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 Reply and Answer to Cross-Appeal

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INTRODUCTION

The district court reviewed the Board of Oil and Gas's October 14, 2021 Pooling Order *de novo*. This Court is tasked with doing the same. In upholding the Pooling Order, the district court incorrectly affirmed the Board's decision to ignore express language in Mont. Code Ann. § 82-11-202. Instead of applying the plain statutory language, the district court disregarded mineral owner Phoenix's requests to voluntarily pool its Minerals for seven months before operator Kraken applied for force pooling. The plain language of § 82-11-202(1)(b) allows the Board to enter a pooling order only if the operator has acted in good faith (Kraken had not), and a pooling order can only be entered upon terms that are just and reasonable to the mineral owner (the terms were not). Critically, the Board lacks jurisdiction to force pool minerals where – as here – the mineral owner has agreed to voluntarily pool.

In determining that risk penalties also applied to Phoenix's interest, the district court again disregarded statutory language. Risk penalties can only be granted under § 82-11-202(2)(b) if a mineral owner has refused, after a demand, to pay its share of costs. The district court incorrectly found that Kraken's January 10, 2020 Notices to the previous owner constituted a demand for payment under the statute, even though there was no amount to pay and no demand included. Kraken created a situation where it was impossible for the mineral owner to

comply with the statute, and the Board unjustly rewarded Kraken for it. The district court followed suit, concluding that Kraken, as the operator, was not required to comply with any statutory timeframe. The district court applied a presumption of refusal to the mineral owner, on the other hand, for not complying with statutory timeframes. The district court's Order misinterpreted § 82-11-202(2) and (3) by applying full statutory burdens to mineral owners and none to operators.

The Board acted in excess of its statutory jurisdiction and without required legal procedures in issuing the Pooling Order. Mont. Code Ann. § 82-11-144. The district court's Order should be reversed because it did the same by incorrectly interpreting the applicable statute. *Estate of Donald ex rel. Donald v. Kalispell Regional Medical Cntr.*, 2011 MT 166, ¶ 17, 361 Mont. 179, 258 P.3d 395. Phoenix should be able to participate in the RKT Carda 7-6#2H, the RKT Carda 7-6#3H, and the RKT Carda 76#4H (the "Wells") as a full cost-bearing owner from the date operations commenced.

Finally, Kraken and the Board (collectively, "Defendants") both argue in their cross-appeals that the district court erroneously excluded hearsay evidence. The district court is not bound by the Board's record, as expressly stated in § 82-11-144. This is not an administrative appeal under MAPA, and Phoenix was not

required to preserve its objections. The district court heard evidence *de novo*, and it correctly determined that the hearsay was not admissible.

ARGUMENT

I. THE BOARD HAD NO JURISDICTION TO FORCE POOL THE MINERALS.

A. Defendants and the district court ignored statutory language.

i. § 82-11-202(1)(b) requires good faith and just and reasonable terms.

In both Defendants' response briefs, they ignore language in the force pooling statute, Mont. Code Ann. § 82-11-202. Defendants argue – incorrectly – that Kraken only needed to show that it made an attempt to voluntarily pool the Minerals four years prior to its Application to meet the requirements of § 82-11-202(1)(b). This argument ignores the key requirement that an applicant must act in "good faith." Mont. Code Ann. § 82-11-202(1)(b). Defendants' argument also ignores the statutory language that a pooling order "must be upon terms that are just and reasonable" and that afford the owner of any interest in a spacing unit "the opportunity to recover or receive without unnecessary expense a just and equitable share of the oil and gas produced and saved from the spacing unit." *Id.*

In fact, neither the Board nor Kraken addresses this second requirement. As the Board correctly notes, a court's purpose is to "ascertain and declare" what a statute says and not "to insert what has been omitted or to omit what has been inserted." Mont. Code Ann. § 1-2-101. Further, the statute should be read as a

whole and "to forward the purpose of that scheme." *Gamble v. Sears*, 2007 MT 131, ¶ 59, 337 Mont. 354, 160 P.3d 537. The purpose of force pooling laws is to "resolve the problem of non-consenting owners" who refuse to "voluntarily pool their ownership rights with other landowners." Dkt. 24, Ex. 1, at § II (Frank Sylvester, *Oil and Gas Spacing and Forced Pooling Requirements: How States Balance Energy Development and Landowner Rights*, 4 U. Dayton L. Rev. 47 (2015)).

Just like Defendants, the Board and district court below failed to address the "just and reasonable" requirement in § 82-11-202(1)(b) or the requirement that a mineral owner be afforded "the opportunity to recover or receive without unnecessary expense a just and equitable share" of the oil and gas produced. Defendants would have this Court eliminate the "good faith" language and the "just and reasonable" language from the statute completely. That language is designed to protect property owners and cannot be omitted.

ii. Kraken did not act in good faith.

Defendants claim that § 82-11-202(1)(b) did not require multiple follow-ups after Phoenix's predecessor, Solis, failed to lease the Minerals in 2017. Phoenix has never argued that it does. The facts of this case, however, are important. This is not a situation where Kraken had no knowledge that the Minerals had been sold, or a case where Phoenix is arguing that Kraken is required to follow up with

subsequent purchasers of minerals (or even know there is a subsequent purchaser). Here, Phoenix actually informed Kraken that it had purchased the Minerals, and Phoenix requested multiple times to voluntarily pool and participate in the Wells before Kraken ever applied for force pooling. Dkt. 24, Exs. 14-17. Phoenix even filed a declaratory judgment action in Richland County requesting to participate in the Wells before Kraken applied for force pooling. Dkt. 25, at Ex. 18. Thus, Phoenix does not assert that Kraken was required to initiate any contact or send any offers to Phoenix. However, "good faith" required Kraken to allow Phoenix to voluntarily pool the Minerals as Phoenix requested multiple times to do before the Application.[1]

iii. The Pooling Order was not just and reasonable.

Because a pooling order "must be upon terms that are just and reasonable" and that afford the mineral owner "the opportunity to recover or receive without unnecessary expense a just and equitable share of the oil and gas produced and saved from the spacing unit," the Board does not have jurisdiction to force pool minerals if the mineral owner has agreed to voluntarily pool them. Mont. Code Ann. § 82-11-202(1)(b). A force pooling order only allocates a 12.5% royalty to a mineral owner, which is not "just and reasonable" to a mineral owner who has

[1] The Board's attempt to turn this into a contract issue, where Kraken's purported offer had expired, is a red herring. This is not a case analyzing contractual duties; it is governed by statutory duties.

agreed to voluntarily pool minerals. Dkt. 25, Ex. 3, at p. 7; Mont. Code Ann. § 82-11-202(2)(c). A 12.5% royalty is far below industry standard. For example, the last proposed lease that Kraken sent to Solis in October 2017 had a proposed royalty of 18.75%, which is common for owners who voluntarily pool. Dkt. 25, Ex. 22. Force pooling orders are punitive toward mineral owners who choose not to lease. Further, the Pooling Order also granted risk penalties against Phoenix. These potentially punitive results are the reason forced pooling statutes contain strict language to protect landowners' rights. Dkt. 25, Ex. 1, at § I. Operators would always choose to force pool and obtain risk penalties if allowed because it is a substantial economic windfall for operators.

The Pooling Order is not just and reasonable and does not "afford to the owner" of the Minerals its equitable share without unnecessary expense. Mont. Code Ann. § 82-11-202(1)(b). The "owner" of the Minerals at the time the Application was submitted was Phoenix. The "owner" under the statute was not the "prior owner" of the Minerals; it was Phoenix. The Pooling Order was required to be "just and reasonable" to Phoenix. And Kraken was required to act in good faith toward Phoenix. Defendants' arguments ignore the express statutory language and the corresponding requirements.

The Board and district court also did so below, focusing only on the fact that Kraken made an attempt in 2017 to lease the Minerals and disregarding the fact

that Phoenix owned the Minerals in 2021 when the Application was eventually submitted. The district court's interpretation would render sections of § 82-11-202(1)(b) "superfluous" and "not give effect to all of the words used." *Belk v. Mont. Dept. of Envtl. Quality*, 2022 MT 38, ¶ 22, 408 Mont. 1, 504 P.3d 1090 (citations omitted). Similarly, despite the Board's argument for agency deference, an agency does not have the power to interpret a statute in a way that simply ignores substantive language when there is nothing "doubtful" or ambiguous about the language. *Bartels v. Miles City*, 145 Mont. 116, 122, 399 P.2d 768, 771 (1965)).[2] Legislative intent, as evidenced by the plain statutory language, supersedes any agency interpretation. *State v. Ohl*, 2022 MT 241, ¶ 11, 411 Mont. 52, 521 P.3d 759.

B. The Pooling Order is based upon a lie.

Defendants fail to address the fact that Kraken understood that it had an obligation to voluntarily pool, if possible, when it submitted its Application the Board. In the Application, Kraken claimed that as of the Application date of August 26, 2021, it "has been unable to establish voluntary pooling of all interest

[2] The Board also claims that its interpretation has stood "unchallenged" for years, but there is nothing of record showing that this particular issue has ever come before the Board before. After it did in this case, the Board promptly and successfully lobbied the legislature to change the exact language that the Board now claims it correctly interpreted. *See* Mont. H.B. 289, 68th Leg., Chp. 441 (2023).

within said spacing unit with respect to" the Wells and that "it is anticipated that such pooling cannot be consummated prior to hearing on this application." Dkt. 25, Ex. 19, ¶ 3. Kraken's statements were false; all it had to do to "establish voluntary pooling" was to accept Phoenix's multiple offers to voluntarily pool. The entire premise for the Board hearing was a lie.

The misstatements in Kraken's Application mirror the requirements of the statute. Because the statute requires that an operator act in good faith and that the Board issue only orders that are just and reasonable to owners, the Board cannot force pool minerals when the owner has agreed to voluntarily pool them. Mont. Code Ann. § 82-11-202(1)(b). The district court erroneously upheld the Board's Pooling Order.

C. There was nothing of record showing Kraken's intent.

Phoenix had owned the Minerals for seven months prior to the Application. This timeframe is important, despite Defendants' arguments to the contrary. According to Defendants, Phoenix was bound by the action (or inaction) of Solis in 2017. When Phoenix purchased the Minerals in 2021, they were unleased, unpooled, and not subject to risk penalties. There was absolutely nothing of record, including with the Board itself, to alert Phoenix to any fact suggesting that Kraken intended to force pool the Minerals or to seek risk penalties when Phoenix purchased them.

If Kraken had complied with statutory requirements, then Phoenix would have had the actual knowledge that Defendants' attribute to it. Because of Kraken's delay, Phoenix still had the opportunity to voluntarily pool the unleased and unpooled Minerals. Unsurprisingly, Kraken did not delay its Wells – it produced oil and gas from them for months, despite having no lease for the Minerals and no order from the Board force pooling them. For seven months during Phoenix's ownership of the Minerals, Kraken simply ignored the owner's property rights.

The district court's Order and the Board's Pooling Order were unsupported by facts, in excess of statutory jurisdiction, and without observance of the procedures required by law. Mont. Code Ann. § 82-11-144. The district court and the Board ignored express language in the statutes meant to protect mineral owner's rights. There is no jurisdiction for the Board to force pool minerals once the mineral owner has volunteered to pool them. The Order should be reversed for incorrectly applying the statute, and the Pooling Order set aside. *Estate of Donald*, ¶ 17.

D. The 1H Well is irrelevant.

As a peripheral issue, both Defendants reference a well that is not part of this litigation in their response briefs: the RKT Carda 7-6#1H well (the "1H Well"). For example, Kraken notes that on February 28, 2018, Meszaros mailed an election

packet to Solis for the 1H Well. Kraken Resp. Br., at 15. The 1H well has nothing to do with this case. Phoenix is challenging the Board's Pooling Order for the RKT Carda 7-6#2H, the RKT Carda 7-6#3H, and the RKT Carda 76#4H. It is undisputed that Kraken did not apply for force pooling of the Minerals for the Wells until September 7, 2021. Dkt. 25, Ex. 19. It is also undisputed that Kraken did not apply for permits to drill the Wells until December 23, 2019. Dkt. 28, Exs. 23-25. Accordingly, any actions Kraken took in 2018 regarding a completely different well – the 1H Well – are irrelevant.

II. KRAKEN WAS NOT ENTITLED TO RISK PENALTIES.

A. Risk penalties are not automatic.

Defendants argue that risk penalties automatically attach to a mineral owner's interest once the interest is force pooled. Defendants, again, disregard express, plain statutory language. According to § 82-11-202(2)(b), "[i]f a well has been drilled prior to the hearing on the application and an owner, after written demand, has failed or refused to pay the owner's share of costs of development or other operations," then "the order must include" risk penalties. (Emphasis added). In short, an operator still must show that the owner has refused to pay its share of costs of development or actually failed to pay those cost after written demand for risk penalties to apply. There is nothing "automatic" about it.

B. It was impossible for the prior mineral owner to pay anything.

Defendants argue that the January 10, 2020 Notices for the Wells, which were returned unclaimed, constituted a written demand for payment and that Solis failed to pay her share of costs of development or other operations after receiving them. Dkt. 25, Exs 11-13. Yet Defendants admit that even if Solis wanted to pay her share of costs or development, as required by § 82-11-202(2)(b), she could not have done so. The Notices do not contain any amount for her pay, nor do they demand that she pay anything. Dkt. 25, Exs. 11-13. Instead, Kraken argues that because the Notices contained an "estimate" of the proposed well costs, and Solis did not execute the Notices, then her actions constituted a "failure to pay." Kraken Br., p. 27.

To be clear, Kraken would have the Court interpret the terms "failed . . . to pay the owner's share" in § 82-11-202(2)(b) as "failed to agree to participate." Kraken's Br., p. 27. Next, it erroneously argues that "costs of developments or other operations" should be interpreted as "estimated share of well costs." *Id.* (emphasis added); Mont. Code Ann. § 82-11-202(2)(b). Finally, Kraken mistakenly claims that a "written demand" is the same thing as an "election letter," which gives an owner the "right to participate" but does not demand anything. *Id.*; Kraken's Br., p. 27. The Board makes the same twisted argument. A plain language interpretation must govern here, not a full rewriting of the statute.

The Notices did not inform Solis of the costs of development or other operations, and they did not demand that she pay anything. Dkt. 25, Exs. 11-13. Instead, each Notice contained an estimated cost of operations and an estimated gross working interest. *Id.* The Notices also requested that Solis agree to pay any bills that she received in the future. *Id.* In sum, the Notices requested that Solis agree to pay future demands for payment but were not a demand themselves. It was not possible for Solis to pay her "share of costs of development or other operations" after receiving the Notices, which means that it was impossible for Solis to comply with the statute, even if she had wanted to. Mont. Code Ann. § 82-11-202(2)(b). Despite this impossibility, the district court nonetheless concluded that Solis failed to pay her share of costs after receiving a written demand to do so. The district court's Order is not supported by the plain language of the statute or the facts.

Further, the only timing requirement contained in § 82-11-202(2)(b) is "prior to the hearing on the application." Even if the Notices were a demand for payment, the owner of the Minerals could have still paid prior to the hearing on Kraken's Application. Again, Phoenix was the owner of the Minerals for seven months prior to the Application, and it offered to participate multiple times.

Defendants disregard the express statutory language and claim that Solis only had 30 days to pay her "share of costs of development or other operations" as

required by the statute because Kraken only gave her 30 days. Mont. Code Ann. § 82-11-202(2)(b). According to Defendants, Solis had 30 days to pay unknown and unknowable costs or the Mineral owner's rights were forever forfeited. Under Defendants' logic, if Solis did not pay those indefinite costs in 30 days, then the owner of the Minerals could not participate in the Wells. Interpreting § 82-11-202(2)(b) in such a manner authorizes an operator to send a notice that overtly precludes a mineral owner from complying with the statute, and then allows that operator to benefit from its own deception. Astoundingly, the district court agreed with this wild statutory interpretation, finding that Kraken's own past failures forever prevented Phoenix from participating. The district court's interpretation of the statute was wrong and must be reversed. *Estate of Donald*, ¶ 17.

C. The district court erroneously applied a presumption.

Defendants do not argue that Solis actually "refused" to pay, because she did not. The only way to obtain a presumption of non-participation (refusal) is under § 82-11-202(3). All parties agree that Kraken could not meet the statutory presumption in that section because it failed to mail the Notices out 30 days prior to spudding of the Wells. The problem, one that neither Kraken nor the Board acknowledge, is that subsection (3) still contained timeframes that were applicable to Solis, whether Kraken met its own requirements or not. Defendants' response to this argument is that Solis had the timeframe that Kraken – not the statute – gave

her. Apparently, Kraken believes an operator can ignore its own statutory timeframes and also modify the mineral owner's statutory timeframes.

Defendants agree that the letters track all the required information included in subsection (3)(e). 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" its share of costs after receipt of the notice defined by subsection (3). Mont. Code Ann. § 82-11-202(3)(a) (emphasis added). Under the plain language of the statute, Solis only had until the spud date of the Wells to participate. That means she had 8 days to pay for the first well, 16 days for the second well, and 27 days for the third well. Dkt. 27, Ex. C 22:32-33; Dkt. 27, p. 5. Kraken, on the other hand, continues to assert that its own failure to comply with the 30-day requirement to send the Notices prior to the spud date is irrelevant. The district court and the Board below applied a strict timeframe to Solis, finding that she had failed to pay her share of costs in a timely manner, and yet did not apply any timeframe to Kraken. There is no other time requirement in the statute other than in subsection (3) that allows a presumption of refusal, but a presumption of refusal is exactly what the district court erroneously applied to the mineral owner in its Order, even though Kraken could not meet its own subsection (3) requirements.

Finally, the Board references an inapplicable order from the North Dakota Industrial Commission in its brief. Dkt. 30, Ex. B. NDIC Order No. 10257 is not analogous. North Dakota has a notice provision for obtaining risk penalties, requiring that an operator send a notice informing an unleased mineral owner of its right to participate in a well. *See* NDCC § 38-08-08(3); NDAC § 43-02-03-16.3. The notice must give the mineral owners 30 days to respond with an election. *Id.* However, unlike Montana, North Dakota does not require that the notice be sent at least 30 days prior to spudding the well, and there is no corresponding language requiring a mineral owner to pay or elect to participate prior to spudding the well. *Id.*[3] NDIC Order No. 10257 is irrelevant, but it is an example of exactly why Montana's statutory language matters. Defendants urge this Court to apply the Montana statute as if it reads like the North Dakota statute. That is exactly what the district court did. It misinterpreted the statute to negate the subsection (3) timing requirements for the operator, but it imposed the full burdens of those timeframes on the mineral owner. The district court erroneously upheld the Pooling Order, and its decision should be reversed.

[3] Again, the version of the statute referenced in this appeal is from 2021. The 2023 amendments to § 82-11-202 now mirror the North Dakota requirements.

III. Kraken's hearsay testimony was not admissible.

Kraken offered testimony from Lindsey Meszaros, its landman, in front of the Board and in an affidavit attached to its summary judgment briefing with the district court. The offered testimony claimed that Solis told Meszaros in one 2017 phone conversation that she did not want to participate in any wells and that Solis's sister told Meszaros the same. Defendants both incorrectly argue that Phoenix did not object to the testimony until it was offered in district court. In fact, Phoenix objected in front of the Board in its request for a rehearing. Dkt. 25, Ex. 21.

Regardless, the district court's review of the Pooling Order was a *de novo* review. *Ostby v. Bard of Oil & Gas Conservation*, 2014 MT 105, ¶ 11, 374 Mont. 472, 324 P.3d 1155. It was not an administrative appeal under MAPA where the parties were bound by objections or evidence submitted below. *Id.* The case "shall be tried de novo and disposed of as an ordinary civil suit and not upon the record of any hearing before the board." Mont. Code Ann. § 82-11-144 (emphasis added). Defendants' argument that the district court's review was limited to the Board record, including objections made, is expressly contradicted by the statute.

The district court correctly excluded the hearsay evidence. Hearsay cannot be considered in a summary judgment motion. *Smith v. Burlington Northern and Santa Fe Ry. Co.*, 2008 MT 225, ¶ 39, 344 Mont. 278, 187 P.3d 639. The district court did not consider Meszaros's testimony regarding what Solis or her sister said

during phone conversations in 2017 because the evidence was inadmissible. *Id.* at ¶ 39. Defendants also claim – incorrectly – that Meszaros's statements were not submitted for the truth of the matter asserted. Mont. R. Evid. 801(c). They were. Kraken and the Board both submitted the statements as evidence that Solis refused to participate in any wells, which is the exact substance of Meszaros's testimony regarding what Solis and her sister said. As to the testimony of Solis's sister, it is hearsay within hearsay, submitted for the truth of what Solis ostensibly told her sister. Both statements were properly excluded.

Further, neither of the asserted exceptions apply. In the case cited for the verbal act doctrine, *In re Estate of Mead*, 2014 MT 264, ¶ 10, 376 Mont. 386, 336 P.3d 362, a signatory to a will told a witness, "That's my shaky handwriting." The statement was not offered for the truth of the matter asserted – that the declarant's handwriting was shaky. *Id.* at ¶¶ 22-23. It was offered for the fact that the declarant acknowledged his signature to a witness, which had legal consequences because it rendered the will valid. *Id.* If a statement is admitted for "existence of the statement" and "not the truth of the matter asserted," then the verbal act doctrine may apply. *Id.* at ¶ 23.

Here, Defendants are trying to submit statements to prove what Solis and her sister allegedly said – that Solis refused to participate in any future wells. There are no other legal consequences at issue, except for the ones that flow directly from

the contents of the statements. The issue is not the existence of the statement, as it was in *Mead*. It is what was said in the statement, which Defendants need to prove that Solis refused to participate. If the words themselves cannot be admitted for the truth of the matter asserted, Defendants have no evidence that Solis actively refused to participate. The verbal act doctrine is not applicable.

The residual exception to hearsay is also inapplicable. The residual exception is found in Mont. R. Evid. 803(24). According to this Court, the residual exception should be used "sparingly and only in exception circumstances." *Larchick v. Diocese of Great Falls- Billings*, 2009 MT 175, ¶ 31, 350 Mont. 538, 208 P.3d 836. The exception allows hearsay if it has "comparable guarantees of trustworthiness." *Id.* (citing Mont. R. Evid. 803(24)). In *Larchick*, the guarantee of trustworthiness was that the affidavit at issue was from an attorney and the Court concluded that it "was admissible as a trustworthy statement from an officer of the Court." *Id.* Obviously, Meszaros is not an officer of the Court, and there are no other guarantees of her trustworthiness submitted by Defendants.

To be clear, Meszaros testified at the Board hearing four years after her alleged conversations about what was said in those calls. She then submitted an affidavit to the district court five years after the conversations. The time lapse alone makes the statements untrustworthy. Finally, Meszaros is an agent of Kraken who has her own motives in testifying. Her testimony essentially proves that she did her job –

attempted to lease the Minerals. There are no guarantees of trustworthiness, and the hearsay was properly excluded by the district court.

CONCLUSION

The purpose of the pooling statute is to protect mineral owners, not to give operators an economic windfall. The district court ignored every part of the statute articulating those protections. Phoenix agreed for seven months to voluntarily pool the Minerals prior to Kraken's Application. The Board did not have jurisdiction under the facts or the statutory language to issue the Pooling Order. The Board also applied a statutory presumption of refusal to the previous owner, even though Kraken did not meet its own statutory requirements to obtain the presumption. The Board acted in excess of its statutory jurisdiction and the Pooling Order was unwarranted by facts or law. The district court's Order must be reversed.

DATED this 6th day of December, 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 4,551 words, excluding table of contents, table of authorities, caption, certificate of service and certificate of compliance.

/s/ Adrian A. Miller
Adrian A. Miller

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