

BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA

FILED

MAR 29 2011

COURT CLERK'S OFFICE — OKC
CORPORATION COMMISSION
OF OKLAHOMA

APPLICANT: YUKON TRADING COMPANY,)
L.L.C.)

RELIEF SOUGHT: SHUT-IN OR RESTRICT)
PRODUCTION)

CAUSE CD NO.
201001230 ✓

LEGAL DESCRIPTION: SECTION 7, TOWNSHIP 6)
NORTH, RANGE 11 WEST,)
CADDO COUNTY, OKLAHOMA)

APPLICANT: ST. MARY LAND &)
EXPLORATION COMPANY)

RELIEF SOUGHT: ACCEPTANCE OF OCC FORM)
1016 - Daryl 1-7)

CAUSE CD NO.
201002150

LEGAL DESCRIPTION: SECTION 7, TOWNSHIP 6)
NORTH, RANGE 11 WEST,)
CADDO COUNTY, OKLAHOMA)

REPORT OF THE OIL AND GAS APPELLATE REFEREE

These Causes came on for hearing before **Michael D. Norris**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 7th and 8th day of October, 2010, at 8:30 a.m. in the Commission's Courtroom, Jim Thorpe Building, Oklahoma City, Oklahoma, pursuant to notice given as required by law and the rules of the Commission for the purpose of taking testimony and reporting to the Commission.

APPEARANCES: **Charles Helm**, attorney, appeared on behalf of applicant, Yukon Trading Company, L.L.C. ("Yukon") and JMA Energy Company ("JMA"); **John C. Moricoli, Jr.**, attorney, appeared on behalf SM Energy Company, successors in interest to St. Mary Land & Exploration Company by corporate name change ("SM"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 22nd day of December, 2010, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Oral Exceptions were referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 14th day of February, 2011. After considering the arguments of counsel and the record contained within these Causes, the Referee finds as follows:

STATEMENT OF THE CASE

SM APPEALS the ALJ's recommendation that the application of Yukon to restrict production of the two SM wells in Section 7 be approved. It was further recommended by the ALJ that the application of SM to accept OCC Form 1016 for the Daryl #1-7 well be denied.

These causes involve the applications of Yukon and SM. Yukon is seeking to shut-in or restrict the production of the Daryl #1-7 well and the Stafford #2-7 well located in Section 7, T6N, R11W, Caddo County, Oklahoma. SM is requesting the acceptance of OCC Form 1016, initial Back Pressure test for natural gas wells for the Daryl #1-7 well. These applications are obviously in conflict. Yukon is seeking the restriction of production and SM is seeking to establish an allowable. Yukon alleges that a penalty should be imposed upon SM's production of these two wells for lack of proper reporting, testing and incomplete or untimely forms. SM asserts that their business procedures provide accurate and timely reporting. SM relies upon past business dealings, procedures and filings to establish the premise that the proper reports were timely and accurately submitted to the Oklahoma Corporation Commission.

SM TAKES THE POSITION:

(1) The Report of the ALJ is arbitrary, unreasonable and discriminatory and fails to effect the ends of the prevention of waste and the protection of correlative rights as is required by applicable laws of the State of Oklahoma.

(2) The recommendation of the ALJ in these combined causes to deny the relief requested in Cause CD No. 201002150 and grant the relief requested in Cause CD No. 201001230 restricting production from all wells within the subject drilling and spacing unit to 10% of currently assigned allowable violates correlative rights, promotes waste and is erroneous as a matter of fact and law.

(3) Yukon and JMA are affiliated companies. The Section 7 ownership breakdown is Yukon – 3.38%; JMA – none; and SM – 47.5%. The Section 8 ownership breakdown is Yukon - 22%; JMA – none; and SM - 30%. The Section 17 ownership breakdown is Yukon - 15.75%; JMA – none; and SM - 30%. The Section 18 ownership breakdown is Yukon - 44%; JMA 0.3333%; and SM - 1%.

(4) The wells in Section 7 are the Daryl #1-7 and the Stafford #7-2. The well in Section 8 is the Silvers Trust #8-1. The well in Section 17 is the Brower #1-17. The well in Section 18 is the Dennis Dwight #1-18.

(5) The wells are in competitive reservoirs: a) all wells are completed in the same correlative intervals; are in pressure communication and competing for the same amount of gas; b) due to the similarity in reservoir conditions encountered all wells exhibit similar bottom hole pressures, flowing tubing pressures, allowables and producing rates; and c) if one well is curtailed or shut-in the gas that well would normally produce will be produced by the other wells completed in the reservoirs.

(6) The well test data is: a) the allowable test on the Daryl #1-7 for calendar year 2009 was conducted, and witnessed by the authorized Corporation Commission representative (field inspector for Caddo County); b) the OCC Form 1016 was prepared utilizing the data from the test referred to in (a) above and "approved by Commission" by Bill Julian, field inspector for Caddo County; and c) a copy of the above mentioned Form 1016 was retained by the field inspector.

(7) As to the unit allowable for year 2009, the above described Form 1016 does not appear in the data base maintained by the Commission in Oklahoma City. By virtue of the foregoing the subject drilling and spacing unit is arguably in an overproduced status.

(8) Under the uncontroverted evidence in this case the requested relief in Cause CD No. 201002150 should have been granted and the relief requested in Cause CD No. 201001230 denied. The retention of Form 1016 by the field inspector for Caddo County in his official capacity should have been sufficient for filing with the Commission. If it is not then the facts in this case mandate its acceptance by the Commission at this time effective as of October 2008, so that the allowable for the subject drilling and spacing unit calculated from it can be applied to 2009.

(9) The ALJ gives no rationale for his recommendation other than that certain regulations require the filing of OCC Form 1016, among others, for the setting of an allowable. This is not a rationale basis for his recommendation. The filing of Form 1016 is purely a ministered or procedural act the failure of

which can be rectified by the Commission under its plenary power concerning assignment of production allowables on wells within the state of Oklahoma. There is ample precedent for the requested relief in Cause CD No. 201002150 under the same facts we have in this case together with situations where the form was never submitted, was submitted but never received, was submitted and received but does not appear in the data base, and even where the required allowable test was not in fact run. In all of these factual situations the Commission has, in the past, entered appropriate orders to prevent injustice and hardship, and to protect correlative rights. Such should be done in this case.

(10) The competitive nature of these reservoirs compels reversal of the ALJ's recommendation by virtue of the correlative rights violations that will occur in the absence of such reversal.

(11) Therefore, SM respectfully requests that the recommendation of the ALJ be reversed and the relief requested in Cause CD No. 201002150 be granted.

THE ALJ FOUND:

(1) It was the ALJ's recommendation that the application of Yukon filed in Cause CD No. 201001230 be approved and the application of SM in Cause CD No. 201002150 be denied. This will result in the two St . Mary wells in Section 7 being restricted to producing 10% of the current allowable. The SM documents should be acknowledged but only as to their existence. They should not be accepted to establish an allowable or to alleviate the penalties that may result from noncompliance.

(2) Yukon presented substantial evidence of the failure of SM to properly and timely submit the required forms to establish allowables for the two wells in Section 7. They also furnished data that brings into question the validity of the tests that were submitted.

(3) The rules concerning these issues are clear. The effective date of allowables, (OCC-OAC 165:10-17-3), general well testing requirements, (OCC-OAC 165:10-17-6), well tests, (OCC-OAC 165:10-17-7(b)), maximum permitted rates of production for unallocated gas wells, (OCC-OAC 165:10-17-11), as well as others are very specific in their requirements. The evidence showed that SM did not comply with the pertinent provisions of the rules. The untimely testing and filing of proper documentation is well documented. SM's own witnesses could not establish an effective chain of control to ensure proper receipt of the required forms in the offices of the Oklahoma Corporation Commission. There appears to be no checks and balances in place by SM to give notice of possible violations, late testing or late filing. This is not an issue of just one missed time frame. There were multiple tests and form filings that were significantly overdue.

(4) SM advanced the theory that two copies of the Form 1016 were always forwarded to the field inspector. They seemed to believe this fact alone relieved them of responsibility to assure timely submission of the required documentation. The evidence has shown that the field inspector is not the proper party to receive such filings. The rules clearly state test results are submitted to the Corporation Commission Conservation Division. The rule even allows a method for the operator to request a copy of the approved Form 1016. Said rule further requires the Conservation Division to acknowledge such request within 15 days stating if the test has been accepted or rejected. (OCC-OAC 165:10-17-6(b)). Following this procedure alone would alert an operator that further inquiry may be needed. It is clear that the operator is responsible for conducting and submitting the required tests on the applicable forms and reporting all required information completely and accurately. In this instance, SM has not complied. Familiarity with the rules as well as aggressive compliance procedures should help alleviate such oversights.

(5) Unrebutted evidence was presented concerning the resultant overproduction in this unit. A substantial portion of the evidence was taken from data supplied by SM. This overproduction resulted in Yukon seeking relief in the form of corrective action from the Commission. In this cause it is the ALJ's belief that the evidence shows that such corrective action is necessary. The facts demonstrate that the overproduction was at least a result of lax adherence to the rules. The rules require certain tests and data to constitute a methodology to be able to compute an accurate allowable. Inaccurate or untimely data flaws this process. The minimum compliance rules would indicate that these wells should be shut-in to alleviate the overproduction and obtain compliance. However the applicant, Yukon, has requested curtailing production by restricting the wells production to 10%. This is a valid solution.

POSITIONS OF THE PARTIES

SM

1) **John C. Moricoli, Jr.**, attorney, appearing on behalf of SM, stated that SM investigated the allegations in Yukon's application. For reasons unknown the Form 1016 test taken on October 3, 2008 never appeared in the records of the Commission Oklahoma City office. At the time these causes were filed both the Daryl #1-7 well and Stafford #2-7 well producing from the Morrow/Springer were allegedly in overproduced status due to there being no 2009 calendar allowable assigned to these wells. The controversy herein arose when the Form 1016 failed to arrive timely at the Oklahoma City offices.

2) SM reiterated the direct examination of Yukon's witness Mike Davis which revolved around the well test which indicated the unit was overproduced by 2.5 BCF. SM pointed out that this being a competitive reservoir that all the wells shared similar BHP, etc. SM reiterated also the amount of the parties' ownership here to inform the Court of the possible motivations for these filed applications.

3) SM stated the allowable test taken in October 2008 had been witnessed by OCC field Inspector Bill Julian. SM pumper, Bill Whitman, had conducted this test. SM employee Lonnie Whitson was responsible to make sure the test was conducted and to fill out the Form 1016.

4) SM employee Whitson had developed a procedure over the past 8 years on filling out Forms 1016. Whitson would send to the witness of the test two copies. SM assumed that the field inspector would sign off on the Form 1016 and mail a copy to both SM and to the Oklahoma City office. Prior to these two wells, SM had never had a problem with their method. SM felt that as long as the Form 1016 had been sent to an OCC employee, that SM had complied with the OCC rules.

5) SM notes the field inspector recalled the test yet stated he had not forwarded any copies to the Oklahoma City office. SM believes this to be a procedural problem. If the Form 1016 had reached the Oklahoma City office there would not now be a current 2.5 BCF overage.

6) SM reiterates about JMA's rebuttal testimony where JMA mentioned all parties had access to all the well data electronically via a computer data base, including SM. JMA had pointed out that these wells had not been shut in on October 3rd, the date the prior SM witness had said the test was conducted. JMA had stated the well actually had been flowing up to 7 pm on October 3, 2008, where it was then shut in until the end of October.

7) SM's counsel was unaware of this computer data base that JMA referenced on rebuttal. SM attempted to rebut this "new information" however the ALJ denied SM's request for surrebuttal. SM's request for a continuance was likewise denied by the ALJ. SM asserts that this was brand "new" data. SM wished to present witnesses to explore what JMA brought out. SM believes the ALJ's denial was an abuse of discretion. SM notes the ALJ immediately closed the record, and after reviewing the transcript, issued his Report two months later.

8) SM's request was denied due to the ALJ's belief that SM did not follow the OCC rules in filing the Oct 2008 Form 1016. SM's employee Whitson assumed that the field inspector would send the Form 1016 to the Oklahoma Office as had been done in the past. SM notes the ALJ discussed the

applicable OCC rules and found there was no excuse for SM to not have filed the Form 1016 with the Oklahoma City offices.

9) SM asserts if JMA's calculations are correct, then this unit is technically 2.5 BCF overproduced, which would ultimately be produced by the offsets should the Court not reverse the ALJ's decision. SM believes this would violate the owner's correlative rights of the two Section 7 wells, resulting in uncompensated drainage to occur. SM believes that JMA's is incorrect in their belief that the unit is overproduced. SM asserts the Commission has authority to grant SM's requested relief to accept the October 2008 Form 1016 to eliminate the alleged overage.

10) SM notes 52 O.S. Sections 29 and 239 and Rule 165:10-17-11(e) apply here. SM also cites *British American Oil Producing Co. v. Corporation Comm'n*, 69 P.2d 669 (Okl. 1937) along with *Brumark Corp. v. Corporation Com'n of State of Okl.*, 924 P.2d 296 (OK CIV APP 1996) ("Brumark II") in support of SM's application here.

11) SM would be producing no more than they would have been authorized to produce had the Form 1016 been timely filed. SM believes the Commission can accept this Form 1016 and cancel the alleged overproduction. SM asserts to do otherwise would violate the owner's correlative rights for the Section 7 wells, as in the Brumark I case. In other words, SM asserts that SM would not produce any more hydrocarbons than the Form 1016 would have authorized had it been sent to the Oklahoma City office timely.

12) SM notes that Exhibit 20-A and 20-B are copies of the October 3, 2008 Form 1016 test for the Daryl #1-7 well test. Exhibit 20-A shows the signed off page by SM preparer Whitson and Exhibit 20-B has Whitson's notes attached per the well parameters and schematics of the wellbore which are required to run allowable calculations. SM states the Form 1016 test was run and transmitted to field Inspector Julian where it was initialed off by Julian showing his approval.

13) SM asserts the ALJ only stated that SM did not file the test. SM would agree it was SM's duty to file the Form 1016 with the Commission. SM finds the ALJ's decision to be too harsh as the owners of the two Section 7 wells correlative rights will be greatly violated if not reversed by the Court. SM further believes this 2.5 BCF overage will be in excess of \$10 million at current market prices.

14) SM respectfully requests the ALJ be reversed with the Commission entering an order accepting the Form 1016 test submitted to the field Inspector in October 2008.

JMA

1) **Charles Helm**, attorney, appearing on behalf of JMA, stated where overproduction occurs the Commission is obligated to reduce the well's production to 10% of its currently assigned allowable until the overage or overproduction is made up. JMA believes that SM ignored the Commission rules here.

2) JMA notes that the Commission Proration Department handles the allowable rules. JMA had submitted data to the Proration Department whom had agreed there was an overage (see Exhibit 17). JMA informs the Court that if JMA had not filed this application in order to get quicker relief, then the Proration Department would have done so. JMA points out that the Proration Department is approximately 1.5 years behind in their review due to their inability to stay up with the allowables, filings, testing and status of state wells.

3) JMA notes Yukon filed in March 2010, which should have put SM on notice. However, SM waited until May 27, 2010 to take corrective action via an application to waive the Commission rules with regard to Section 7 well allowables. JMA believes that SM is attempting to ask the Commission to retroactively accept a Form 1016 from an October 3, 2008 test to set an allowable for year 2009, to verify that the test was run and to waive the notice requirements of the filing of the data at the Commission.

4) JMA notes that SM did concede that SM didn't file the Form 1016 test. JMA further notes that SM's witness had no routine for processing Commission tests. JMA notes that SM's proposed procedure was to contact a field person to run the test. This field person would have the test witnessed by a third party. In this case, the SM witness opted to let the pumper, who had a relationship with the Commission field inspector, to handle the Form 1016 test.

5) JMA put on the Commission field Inspector Julian in order to hear the data first hand about how the Form 1016 came about. JMA further believes the testimony was vague as to cross examination as SM's witness had no memory of the Form 1016 test done in October 2008. JMA notes Julian had no memory of being on the location to perform this test, nor did Julian have any notes to reflect such test being performed.

6) JMA believes there is significant doubt that this Form 1016 test was actually run and that the facts shown on it are accurate. JMA finds the Form 1016 facts are not consistent with the well data furnished by SM. JMA notes that every test must be sent to the Commission Proration Production Department for either acceptance or rejection. JMA observed that none of SM's witnesses were aware of the test procedures on how to handle the Form 1016

internally. JMA notes that SM had no awareness whether or not their Form 1016 had been received by the Commission Oklahoma City offices.

7) JMA notes that the ALJ believed that the Exhibits 20-A and 20-B copies of Form 1016 for the Daryl #1-7 well should not be considered for testing purposes due to the questions regarding its validity and due its never being filed according to the Commission rules. JMA found the ALJ made a special finding that the Exhibits 20-A and 20-B should not be accepted to establish an allowable or alleviate the penalties that result from noncompliance with Commission rules. JMA points out the Commission rules show what is expected or required of an operator. JMA believes it is the operator's responsibility to cause the testing, submit the data, file the test and have the Commission review such for its approval.

8) JMA finds the Commission rules are clear regarding how to establish a well's allowable and or unit allowable. JMA notes the Commission rules require certain steps in order to make allowables effective. JMA notes that all operators are expected to be familiar with Commission well tests and rules. JMA notes that the Commission rules are clear as to penalties if such rules are not complied with.

9) JMA notes the allowable rules affect owners' correlative rights, which have the force and effect of law. JMA disagrees that these rules are procedural as SM believes. JMA notes that SM's failure to timely run and properly document the Form 1016 test is shown in the record. JMA notes that SM had no effective chain of control that ensured proper receipt of the requested form to the Commission Oklahoma City offices. JMA further finds that SM has no apparent checks and balances in place which would give notice of possible violations, etc.

10) JMA notes this lack of rule compliance by SM began when the Daryl #1-7 well was drilled and continued on thereafter. JMA points out that SM has multiple tests and form filings that are significantly overdue for the two Section 7 wells. JMA notes that SM's purported theory of partial compliance with Commission rules is misplaced as SM attempted to pass that responsibility onto field Inspector Julian. JMA notes that even case law supports the fact that it is the operator's duty to comply with the Commission rules, i.e. not the inspectors.

11) JMA notes that the Exhibits 20-A and 20-B data does not comport to be from the well that it is purported to be tested from. JMA does not believe the data fits.

12) 52 O.S. Section 239 indicates the Commission is obligated to enact and regulate rules on allowables to protect the correlative rights of all those parties in the common source of supply that's being produced. The unrefuted

evidence shows that: 1) SM systematically violated the allowable rules in Section 7; 2) that SM ran their initial test on the Daryl #1-7 well late; 3) that SM filed the initial test data on the Daryl #1-7 well late; 4) that SM never filed their first annual test on the Daryl #1-7 well; 5) that SM filed the second annual test on the Daryl #1-7 well late; 6) that SM filed their 1002A completion report on the Stafford #2-7 well late; and 7) that SM filed their initial test on the Stafford #2-7 well nine months after SM ran the test late.

13) JMA basically finds that SM essentially overproduced Section 7's allowable by producing 2.13 BCF before Section 7 was assigned an allowable. JMA points out the first 2.13 BCF produced in Section 7 has yet to have an allowable established on it.

14) JMA notes that after the Section 8 Silvers Trust #8-1 well came on line SM restricted its flow rate so that it could not produce its allowable while overproducing Section 7 by 2.5 BCF. JMA would estimate since 2009 that SM's production in Section 7 versus Section 8 to be 7.5 to 4.6 BCF respectively.

15) JMA believes the Commission field inspector is only responsible for witnessing tests performed by operators, not for sending that data direct to the Oklahoma City offices for filing purposes as that is part of the operator's duty. JMA believes a Commission field inspector is an agent of the Commission only. JMA notes that case law and Commission rules are specific on that point. The Commission Proration and Production Department personnel are the ones that approve the operator's test, not a field inspector.

16) JMA cites *Ashland Oil Inc. v. Corporation Comm'n*, 595 P.2d 423 (Okla. 1979). In the *Ashland* case the Court said the field inspector is merely an agent of the Commission without authority to waive Commission rules. Further, the Commission rules are not procedural but have the force and effect of law wherever such affect correlative rights. JMA believes that allowables affect correlative rights.

17) JMA notes that SM assumed the pumper information given on the Form 1016 was correct. Yet JMA points out the rules require the well to be shut in for 24 hours prior to the Form 1016 test, then flow tested for 24 hours, i.e. 48 hours total. Here, JMA notes that SM's pumper called this data in on October 3, 2008. JMA notes that the Daryl #1-7 well was not shut in on October 1st and was not flow tested on October 2, 2008 per the Commission rules. The record shows the Daryl #1-7 well produced all day on both October 1st and 2nd and for 19 hours on October 3, 2008, and then it was shut in. JMA asserts the Daryl #1-7 well was not shut in for 24 hours, opened up and flow tested. It was shut in from October 3rd through the end of October and then opened back up. JMA believes this to be contrary to the Commission rules and thus the data on Form 1016 is flawed.

18) JMA notes the rate of flow is a critical element to establishing a well's allowable. JMA believes the numbers provided by the pumper on Form 1016 to be erroneous, hence the Form 1016 is unreliable.

19) JMA disagrees with the case law cited by SM in support of SM's relief. The Supreme Court supports JMA's belief that the Commission cannot grant relief effective prior to the date of the filed application. JMA also disagrees that SM can backdate to October 12, 2008 and hereby waive testing and filing requirements to fix their alleged violation of the Commission rules.

20) JMA cites *Brumark Corp. v. Corporation Com'n*, 864 P.2d 1287 (OK CIV APP 1993) ("Brumark I"). In the *Brumark I* case Santa Fe had drilled a well and forgot to file a commingling application which resulted in an overproduced well. Brumark felt their correlative rights were at risk yet withdrew their protest and a Commission order issued. The Commission found Santa Fe hadn't meant to violate the rules and made an exception. Brumark appealed. The Supreme Court reversed, stating that the Commission exceeded its authority by waiving a non-procedural rule and granting retroactive commingling order in violation of an established rule of the Commission.

21) JMA cites also the *Ashland Oil Inc. v. Corporation Comm'n*, 595 P.2d 423 (Okla. 1979). The *Ashland* case was where a field inspector had witnessed a plugging related to a pollution case with the Inspector saying it was fine. The Court found the Inspector's implied permission to forego the Commission rules was not binding, as the Commission rules have the force and effect of law. As an agent of the Commission the inspector was without authority to waive any Commission rule requirements.

22) In the *Brumark II* case, 924 P.2d 296 (OK CIV APP 1996) the parties tried a new case (after *Brumark I* was remanded back to the Commission, saying the Commission order violated the law as the OCC rules had been violated) with the new application not being made effective any date earlier than the filing of the application. The Commission gave the parties a separate allowable.

23) Here, JMA notes that SM has not filed for a separate allowable as in the *Brumark II* case, rather SM merely wants the Commission to waive their rules so another Form 1016 test will not need to be run, as this is just a procedural matter. JMA asserts that in this case, SM's request to the Commission to waive the Commission rules violates the previously mentioned court cases.

24) JMA would concur with the ALJ's finding that Exhibits 20-A and 20-B have no probative value for allowable purposes and cannot be considered in attempting to retroactively file an erroneous Form 1016.

25) JMA believes the law is settled in that the OCC cannot retroactively repair an allowable rule violation by back dating two years to eliminate a well's overage.

26) JMA believes that SM is violating the correlative rights of offset owners by overproducing Section 7 wells to drain the offsets.

27) JMA believes the rules on allowables have the force and effect of law. Thus, as an agent, the field inspector in JMA's opinion, cannot waive a requirement of the Commission rules under any circumstances.

28) JMA notes the ALJ wrote a well-reasoned report of the findings and summary of the evidence before him which is consistent with the Commission rules. JMA notes even the Supreme Court cases support the ALJ's decision.

29) JMA believes that every operator should be held to the same standards. JMA believes the ALJ's report is supported by the facts, law and respectfully requests such be upheld.

RESPONSE OF SM

1) SM differs with JMA's interpretation of the transcript reading. SM was unaware of the nonfiled Form 1016 until Yukon filed its application. SM did not intentionally violate the Commission rules nor withhold data about the Section 7 prolific wells. SM notes these wells producing from intervals at 22,000 feet cost approximately \$10 million to drill and complete. SM notes that as more wells are drilled, the geological interpretation changes as well.

2) SM, upon investigation, found the test had been conducted with the Form 1016 prepared. SM presumed that the SM Whitson procedure had resulted in Form 1016 being filed with the Commission. The facts herein support SM's belief.

3) SM notes the field Inspector did recall the Form 1016 test, as it was witnessed by both SM Whitman and the Commission Inspector. SM notes the Form 1016 was kept at the Commission's Anadarko District office. SM asserts this should be sufficient for filing purposes under the circumstances of this cause to set the 2009 allowable and eliminate the alleged 2.5 BCF overage.

4) SM is not attempting to conceal data from the public in order to cause uncompensated drainage for pecuniary gain on SM's part. SM notes there are other interest owners besides SM in Section 7. Should the OCC opt not to accept the Form 1016, the rights of the royalty owners, the overriding royalty

interest owners and other working interest owners will be adversely impacted. SM sees no reason for the Commission to take this action.

5) SM believes the filing of a Form 1016 is a procedural matter, not a substantive one. SM admits the Form 1016 test is important yet the evidence shows the test was performed. This testimony was unrebutted. However, for unknown reasons the original of Form 1016 did not reach the Oklahoma City offices.

6) SM asserts this case has nothing to do with the Commission creating an order making the effective date of the Form 1016 prior to the subject matter jurisdiction attaching under an application. SM would request the Court to read the *Brumark II* case, the *British American* case and look at the Oklahoma statutes. SM asserts the Commission has ample authority to grant SM's relief.

7) SM asserts the Commission has the authority to accept this Form 1016 and correct the alleged overproduction. The Commission can set an allowable for this unit for 2009 to correct the inequity and violation of correlative rights of the owners in Section 7.

CONCLUSIONS

The Referee finds the Report of the Administrative Law Judge should be affirmed.

1) 52 O.S. Section 239 provides:

Any person, firm or corporation, having the right to drill into and produce gas from any common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by the person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent the person, firm or corporation securing any unfair proportion of the gas from the common source of supply. Except as otherwise provided in this section, the Corporation Commission is authorized and directed to prescribe rules for the determination of the natural flow of any well or wells, and to promulgate field rules to regulate

the taking of natural gas from any or all common sources of supply within the state, so as to prevent waste as the same is defined in Section 86.3 of this title, protect the interests of the public, and the correlative rights of all those having a right to produce from the common source of supply, and to prevent unreasonable discrimination in favor of any one common source of supply as against another.

2) The evidence reflects that: 1) SM did not follow the allowable rules in Section 7; 2) that SM ran the initial test on the Daryl #1-7 well late; 3) that SM filed the initial test data on the Daryl #1-7 well late; 4) that SM never filed their first annual test on the Daryl #1-7 well; 5) that SM filed the second annual test of the Daryl #1-7 well late; 6) that SM filed their 1002A completion report on the Stafford #2-7 well late; and 7) that SM filed their initial test on the Stafford #2-7 well nine months after SM ran the test late.

3) There are definitive rules concerning these issues. OCC 165:10-17-3 deals with the effective date of allowables. OCC 165:10-17-6 deals with general well testing requirements. OCC 165:10-17-7(b) deals with maximum permitted rates of production for unallocated gas wells. OCC 165:10-17-11 deals with maximum permitted rates of production for unallocated gas wells. The evidence reflects that SM did not comply with the pertinent provisions of these rules. Evidence was presented that SM conducted untimely testing and filing of proper documentation. The evidence further reflected that there was no effective chain of control to insure proper receipt of the required forms in the offices of the Oklahoma Corporation Commission. As the ALJ reflected, this is not an issue of just one missed timeframe due to inadvertence, but many tests and form filings that were significantly overdue or never filed. One could imply from the evidence that SM either knowingly or recklessly disregarded the rules. See *Brumark Corporation Commission v. Corporation Commission of State of Oklahoma*, 924 P.2d 296 (Okl. App. 1996).

4) The Referee has reviewed the transcripts of the proceedings before the ALJ and the evidence presented reflects that there was substantial evidence of a failure by SM to properly and timely submit the required forms to establish allowables for the two wells in Section 7. There was also testimony concerning the questionable validity of the tests that were submitted. The Findings of Fact and Conclusions of Law by the ALJ must be sustained by law and substantial evidence. *Samson Resources Company v. Oklahoma Corporation Commission*, 742 P.2d 1114 (Okl. 1987). There is no requirement to weigh the evidence but the supporting evidence must possess substance and relevance. *Id.* at 116. The Referee agrees with the ALJ that the evidence presented established frequent violations of the letter and spirit of the rules of the Commission. At the end of the calendar year 2009 Section 7 had a cumulative overproduction

of 2.53 BCF of gas. Upon a review of the record the Referee concludes that substantial evidence supports the ALJ's recommendations.

5) SM cites the cases of *British American Oil Producing Company v. Corporation Commission*, 69 P.2d 669 (Okl. 1937); *Brumark Corporation v. Corporation Commission*, 864 P.2d 1287 (Okl. App. 1993) ("Brumark I"); and *Brumark Corporation v. Corporation Commission of State of Oklahoma*, 924 P.2d 296 (Okl. App. 1996) ("Brumark II") for the proposition that the misfilings and or late filings of SM were mere inadvertences and procedural only. SM argues that the Commission has the power to waive the requirements of its own rules of procedure. SM believes the Commission can accept the Form 1016s and cancel the alleged overproduction which would protect the correlative rights of the owners in the Section 7 wells.

6) In *Brumark I* the Commission granted Santa Fe's application for exception to the rules and determined that Santa Fe's failure to file the commingling application for a well "was the result of inadvertence and was not done knowingly or in reckless disregard of the true situation." The Court of Appeals, however, found the Commission exceeded its authority in granting Santa Fe a retroactive allowable back to the date of first production. The Court found that the Commission does have discretionary authority to waive its own rules, however, the Commission specifically only retains the power to waive the requirements of rules of procedure. See *VanHorn Oil Company v. Oklahoma Corporation Commission*, 753 P.2d 1359 (Okl. 1988). In the *Brumark I* case the Court stated that it was not dealing with a rule of procedure but was dealing with a rule affecting the correlative rights of the parties. The *Brumark I* court stated that:

The Corporation Commission is empowered to issue orders to protect the correlative rights of interest owners in common sources of supply. 52 O.S. Section 87.1(a). OCC/OGR Section 3224(A)(a) and (E)(3)(a)(B) provides that a commingling order shall be acquired prior to commingling, and an allowable shall be assigned only after issuance of the commingling order....The Corporation Commission exceeded its authority by waiving a nonprocedural rule and granting a retroactive commingling order in violation of an established rule of the Corporation Commission....

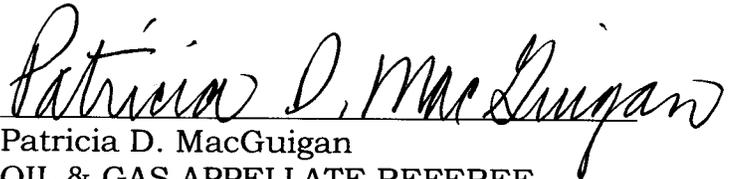
7) Thus the Court of Appeals in *Brumark I* determined the Commission had exceeded its authority by waiving a non-procedural rule and granting a retroactive commingling order. In *Brumark II* Santa Fe was not permitted to and did not relitigate the issue of whether the Commission may waive a non-procedural rule and grant a retroactive commingling order. The issues

considered included whether a certain well should be shut in and whether Santa Fe's request for a separate allowable should be granted. The Commission had effectively denied Brumark's application to shut in the well and granted Santa Fe's application for a separate allowable. Thus, *Brumark II* did not overturn *Brumark I*'s conclusion that a rule affecting the correlative rights of the parties is a nonprocedural rule and cannot be waived. The *Brumark II* case dealt with the issues of shutting in a well and assigning an allowable to a well. In the present case SM has not filed for a separate allowable as in the *Brumark II* case, rather SM merely wants the Commission to waive their rules concerning the requirement that certain forms must be filed prior to establishment of allowables for the two wells in Section 7. SM asserts that following these rules and filing these forms are just procedural matters. However, the Referee believes the rules concerning well testing and the establishment of allowables affect correlative rights. See *Brumark I*, supra, 864 P.2d at 1287; *VanHorn Oil Company v. Oklahoma Corporation Commission*, 753 P.2d at 1363.

8) SM also asserts that the retention of Form 1016 by the Oklahoma Corporation Commission field inspector for Caddo County in his official capacity should have been sufficient for filing with the Commission. However rules concerning allowables affect correlative rights and such rules are not procedural. SM failed to properly and timely submit the required forms to establish allowables for the two wells in Section 7. These rules have the force and effect of law and an agent or employee of the Commission is powerless to waive the requirement of these rules. *Ashland Oil Inc. v. Corporation Commission*, 595 P.2d 423 (Okla. 1979).

9) For the above stated reasons the Referee affirms the recommendation of the ALJ that the application of Yukon filed in Cause CD No. 201001230 be granted and the application of SM in Cause CD No. 201002150 be denied with the result that the two SM wells in Section 7 will be restricted to producing 10% of the currently assigned allowable.

RESPECTFULLY SUBMITTED THIS 29th day of March, 2011.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Murphy
Commissioner Cloud

Commissioner Anthony
Jim Hamilton
ALJ Michael D. Norris
Charles Helm
John C. Moricoli, Jr.
Office of General Counsel
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks – 1
Commission Files