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ARKANSAS COURT OF APPEALS

DIVISION III
No. CV-21-136

FLYWHEEL ENERGY PRODUCTION, LLC PLAINTIFF V. ARKANSAS OIL AND GAS COMMISSION DEFENDANT	Opinion Delivered November 1, 2023 APPEAL FROM THE PULASKI COUNTY CIRCUIT COURT, SEVENTEENTH DIVISION [NO. 60CV-20-4297] HONORABLE MACKIE M. PIERCE, JUDGE AFFIRMED

RAYMOND R. ABRAMSON, Judge

The appellant, Flywheel Energy Production, LLC ("Flywheel"), purchased all of the membership interests SWN Production (Arkansas), LLC, held in the Fayetteville Shale Play from its sole owner, Southwestern Energy Company ("Southwestern" but collectively "SWN"), on December 3, 2018. Following a review of its newly acquired interests and in a departure from existing practice, Flywheel began deducting postproduction expenses[1] from

[1]While neither party stated precisely what expenses were deducted by Flywheel, the Arkansas Oil and Gas Commission ("AOGC") Staff suggested Flywheel was deducting costs for compression, dehydration, and treating and gathering the gas in addition to taxes, assessments, and third-party costs. Further, the phrase "third-party costs" was not defined with any particularity or precision. It should also be noted that Flywheel used the phrase "post-production expenses" throughout, while AOGC used the term "costs." For purposes of this opinion, we will use the term postproduction expenses.

the statutory royalties set forth in Ark. Code Ann. § 15-72-305(a)(3) (Supp. 2023). After receiving complaints from royalty owners, the AOGC Staff sought an explanation from Flywheel regarding the increase in deductions from royalty payments.

The AOGC conducted a hearing regarding Flywheel's increase in deductions from integrated royalty interest payments and determined that Flywheel improperly deducted postproduction expenses from royalties. Flywheel appealed the AOGC's decision to the Pulaski County Circuit Court. The circuit court affirmed the AOGC's order in full. Flywheel now appeals the circuit court order. We affirm.

I. *Factual Background*

The Fayetteville Shale is a dry natural-gas formation located on the Arkansas side of the Arkoma Basin consisting of approximately 2.5 million acres. In 2002, SWN discovered the Fayetteville Shale Play and was the primary operator and producer through its subsidiary SEECO. In 2006–2007, there was a significant increase in oil and gas activity in the Fayetteville Shale Play. From 2004 through 2011, the AOGC issued roughly 4,800 drilling permits in the Fayetteville Shale Play. The revenue generated from the Fayetteville Shale Play from 2005 through 2011 was estimated to be around $24 billion.

Integration, also known as forced pooling, compulsory pooling, or statutory pooling, provides a method for oil and gas operators to drill wells in a production unit when fewer than 100 percent of the mineral-interest owners agree to the drilling of a well. Arkansas allows the AOGC to join unleased or uncommitted mineral interests into a production unit, also known as a "force" or "compulsory" pooled unit, by entering an "order integrating all

tracts and interests in the drilling unit for the development or operation of the drilling unit and the sharing of production from the drilling unit." Ark. Code Ann. § 15-72-303 (Repl. 2009). This integration process requires the AOGC to issue orders governing the terms of production and equitable allocation of royalties for those mineral owners that are integrated or force pooled by law. The AOGC requires that all integration orders be entered "upon terms and conditions that are just and reasonable and that will afford the owner of each tract or interest in the drilling unit the opportunity to recover or receive his or her just and equitable share of the oil and gas in the pool without unnecessary expense." Ark. Code Ann. § 15-72-304(a) (Supp. 2023). In the integrated units, "[i]n the event there is an unleased mineral interest or interests in any drilling unit, the owner thereof shall be regarded as the owner of a royalty interest to the extent of a one-eighth interest in and to the unleased mineral interest." Ark. Code Ann. § 15-72-304(d). In order to accommodate the increase in activity and fulfill its duty pursuant to section 15-72-304(a), the AOGC adopted model forms and processes for the force-pooled interests. The parties agree that since 2006, the AOGC and oil and gas producers have historically interpreted the phrase "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) to allow only the deduction of taxes, assessments, and true third-party expenses, i.e., transportation expenses, to be deducted from royalties paid to the integrated mineral owners.

In December 2018, Flywheel purchased all membership interests in SWN and conducted a review of SWN's business practices, including how royalties were calculated and paid. Flywheel asserts that following December 2018, it interpreted the phrase "net

proceeds" in Ark. Code Ann. § 15-72-305(a)(3) to require that postproduction expenses, such as any expenses incurred between the wellhead and the place that the sale occurs, be deducted when calculating the statutory royalty.[2] The AOGC began receiving complaints from royalty holders about the number and nature of deductions taken by Flywheel. In 2019, the AOGC staff ("Staff") sent a letter to Flywheel requesting an explanation for the additional deductions being taken when calculating royalties pursuant to section § 15-72-305(a)(3).

On July 3, 2019, Flywheel responded to the Staff's letter, arguing that it was entitled to deduct postproduction expenses from the one-eighth royalty in accordance with Ark. Code Ann. § 15-72-305(a)(3) and *Whisenhunt Investments, LLC v. ExxonMobil Corp.*, No. 4:13CV00656 JM, 2016 WL 7494266 (E.D. Ark. July 28, 2016). Following receipt of Flywheel's response, the Staff requested a determination and order from the full AOGC regarding whether Ark. Code Ann. § 15-72-305(a)(3) allowed an oil and gas operator to deduct postproduction expenses from royalties. The Staff amended its request for a determination regarding whether section 15-72-305(a)(3) "required the operator and non-operating working interests to deduct post-production expenses from royalties for integrated parties."

[2]The AOGC's interpretation of "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) remained unquestioned until Flywheel purchased SWN's interests in the Fayetteville Shale Play.

The AOGC conducted the requested hearing, and the Staff, Flywheel, several AOGC commissioners, and one interested royalty owner offered statements during the hearing. The Staff argued that Ark. Code Ann. § 15-72-305(a)(3) is ambiguous because it does not define "net proceeds" and asserted that SWN, Flywheel's predecessor in interest, historically operated consistently with the understanding that only deductions for taxes, assessments, and true third-party expenses were permitted for integrated royalty owners. The Staff relied, in part, on a transcript from a 2014 AOGC hearing in which SEECO, a subsidiary of SWN, testified that transportation expenses were the only deductions, besides taxes and assessments, taken from the integrated royalty interests. SWN further testified that it never deducted fees for marketing, compression, or dehydration.

The Staff claimed that pursuant to Ark. Code Ann. § 15-72-304(a), the AOGC possessed the authority to interpret the phrase "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) as to the integrated royalty owners because, otherwise, the integrated royalty owners would have no relationship to those minerals. The Staff argued that the AOGC's course of dealing with Flywheel's predecessor—in addition to the AOGC's consistent interpretation of Ark. Code Ann. § 15-72-305(a)(3)—should control, thereby precluding Flywheel from deducting additional expenses from the integrated royalty interests.

Flywheel conceded that its predecessors did not dispute the AOGC's interpretation of "net proceeds" and argued instead that those parties may not have known or realized that they were entitled to deduct additional expenses. Flywheel stated that XTO, another party operating in the Fayetteville Shale Play, had deducted other types of expenses from the

integrated royalty interests and that XTO was sued over such deductions and won. Flywheel argued that it purchased its interests in the Fayetteville Shale Play recognizing that production had slowed, so it investigated and vetted ways to increase its revenue stream and made a business decision to deduct other types of expenses on the integrated royalty interests.

Flywheel further argued that Ark. Code Ann. § 15-72-305(a)(3) is unambiguous and explicitly described how the one-eighth royalty was to be paid from "net proceeds," as it was common knowledge that "net proceeds" meant that expenses were to be deducted. Flywheel further claimed that the AOGC was required to interpret Ark. Code Ann. § 15-72-305(a)(3) by following the clear and unambiguous meaning of the statute. Flywheel argued that the language "computed at the mouth of the well" had been consistently interpreted by Arkansas courts as permitting the deduction of all expenses between the head of the well and the point at which sale of the gas occurs. Flywheel defined "lawful expenses" as any expenses necessary to make the gas marketable, both to move the gas and to treat or compress the gas.

During the hearing, a royalty owner from Conway, Arkansas, spoke and noted that he held a "gross at the wellhead" lease which meant that no expenses could be deducted from his royalty interests. He indicated that every previous gas company would initially deduct expenses until he provided the company with a copy of his lease, after which he was charged no expenses. He testified that all of that changed with Flywheel because Flywheel would deduct other types of expenses resulting in his checks being cut in half.

Flywheel requested the AOGC first make a decision about its interpretation of Ark. Code Ann. § 15-72-305(a)(3), and in the event that the AOGC granted the Staff's

application, Flywheel asked that such finding be stayed to allow it to file an appeal. The Staff agreed to a stay so long as Flywheel was willing to escrow the disputed payments.

Upon consideration, the AOGC voted to

> affirm the staff's recommendation and that we stay with our historic definition of deductions as expressed and provide it to the stay with escrow . . . . That the post-production costs be escrowed into an interest-bearing account, if possible, and if the Court eventually rules in favor of the Commission that the interest be passed along to the royalty owners.

The AOGC entered Order No. 078A-2019-10 ("AOGC order") on July 23, 2019, finding that the term "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) was undefined by the statute and ambiguous. The AOGC order found that the long-term course of dealing that resulted in its model lease permitted royalty deductions only for taxes, assessments, and true third-party expenses. The AOGC order further stated provisions of the order could be stayed if Flywheel escrowed the disputed payments in an interest-bearing account with regular reporting of "the location, account number, and balance of the account."

Flywheel appealed AOGC's decision to the circuit court. Flywheel requested an order from the circuit court "confirming that the clear and unambiguous language of Ark. Code Ann. § 15-72-305 allows the deduction of post-production expenses from the statutory 1/8 royalty." Flywheel additionally requested that the court stay the AOGC's order without the requirement of escrow of the disputed payments because such requirement was in excess of the AOGC's authority.

The AOGC responded that all its actions taken in the AOGC order were in accordance with the Administrative Procedure Act. The AOGC contended that Flywheel's

definition of "net proceeds" was a "significant shift" in the historical interpretation of Ark. Code Ann. § 15-72-305, resulting in royalty owners being charged "substantial new expenses." The AOGC further argued that its order requiring Flywheel to put the disputed proceeds in escrow was a just and fair result because Flywheel is the single largest operator of gas wells in the state, thereby impacting a large number of royalty owners. The AOGC recognized that Arkansas courts had not ruled specifically on the interpretation of Ark. Code Ann. § 15-72-305 but claimed there was a long-standing practice under the statute that certain postproduction expenses were not deducted from the royalties of integrated mineral interests. The AOGC further claimed that Flywheel's and SWN's vastly different interpretations of Ark. Code Ann. § 15-72-305 illustrated that the statute is ambiguous and asserted that its interpretation of section 15-72-305 took into account the policy behind the statute and the importance of protecting the financial interests of integrated royalty owners.

The circuit court held a hearing on Flywheel's petition and, in its order, stated that the sole issue for consideration was the interpretation of whether Ark. Code Ann. § 15-72-305 required the deduction of postproduction expenses from integrated royalties. The circuit court found that the term "net proceeds" in Ark. Code Ann. § 15-72-305 is undefined by statute, is subject to more than one reasonable interpretation, and is ambiguous. The circuit court further concluded that

> by consistently applying the statutory language of section 15-72-305 in a manner to protect those integrated mineral interest owners, the AOGC was upholding its duty to ensure that integration orders 'shall be upon terms and conditions that are just and reasonable and that will afford the owner of each tract or interest in the drilling unit the opportunity to recover or receive his or

> her just and equitable share of the oil and gas in the pool.' Ark. Code Ann. § 15-72-304(a).

The circuit court further concluded that pursuant to *Hanna Oil & Gas Co. v. Taylor*, 297 Ark. 80, 81, 759 S.W.2d 563, 565 (1988), the lease incorporating the integrated royalty interests must have specifically identified any intention to deduct postproduction expenses. In *Hanna*, the supreme court noted that it had not previously interpreted a "proceeds royalty clause" like the one at issue, which stated: "Lessee shall pay Lessor one-eighth of the proceeds received by Lessee at the well for all gas (including all substances contained in such gas) produced from the leased premises and sold by Lessee." *Id.* at 81, 759 S.W.2d at 564. The circuit court adopted in full the AOGC's argument and found that

> the Commission's decision is not in violation of statutory provisions; is not in excess of the agency's statutory authority; is not affected by other error of law; and is not arbitrary, capricious, or characterized by an abuse of discretion. The record contains substantial evidence to support the agency decision, which is upheld in its entirety.

It is from that order Flywheel instituted the present appeal.

II. *Issues on Appeal*

Flywheel raises four issues on appeal. First, Flywheel argues that the unambiguous language of Ark. Code Ann. § 15-72-305(a)(3) requires the operator to pay the first one-eighth royalty from net proceeds, to include postproduction expenses. Second, Flywheel claims that the AOGC's order failed to utilize proper statutory construction, which constitutes a violation of the separation of powers. Third, Flywheel contends that the extrinsic evidence considered by the AOGC does not support its conclusion prohibiting

operators from deducting postproduction expenses from integrated royalty interests. Fourth, Flywheel asserts that the AOGC lacked the authority to require Flywheel to place the disputed funds in escrow. Because these issues are largely intertwined, we combine them below for clarity.

III. *Standard of Review*

The Arkansas Supreme Court has held that appellate review of agency decisions "is directed not toward the circuit court, but toward the decision of the agency. That is so because administrative agencies are better equipped by specialization, insight through experience, and more flexible procedures than courts, to determine and analyze legal issues affecting their agencies." *Ark. State Police Comm'n v. Smith*, 338 Ark. 354, 357, 994 S.W.2d 456, 458 (1999) (citations omitted). "Our review of administrative decisions is limited in scope. Such decisions will be upheld if they are supported by substantial evidence and are not arbitrary, capricious, or characterized by an abuse of discretion." *Id.* The appellate court's "review is limited to ascertaining whether there is substantial evidence to support the agency's decision or whether the agency's decision runs afoul of one of the other criteria set out in section 25–15–212(h)" of the Administrative Procedure Act. *Id.* "We review the entire record in making this determination. We also note that in reviewing the record, the evidence is given its strongest probative force in favor of the agency's ruling." *Id.*

The Arkansas Supreme Court clarified that in relation to an agency's interpretation of statutes, the standard of review is "that agency interpretations of statutes will be reviewed de novo. After all, it is the province and duty of this Court to determine what a statute

means." *Myers v. Yamato Kogyo Co., Ltd.*, 2020 Ark. 135, at 5, 597 S.W.3d 613, 617 (citations omitted). "In considering the meaning and effect of a statute, we construe it just as it reads, giving the words their ordinary and usually accepted meaning in common language. An unambiguous statute will be interpreted based solely on the clear meaning of the text." *Id.* "[W]here ambiguity exists, the agency's interpretation will be one of our many tools used to provide guidance. . . . We do not disturb the general standard of review for Commission decisions." *Id.* at 6, 597 S.W.3d at 617.

IV. *Interpretation of Arkansas Code Annotated § 15-72-305(a)(3)*

The parties agree that the primary issue considered by the AOGC and the circuit court was whether Ark. Code Ann. § 15-72-305(a)(3) (2023) requires the deduction of postproduction expenses from integrated royalty interests. Flywheel contends that section 15-72-305(a)(3) is plain and unambiguous and requires the deduction of postproduction expenses. Flywheel contends that because Ark. Code Ann. § 15-72-305 is plain and unambiguous, the AOGC improperly considered extrinsic evidence in its interpretation of the statute, which in turn, violated the separation-of-powers doctrine through such improper interpretation. Flywheel further argues that the AOGC's model lease identifies that the point of sale is "at the well," so the extrinsic evidence offered does not support the AOGC's determination.

The AOGC disagrees with Flywheel's interpretation, arguing that the phrase "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) is ambiguous and open to more than one reasonable interpretation. The AOGC claims that its long-standing interpretation of section

15-72-305(a)(3)—to which Flywheel's predecessors agreed—allowing only taxes, assessments, and true third-party expenses to be deducted from the integrated royalty interests should prevail. The AOGC further contends that Flywheel failed to preserve for appeal the issue of whether it possessed the authority to require Flywheel to place the disputed funds in escrow because Flywheel failed to obtain a ruling on the issue from either the AOGC or the circuit court.

V. *Preservation*

First, we address whether Flywheel preserved its objection to the AOGC's order requiring it to place the disputed funds in escrow during a stay of the proceeds for appeal.

At the hearing before the full AOGC, Flywheel made the following request: "I would ask if you grant the staff's application that any order directing Flywheel what to do could be stayed, assuming an appeal was timely filed, until the appeal resolved." The AOGC granted the stay subject to Flywheel placing the disputed royalty payments into an escrow account. Flywheel did not lodge any objection to the escrowing of postproduction expenses during the AOGC hearing. Although Flywheel filed a motion to stay before the circuit court requesting that the stay not require the escrow of funds, the circuit court stated that "[t]he sole issue in this case is a narrow statutory interpretation question of whether Arkansas Code Annotated section 15-72-305 requires the deduction of post-production expenses from royalties of integrated mineral interests." The circuit court affirmed the AOGC's argument in its entirety with no discussion of, or ruling on, Flywheel's motion to stay.

"It is the appellant's obligation to raise an issue first to the administrative agency and obtain a ruling thereupon in order to preserve an argument for appeal." *Mountain Pure, LLC v. Little Rock Wastewater Util.*, 2011 Ark. 258, at 11, 383 S.W.3d 347, 355. "Where neither the administrative agency nor the circuit court makes a ruling on an issue, that issue is not preserved for appellate review." *Burton v. Ark. Dep't of Hum. Servs.*, 2015 Ark. App. 701, at 4, 478 S.W.3d 221, 224. Because Flywheel did not object to, or obtain a ruling on, whether the AOGC had the authority to order Flywheel to place all disputed funds in an interest-bearing escrow account, we hold the issue is not preserved for this court on appeal.

VI. *Ambiguity*

Arkansas Code Annotated § 15-72-305(a)(3) provides that

> [o]ne-eighth (1/8) of all gas sold on or after the first day of the calendar month next ensuing after March 6, 1985, from any such unit shall be considered royalty gas, and the net proceeds received from the sale thereof shall be distributed to the owners of the marketable title in and to the leasehold royalty and royalty as defined under § 15-72-304(d).

Section 15-72-304(d) states in relevant part that "[i]n the event there is an unleased mineral interest or interests in any drilling unit, the owner thereof shall be regarded as the owner of a royalty interest to the extent of a one-eighth interest in and to the unleased mineral interest."

Flywheel argues that consideration of Ark. Code Ann. § 15-72-305(a)(3)(B)(i) is necessary for this court to appropriately interpret "net proceeds" in section 15-72-305(a)(3), which states:

> [E]ach working interest owner or marketing party who has sold gas shall remit or cause to be remitted to the operator one-eighth (1/8) of the revenue realized or royalty moneys from gas sales computed at the mouth of the well, less all lawful deductions, including, but not limited to, all federal and state taxes levied upon the production or proceeds and shall indemnify and hold the other working interest owner free from any liability therefor. However, if any portion of the price received by a marketing party is subject to possible refund to the gas purchaser pursuant to the regulations, rules, or orders of any governmental authority, the refundable portion need not be included in the amount remitted to the operator for distribution hereunder until the possibility of refund has terminated. The funds or amounts as so remitted shall be held in trust by the operator for the account of the royalty owner or owners entitled thereto until distributed and paid as provided in this section.

Section 15-72-305(a)(3)(B)(i) does not describe the deductions that may be taken from integrated royalty interests. Instead, section 15-72-305(a)(3)(B)(i) provides that working interest owners must remit one-eighth of revenue realized "less all lawful deductions" to the operator and states that such deductions include deductions for all federal and state taxes. Section 15-72-305(a)(3)(B)(i) does not identify any "lawful deductions" other than state and federal taxes.

This court recently reaffirmed that "[t]he basic rule of statutory construction is to give effect to the intent of the legislature. We construe the statute just as it reads, giving the words their ordinary and usually accepted meaning in common language." *Sartor v. Cole*, 2023 Ark. App. 131, at 8, 662 S.W.3d 697, 703 (citations omitted). "A statute is ambiguous only when it is open to two or more constructions or when it is of such obscure or doubtful meaning that reasonable minds might disagree or be uncertain as to its meaning." *Id.* The Arkansas Supreme Court has held that "[w]hen a statute is ambiguous, this court must interpret it according to legislative intent and our review becomes an examination of the whole act."

Simpson v. Cavalry SPV I, LLC, 2014 Ark. 363, at 3–4, 440 S.W.3d 335, 338 (citations omitted). The Arkansas Supreme Court has further concluded that "[w]hen the meaning [of a statute] is not clear, we look to the language of the statute, the subject matter, the object to be accomplished, the purpose to be served, the remedy provided, the legislative history, and other appropriate means that shed light on the subject." *MacSteel Div. of Quanex v. Ark. Okla. Gas Corp.*, 363 Ark. 22, 30, 210 S.W.3d 878, 882–83 (2005). One such appropriate means to consider for guidance is the agency's interpretation of the statute. *Myers*, 2020 Ark. 135, at 5–6, 597 S.W.3d at 617.

Flywheel first contends that Ark. Code Ann. § 15-72-305 is unambiguous but also urges this court to look outside the statute to conclude that it requires the deduction of postproduction expenses. "Where the language of a statute is plain and unambiguous, we determine legislative intent from the meaning of the language used." *Sartor*, 2023 Ark. App. 131, at 8, 662 S.W.3d at 703. "A statute is ambiguous only when it is open to two or more constructions or when it is of such obscure or doubtful meaning that reasonable minds might disagree or be uncertain as to its meaning." *Id.* We disagree with Flywheel's assertion that this statute is unambiguous and hold that the statute is, in fact, ambiguous, requiring us to resort to alternate means of interpretation. Flywheel asserts that this court should look outside the statute for the definition of "net proceeds" and value "at the well" or "at the mouth of the well" and hold that the statute requires the deduction of postproduction expenses. In making this assertion, Flywheel relies on *Parnell, Inc. v. Giller*, 237 Ark. 267, 372 S.W.2d 627 (1963), *Clear Creek Oil & Gas Co. v. Bushmiaer*, 165 Ark. 303, 264 S.W. 830

(1924), and *Whisenhunt Investments, LLC v. Exxon Mobil Corp.*, No. 4:13CV00656 JM, 2016 WL 7494266 (E.D. Ark. July 28, 2016).

In *Bushmiaer*, 165 Ark. 303, 264 S.W. 830, the Arkansas Supreme Court was called on to interpret the terms of an oil and gas lease. The relevant lease provision stated: "It is agreed that the market price of royalty gas at the well at the time shall be the basis upon which royalty shall be paid." *Id.* at 304, 264 S.W. at 831. The parties therein disagreed what the market price under that provision should be. The *Bushmiaer* Court held that market price, under these facts, was the cost paid by industrial consumers minus transportation and distribution expenses. *Id.*at 308, 264 S.W. at 832. This was because there was no market for the sale of gas at the well.

Relying in part on *Bushmiaer*, the Arkansas Supreme Court in *Parnell* considered whether certain deductions were permitted in determining royalties due under a lease agreement when the lease agreement was patterned off of a common form of oil-and-gas lease. The issue in *Parnell* was whether expenses in piping salt water to a chemical company and disposing of its spent brine could be considered when determining royalties. *Parnell*, 237 Ark. at 268, 372 S.W.2d at 627–28. The relevant portion of the lease at issue in *Parnell* stated that royalties were to be paid in the amount of one-eighth of the amount realized from such sale. *Id.* at 268, 372 S.W.2d at 628. In interpreting the lease language, the supreme court noted that that where the gas was used off the premises, the lessee was entitled to deduct its transportation and distribution expense in determining the market value of the gas at the well. *Id.* at 268, 372 S.W.2d at 628 (citing *Bushmiaer*, 165 Ark. 303, 264 S.W. 830).

Flywheel further relies on *Whisenhunt Investments, LLC*, *supra*, for the proposition that Ark. Code Ann. § 15-72-305 is "clear" and leaves "no room for extrinsic evidence about legislative intent." In *Whisenhunt*, the United States District Court for the Eastern District of Arkansas was called on to determine whether Exxon Mobil improperly paid royalties on the first one-eighth of proceeds. The parties agreed that Exxon Mobil paid the first one-eighth of net proceeds in accordance with Act 272 (now Ark. Code Ann. § 15-72-305(a)(3)), not in accordance with Whisenhunt's "40% of the gross proceeds" lease. *Whisenhunt*, 2016 WL 7494266, at *2. Exxon Mobil argued that it was not required to pay Whisenhunt 40 percent of the first one-eighth royalty but instead was only required to pay the one-eighth royalty on net proceeds. *Id.* The court in *Whisenhunt* agreed with Exxon Mobil and stated that Ark. Code Ann. § 15-72-305(a)(3) was "clear" that royalties were to be paid on the first one-eighth royalty from net proceeds, not 40 percent of gross proceeds, and that pursuant to Ark. Code Ann. § 15-72-305(a)(8)(C), the remaining royalties "in excess of the one-eighth (1/8) royalty" would be paid in accordance with the lease. *Id.* at *3. Notably, however, the court in *Whisenhunt* did not define nor describe "net proceeds." *Id.*

We are not persuaded by Flywheel's arguments. Nothing in *Parnell*, *Bushmiaer*, or *Whisenhunt* holds or even suggests that postproduction expenses, such as compression, dehydration, and treating and gathering, are chargeable against integrated royalty interests, which is the crux of the issue here.

Turning to other means of statutory construction, we focus our attention on the agency's interpretation of the statute. Importantly, the AOGC emphasizes that there had

been no arguments raised before the AOGC concerning the definition of "net proceeds" prior to Flywheel's change in position because all parties previously agreed with the AOGC's interpretation that "net proceeds" permitted only deductions for assessments, taxes, and transportation expenses. The AOGC discussed the history of the increase in activity in the Arkoma Basin accompanied by the multitude of royalty complaints that gave rise to Ark. Code Ann. § 15-72-305. The AOGC further noted that its long-term course of dealing with operators in the Arkoma Basin resulted in its model lease, which was created to prevent operators from making broad deductions. In support of its position, the AOGC included a transcript from a 2014 hearing wherein SWN and its subsidiary SEECO argued that the only deductions taken from integrated royalty interests were for transportation expenses. Flywheel, as SEECO's and SWN's successor in interest, conceded that SWN and its subsidiaries previously accepted the AOGC's interpretation of section 15-72-305(a) as permitting only deductions for assessments, taxes and true third-party expenses. The AOGC further claimed that Flywheel's definition of "at the well" is contrary to the definition of "at the well" adopted by SWN and its subsidiaries at the 2014 hearing.

Both parties have cited *Hanna Oil & Gas Co.*, 297 Ark. 80, 759 S.W.2d 563, to support their interpretation of "net proceeds." In *Hanna*, the Arkansas Supreme Court considered whether an oil and gas producer could change the royalties paid pursuant to a lease to include charges for compression expenses. The language at issue in *Hanna* stated: "Lessee shall pay Lessor one-eighth of the proceeds received by Lessee at the well for all gas

(including all substances contained in such gas) produced from the leased premises and sold by Lessee." *Id.* at 81, 228 S.W.2d at 564. The supreme court held:

> Unless something in the context of an agreement provides otherwise, "proceeds" generally means total proceeds. . . . Thus, we find it unnecessary to go beyond the clear language of the agreement between the parties to hold that appellant is not entitled to deduct compression costs. If it had been their intention to do so, they would have made some reference to costs, or "net" proceeds.

Id. at 81, 228 S.W.2d at 564-65. Flywheel contends that in accordance with *Hanna*, because Ark. Code Ann. § 15-72-305(a)(3) refers to "net proceeds," all postproduction expenses are required to be deducted. However, the *Hanna* court found the most compelling factor underlying its decision that compression expenses were not deductible was based on the parties' performance under the agreement. "Compression became necessary in April 1984; however, the expenses associated with compression were not deducted from the royalty paid to appellee until October 1986." *Id.* at 82, 759 S.W.2d at 565. "Thus, for over two years appellant's construction of the lease was consistent with that urged by appellee. The construction placed upon an agreement by the parties is an important, and often decisive factor in construing an instrument." *Id.*

As noted above, Flywheel conceded that its predecessor in interest previously accepted the AOGC's interpretation of Ark. Code Ann. § 15-72-305(a)(3) as permitting only deductions for assessments, taxes, and true third-party expenses. It is also clear that Flywheel's definition of "at the well" herein is contrary to the definition of "at the well" adopted by SWN and its subsidiaries at the 2014 hearing.

Nothing in *Hanna* elucidates the types of deductions that may be taken against integrated royalty interests pursuant to Ark. Code Ann. § 15-72-305(a)(3). We further recognize that Arkansas courts have not specifically defined "net proceeds" pursuant to Ark. Code Ann. § 15-72-305(a)(3) or generally as pertaining to integrated royalty interests.

We hold that Ark. Code Ann. § 15-72-305(a)(3) does not define "net proceeds" and does not delineate any specific expenses that must be deducted from integrated royalty interests. We find it compelling that the AOGC and operators in the Fayetteville Shale Play, including Flywheel's predecessor in interest, continuously agreed that section 15-72-305(a)(3) permitted deductions for only taxes, assessments, and true third-party expenses from the integrated royalty interests. Furthermore, after its purchase of SWN's interests, Flywheel continued to pay royalties without deducting postproduction expenses for months. As such, we find no error in the AOGC's decision that Ark. Code Ann. § 15-72-305(a)(3) is ambiguous because both the AOGC's and Flywheel's interpretations of "net proceeds" are reasonable constructions of its language. Accordingly, we affirm the AOGC's order finding that Ark. Code Ann. § 15-72-305(a)(3) does not require the deduction of postproduction expenses.

VII. *Abuse of Discretion*

In its second issue, Flywheel contends that the AOGC's order was an attempt to rewrite Ark. Code Ann. § 15-72-305 and was "an error of law; exceeded the Commission's authority; and was arbitrary, capricious, and characterized by an abuse of discretion." Our review of the AOGC's order is limited to a determination of whether the order is supported

by substantial evidence. *See Smith*, 338 Ark. 354, 994 S.W.2d 456; *Ark. Pro. Bail Bondsman Licensing Bd. v. Oudin*, 348 Ark. 48, 69 S.W.3d 855 (2002). In short, Flywheel must show that the AOGC's order was not based on "valid, legal, and persuasive evidence that a reasonable mind might accept as adequate to support a conclusion, and force the mind to pass beyond conjecture." *Oudin*, 348 Ark. at 55, 69 S.W.3d at 860. Flywheel is required to establish that "the proof before the administrative tribunal was so nearly undisputed that fair-minded persons could not reach its conclusion" or was "not supportable on any rational basis." *Id.* "[O]nce substantial evidence is found, it automatically follows that a decision cannot be classified as unreasonable or arbitrary." *Id.*

The Arkansas Supreme Court has concluded that "the clear and unambiguous language in section 15-72-304(a) explicitly authorizes the AOGC to ensure that all integration orders are upon terms that are 'just and reasonable' and that will afford each owner the opportunity to receive 'his or her just and equitable share . . . without unnecessary expense.'" *Hurd v. Ark. Oil & Gas Comm'n*, 2020 Ark. 210, at 9, 601 S.W.3d 100, 105. The supreme court further held that "'[s]tate agencies possess such powers as are conferred by statute or are necessarily implied from a statute.'" *Id.* at 10, 601 S.W.3d at 105 (citation omitted).

As described above, the AOGC was called on to interpret whether Ark. Code Ann. § 15-72-305(a)(3) required Flywheel to deduct postproduction expenses from integrated royalty interests or whether, as asserted by the AOGC Staff, Flywheel was entitled to only deduct expenses for assessments, taxes, and true third-party expenses. Because we have

concluded that Ark. Code Ann. § 15-72-305(a)(3) is ambiguous, consideration of the legislative history and the AOGC's interpretation and application of the statute, which included evidence presented to the AOGC of SWN's prior interpretation of section 15-72-305(a)(3) during an earlier AOGC hearing, was required in order for the AOGC to adequately construe the statute.

During the AOGC hearing, multiple current commissioners discussed the factual history underlying both the creation of Ark. Code Ann. § 15-72-305 and the AOGC's model leases. The commissioners agreed that when the model leases and section § 15-72-305 were drafted, "net proceeds" was not intended to include postproduction expenses. Furthermore, the parties to this appeal agree that the AOGC had consistently interpreted "net proceeds" as permitting only deductions for assessments, taxes, and true third-party expenses, and Flywheel conceded that its predecessor in interest agreed with the AOGC's position on "net proceeds."

In light of the foregoing, we find substantial evidence that the AOGC's order interpreting "net proceeds" in Ark. Code Ann. § 15-72-305(a)(3) was based on "valid, legal, and persuasive evidence that a reasonable mind might accept as adequate to support a conclusion, and force the mind to pass beyond conjecture." *Oudin*, 348 Ark. at 55, 69 S.W.3d at 860. The AOGC's order was based on substantial evidence and, as such, "cannot be classified as unreasonable or arbitrary." *Id.*

We decline to accept any of Flywheel's arguments on appeal and instead defer to the superior position of the agency in analyzing this complex legal issue in accordance with its

legislative purpose. *See, e.g.*, *Smith*, 338 Ark. at 357, 994 S.W.2d at 458. We agree with the circuit court that

> the Commission's decision is not in violation of statutory provisions; is not in excess of the agency's statutory authority; is not affected by other error of law; and is not arbitrary, capricious, or characterized by an abuse of discretion. The record contains substantial evidence to support the agency decision, which is upheld in its entirety.

For each of the aforementioned reasons, we affirm.

Affirmed.

VIRDEN and HIXSON, JJ., agree.

PPGMR Law, PLLC, by: *G. Alan Perkins* and *Kimberly D. Logue*, for appellant.

Shane E. Khoury, *Michael McAlister*, and *Daniel Pilkington*, for Arkansas Oil & Gas Comm'n, appellee.