent. The district court and the Board

[7] The same language applies in that subsection "if a well has not been drilled prior to the hearing." Mont. Code Ann. § 82-11-202(2)(b). Once again, the district court's determination that operators do not apply for force pooling or risk penalties until a well is successful is contradicted by the statutory language.

acknowledged the same. JA 1 - 12; Dkt. 27, Ex. C 24:23-37. Thus, everyone agrees that the Board could not apply risk penalties under subsection (3) of § 82-11-202 because Kraken did not meet the statutory requirements to obtain a presumption of non-participation from the mineral owner.

Instead, both the Board and the district court found that subsection (3) was irrelevant because Kraken had sent Solis a "written demand" for payment via the Notices, and she had failed to pay her share of costs after receiving the demand. Dkt. 25, Ex. 20; JA 1 - 9-14.[8] In sum, the district court determined that Kraken was not required to meet subsection (3) because it was not applicable to Kraken.

The district court's interpretation of the statute, finding that subsection (3) did not "add new, substantive requirements to Section 82-11-202" and simply "clarifies the already-existing requirements of (a) written demand and (b) failure or refusal to pay" did not recognize the burdens that subsection (3) imposes on mineral owners. JA 1 - 13. While the district court found that Kraken did not have to meet the statutory presumption and send the Notices 30 days prior to the spud date as required by subsection (3), the district court ignored the explicit presumption that applies to the mineral owner in that same subsection.

[8] The district court also erroneously determined that the Notices constituted a written demand for payment, as explained in Section II(b). The Notices did not provide an amount for Solis to pay, request her to send payment, or provide any method for payment.

When interpreting a statute, a court must not "insert what has been omitted or omit what has been inserted." Mont. Code Ann. § 1-2-101. Here, the district court omitted from its decision the timeframe in subsection (3) that is applicable to a mineral owner, yet still applied the presumption from subsection (3) to the mineral owner. A mineral owner is "presumed to have refused to pay the owner's share of costs if prior to the spud date of the well, the owner fails to pay or agree in writing to pay" their share of costs after receipt of the notice defined by subsection (3). Mont. Code Ann. § 82-11-202(3)(a) (emphasis added). In other words, while Kraken claims that it did not have to send the Notices 30 days prior to the spud date of the Wells, Solis only had until the spud date to pay or agree to pay under the statutory presumption in subsection (3). The Notices contain the exact information required by subsection (3), including the "location of the well, the projected depth and target formations, the anticipated costs of drilling and completing the well, and the anticipated spud date of the well." *Id.* at (3)(b). Kraken obviously sent the Notices pursuant to the language of subsection (3), but now that Kraken realizes it cannot meet its timeframe in that provision, it claims that the subsection is irrelevant.

However, the timeframe in subsection (3) was still applied to Solis. Under the statute, Solis only had until the spud date of the Wells to pay, if she either acknowledged receipt of a requisite notice in writing or it was sent at least 30 days

prior to the spud date Mont. Code Ann. § 82-11-202(3)(a). When she failed to pay in that timeframe, the statute automatically applied a presumption of non-consent to her, so long as the notice requirement was met.[9] Though the Notices were irrefutably deficient, that is exactly what the district court did – it applied a statutory presumption to Solis, finding that she "'failed' to pay her share of costs, per the express terms of the statute . . . ." Dkt. 43, p. 13. Yet, the district court did not explain the timeframe under which the mineral owner was required to pay.

In short, the district court did not acknowledge that under the same statute that it found to be inapplicable, Kraken created a situation where Solis only had 8 days to pay those costs for the first well, 16 days for the second well, and 27 days for the third well. Kraken's failure to follow, and the district court's refusal to enforce, the required timeframe for the Notices in subsection (3) prevented Solis from meeting the court-imposed timeframe to participate. Although the district court did not acknowledge such in its decision, it obviously imputed a timeframe upon the mineral owner for payment. Since the only timeframe for a mineral owner to pay is found in subsection (3), the district court implicitly applied subsection (3) to the mineral owner while simultaneously finding the timing or acknowledgment of Notices inapplicable to the operator.

[9] There was actually nothing for Solis to pay, as explained below.

If the district court's interpretation is right, by the time Phoenix purchased the Minerals, Solis had already missed the statutorily required timeframe to either pay or agree to pay costs simply because Kraken ensured that she could not meet it. The district court's interpretation of the statute, applying a statutory presumption to the mineral owner but refusing to apply the statutory requirement to the operator, is not correct. An operator cannot fail to follow its required timeframe and then obtain a presumption of non-consent for a mineral owner's failure to follow the owner's timeframe in the same ostensibly inapplicable subsection. Such a legal conclusion ignores certain parts of the statute while emphasizing others.

Without the timeframe and presumption in subsection (3), when exactly was the mineral owner required to pay? Subsection (2) has no timeframe. It simply states that if a well has been drilled "prior to hearing on the application" and if a mineral owner "failed" to pay after "written demand," then risk penalties will apply. Mont. Code Ann. § 82-11-202(2)(b). Without a deadline in subsection (2)(b), Phoenix still had the option to pay before Kraken's Application and the Board hearing, as it offered multiple times to do after it purchased the Minerals. According to the plain language of subsection (2)(b), since the owner of the Minerals agreed to pay and offered to pay months before the Application for risk

penalties, then at the time of the hearing, the mineral owner had not "failed or refused to pay" its share. *Id.*

Kraken needed the statutory presumption in subsection (3) to be applied to Solis, the prior mineral owner, to obtain risk penalties. That's exactly what the district court did – applied a presumption of refusal to Solis. Without the deadline in subsection (3), the mineral owner could have paid or agreed to pay at any point prior to Kraken's Application for risk penalties. The district court's decision to apply a statutory timeframe to Solis but not to Kraken was incorrect. It misinterpreted the statute to negate the subsection (3) requirements for the operator, while imposing the full burdens of subsection (3) on the mineral owner. Similarly, the Board's Pooling Order, which did the exact same thing, was in excess of its statutory jurisdiction and "without observance of procedure required by law." Mont. Code Ann. § 82-11-144. The district court erroneously upheld the Pooling Order and its decision should be reversed. *Estate of Donald*, ¶ 16.

b. The Notices sent under subsection (3) of § 82-11-202 did not constitute a demand under subsection (2).

In finding that Kraken had complied with subsection (2) of § 82-11-202, the district court found that the Notices constituted a "written demand" for payment of the Wells' costs. The district court acknowledged that the statute does not define "demand." JA 1 - 11. Nonetheless, it determined that in the Notices were a demand because in them, "Kraken asserted its rights and claimed Solis owed either

payment or would be assessed penalties." *Id.* at 12. In fact, the Notices did not inform Solis that she "owed" any payment, nor was there any direction for payment.

The Notices were informational and tracked the exact requirements of § 82-11-202(3)(a), save for the mailing date. The following data appeared in the Notices: the location of each well, the projected depth of each well, estimated costs of drilling, and an estimated spud date of each well. Dkt. 25, Exs. 11-13; *see, also,* Mont. Code Ann. § 82-11-202(3)(a). According to the Notices, Solis had 30 days from the receipt of each letter "to accept or reject this well proposal." Dkt. 25, Exs. 11-13. Finally, the Notices stated, "By electing to participate, the working interest owner [Solis] agrees to tender payment to Kraken within (30) days of receipt of any joint interest billing or invoice." *Id.*

There is not a single place in the Notices that told Solis that she <u>owed</u> any payment at that time. *Id.* Instead, the Notices requested that Solis agree to pay any "joint interest billing or invoice" that she received in the future. *Id.* The Notices expressly stated that billing and invoices would be submitted to a participating owner and that the owner would be required to "tender payment to Kraken within (30) days of receipt" of any such statements. *Id.* The Notices were not a demand for payment; they were a request for an agreement to make payments within 30 days of receipt of an <u>actual, future</u> demand for payment.

In fact, if Solis had wanted to pay her share of costs upon receipt of the Notices, it would have been impossible for her to do so. Not only was there no demand for payment, but there was no amount for her to pay. The closest thing to a payment amount in the Notices was data on the "total estimated cost for the proposed operation" and Solis's "estimated gross working interest" in the spacing unit "[c]ontingent on verification of title." Dkt. 25, Exs. 11-13 (emphasis added). If the Notices were a demand for payment, as required by subsection (2) of § 82-11-202, then the only way Solis could have complied with the demand was to somehow calculate her share of the "estimated" operation cost by using her "estimated gross working interest" to pay her entire share of well costs up front instead of upon receipt of each future bill. *Id.* Requiring the recipient to make such a convoluted calculation to comply with a "demand" for payment shows that it is not a "demand" at all.

Instead, the Notices were informational. They notified Solis about her opportunity to participate in the Wells as expressly required by subsection (3) of § 82-11-202, the exact subsection that the district court and Board determined was inapplicable. Of course, if the Notices were a demand for payment, then Solis only had mere days until the well spud date to make such payment under that same provision. Mont. Code Ann. § 82-11-202(3). Once again, the district court incorrectly interpreted the statute in a way that penalized the mineral owner while

allowing ambiguous leeway to the operator. *Estate of Donald*, ¶ 16. The Board's Pooling Order should have been set aside as unlawful because it ignored the required legal procedures and violated the mineral owner's statutory rights. Mont. Code Ann. § 82-11-144.

c. The district court incorrectly deferred to the Board's interpretation of § 82-11-202.

As part of its decision, the district court found that "courts in Montana give deference to administrative agencies' scientific and industrial expertise, and therefore their interpretation of the statutes they are charged with implementing." JA 1 - 7-8 (citing *Mont. Power Co. v. Mont. PSC*, 2001 MT 102, ¶ 23, 305 Mont. 260, 26 P.3d 91). In the case the district court cites for this proposition, this Court cautioned against such broad agency deference in the very next paragraph. As stated by the Court, "Once this rule is properly traced to its source, however, it is necessary to temper the District Court's as well as the Appellants' slight but significant overstatement of its breadth." *Mont. Power. Co.*, ¶ 24. Instead, a rule of deference applies "where the particular meaning of a statute has been placed in doubt, and where a particular meaning has been ascribed to a statute by an agency through a long and continued course of consistent interpretation, resulting in an identifiable reliance." *Id.* at ¶ 25. "Even then, such administrative interpretations are not binding on the courts; rather, they are entitled to 'respectful consideration.'" *Id.* (emphasis added).

The district court gave the Board's interpretation of § 82-11-202 far more than "respectful consideration." It omitted various provisions of the statute to uphold the Board's Pooling Order, including the provision that allows an operator to obtain force pooling at any point after a permanent spacing unit is formed and the provision that sets strict timing requirements on both the operator and mineral owner. *See, e.g.*, Mont. Code Ann. § 82-11-202(1)(b) and (3)(a); JA 1 - 9 (finding that voluntary pooling is not sought until after a well is successful) & JA 1 - 13 (finding that the prior mineral owner failed to pay her share of costs in some unexplained timeframe and ignoring Kraken's own timing requirements). More importantly, if the Board truly believed its interpretation and historical application of the statute was correct, then it would not have lobbied the 2023 Montana Legislature to amend it. If the Board's interpretation of its statute is to be given weight, then its actions helping revise that same statute should also be given weight.

The 2023 version of § 82-11-202 completely removes the requirement that a notice be sent 30 days "prior to the spud date" of a well. *See* Mont. Code Ann. § 82-11-202 (2023); Mont. H.B. 289, 68th Leg., Chp. 441 (2023). Noticeably, the amended statute also removes the language stating that a mineral owner is presumed to have refused to pay if "prior to the spud date of the well" the owner fails to pay or agree to pay its share. *Id.* If the 2023 version of the statute had

existed in 2020-2021, this case would not exist. The mineral owner would have had more than 8 days to pay her share of costs, and Kraken would have been able to send the Notices at any time. The district court would not have had to determine whether subsection (3) was applicable or impute some arbitrary timeframe for the mineral owner to pay. However, under the version of the statute that existed, the district court's extreme deference to the Board was simply wrong.

The statutory scheme was not created to favor operators while ignoring mineral owners' rights. Pooling orders are meant to "balance states' goals of resource development with landowners' rights." Dkt. 25, Ex. 1. The pre-2023 statute attempted to do just that, requiring pooling orders to be "just and reasonable," affording all interest owners (including mineral owners) "the opportunity to recover or receive without unnecessary expenses a just and equitable share of the oil or gas produced and saved from the spacing unit." Mont. Code Ann. § 82-11-202(1)(b). There is nothing in the Board's Pooling Order that is "just and reasonable" to Phoenix, the owner of the Minerals that are the subject of the order.

Kraken sat on its rights for years, ignored Phoenix's attempts to participate, and then waited until it had three successful, producing Wells to apply for risk penalties against Phoenix. Dkt. 25, Exs. 14-16; JA 2 - 65:19- 66:2. In fact, it appears that Kraken may have simply forgotten about the status of pooling for

these Minerals until Phoenix tried to voluntarily pool them. Phoenix attempted to participate as a cost-bearing owner before the Wells were completed, before it was clear that they would be successful, and when Kraken still had risk. *Id.* That is, of course, the exact point of "risk penalties" – acknowledging that the operator is taking a risk in carrying costs for a well that may not be successful. Dkt. 25, Ex. 3, at p. 7. Kraken did not apply for risk penalties when it still faced that risk, such as in January 2021, prior to Phoenix's first request to participate. It waited 8 months after Phoenix's request, until the Wells were completed and financially successful, to apply for risk penalties and obtain a financial windfall against Phoenix. Dkt. 25, Ex. 19.

Kraken admits that it chose to wait to apply for risk penalties until it determined whether "there was a successful payoff until the wells [were] completed, and that was on 8/18/2021 . . . ." JA 2 - 65:24-66:2. Even then, it waited almost another month to file its Application with the Board. Dkt. 25, Ex. 19. The district court's Order required the mineral owner do everything in a timely manner, lest the owner lose certain rights to the minerals. Yet, the district court did not require the operator to timely do anything – send the Notices, apply for force pooling, or apply for risk penalties. Under the district court's interpretation of § 82-11-202, a mineral owner has fewer rights than the entity removing the

minerals from the ground. Surely a property owner is more protected than that under Montana law.

The district court's deference to the Board's interpretation of § 82-11-202 was incorrect and a misunderstanding of the law. *Estate of Donald*, ¶ 16. The Order should be reversed, and Phoenix should be allowed to participate in the Wells from the date of drilling as a full cost-bearing owner.

CONCLUSION

The district court's Order should be reversed. It incorrectly interpreted and applied Mont. Code Ann. § 82-11-202. Because Phoenix offered multiple times to voluntarily pool its Minerals, Kraken was not entitled to an order force pooling the Minerals. The Board ignored the facts and exceeded its statutory jurisdiction in finding that Kraken was unable to accomplish voluntary pooling of the Minerals and issuing the Pooling Order, and the district court should have set aside the Pooling Order as unlawful. Mont. Code Ann. § 82-11-144.

The district court also erred when it upheld the risk penalty provision of the Pooling Order. Without explaining the mineral owner's timeframe to participate, the district court applied a presumption of non-participation to the mineral owner from subsection (3) of § 82-11-202, while acknowledging that Kraken could not meet the requirements of that same subsection. Under subsection (2) of § 82-11-202, which the district court and Board ostensibly applied, the mineral owner had

at least until Kraken applied for risk penalties to participate in the Wells because Kraken was not entitled to a presumption of nonparticipation.

The Notices also did not constitute a written demand for payment under subsection (2). Neither the prior mineral owner nor the current mineral owner ever received a written demand for payment. Accordingly, because Kraken could not meet the statutory presumption for non-participation of subsection (3), Phoenix still had the right to participate when it offered multiple times to do that exact thing. The district court's deference to the Board, misunderstanding of pooling and risk penalty procedures, and misapplication of the law require reversal of the Order. The Board's Pooling Order is unlawful, and Phoenix should be able to participate in the Wells from the date that costs were first incurred.

DATED this 16th day of August, 2023.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 11(4)(e) of the Montana Rules of Appellate Procedure, I certify that this Brief is printed with a proportionately spaced Times New Roman text typeface of 14 points; is double-spaced, except for quoted and indented material; and the word count calculated by Microsoft Word is 9,071 words, excluding table of contents, table of authorities, caption, certificate of service and certificate of compliance.

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