

*Deliber
3/29*

**BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA**

FILED

MAR 11 2011

COURT CLERK'S OFFICE — OKC
CORPORATION COMMISSION
OF OKLAHOMA

<u>APPLICANT:</u>	SM ENERGY COMPANY)	
)	
<u>RELIEF SOUGHT:</u>	LOCATION EXCEPTION)	CAUSE CD NO.
)	201005529-T
)	
<u>LEGAL DESCRIPTION:</u>	ALL OF SECTION 26,)	
	TOWNSHIP 11 NORTH, RANGE)	
	23 WEST, BECKHAM COUNTY,)	
	OKLAHOMA)	

**REPORT OF THE OIL AND GAS APPELLATE REFEREE ON
AN ORAL APPEAL FOR AN EMERGENCY APPLICATION**

This Emergency Application came on for hearing before **Curtis Johnson**, Deputy Administrative Law Judge for the Oklahoma Corporation Commission, at 9 a.m. on the 28th day of February, 2011, in the Commission's Courtroom, Kerr Building, Tulsa, Oklahoma, pursuant to notice given as required by law and the rules of the Commission for purpose of taking testimony and reporting to the Commission.

APPEARANCES: **John C. Moricoli, Jr.**, attorney, appeared for applicant, SM Energy Company ("SM"); **Charles L. Helm**, attorney, appeared for JMA Energy Company, LLC ("JMA"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") issued his Oral Ruling on the Emergency Application to which Oral Exceptions were timely lodged and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Oral Exceptions was referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 10th day of March, 2011. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

SM requests the authorization to drill and complete a well at the locations described below prior to a final determination in this cause. Because of

contractual commitments, SM believes it is necessary to commence operations of said well prior to the date on which this cause is set for hearing.

SM states that all of Section 26, T11N, R23W, Beckham County, Oklahoma constitutes a drilling and spacing unit for the production of hydrocarbons from the Brown Dolomite, Virgil and Missouri common sources of supply by Order No . 235803, as corrected by Order No . 269814.

That heretofore, on the 22nd day of December, 2010, the Applicant filed in this cause, its application for an order granting a location exception to the spacing pattern and requesting that it be allowed to locate its well at the following locations:

SURFACE LOCATION: No closer than 265 ' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

BROWN DOLOMITE:

TOP: No closer than 1.0' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

BASE: No closer than 1.0' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

VIRGIL:

TOP: No closer than 1.0' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

BASE: No closer than 1.0' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

MISSOURI:

TOP: No closer than 1.0' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

FIRST PERFORATION: No closer than 300' South of the North line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

LAST PERFORATION: No closer than 300' North of the South line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma;

BASE : HORIZONTAL IN MISSOURI

BOTTOM HOLE LOCATION: No closer than 1.0' North of the South line and no closer than 500' West of the East line of Section 26, T11N, R23W, Beckham County, Oklahoma.

REPORT OF THE ADMINISTRATIVE LAW JUDGE

ALJ CURTIS JOHNSON REPORTED that SM had a drilling contract in place which allowed them to drill three wells or pay a penalty of \$250,000. The contract was entered into in November or December of 2010. All other potential SM locations are currently being reevaluated economically and therefore SM has no alternative place to move this rig that is not currently protested by JMA. SM requests to drill, test and complete, but not produce, with a 90 day expiration period of the emergency order.

JMA argues that SM had created the emergency by entering into the drilling extension of the drilling contract for three wells when they knew the cause was protested. SM argued the causes weren't protested by JMA until January of 2011 and the rig contract was entered into in November 2010. Furthermore, SM had already drilled two wells pursuant to the rig contract so they just needed one additional well.

The ALJ agreed with SM's argument that SM had not created the emergency by entering into the extension of the Unit Drilling contract because they had drilled two wells pursuant to the extension of the Unit Drilling contract so they just needed one more. SM had this cause that was currently being protested by JMA plus three more location exceptions being protested by JMA, so that's four potential locations for the rig. The ALJ thinks it is highly unlikely that SM would have anticipated that all four of these location exception possibilities would be protested by JMA. Based upon those facts the ALJ recommended the emergency application for good cause shown.

That SM established a substantial financial loss which justifies the granting of the emergency application. In these circumstances SM should be allowed to drill, test and complete but not produce the proposed well in Section 26 on an emergency basis.

POSITIONS OF THE PARTIES

JMA

1) **Charles Helm**, attorney, appearing on behalf of JMA, stated that at the time of the hearing on the emergency application, SM amended the application to reflect that the first perforation is no closer than 330 feet south of the north line and the last perforation is no closer than 330 feet north of the south line of Section 26. The application was fax filed on December 22, 2010. JMA received notice of the application and contacted Mr. Helm on January 7th. They then advised SM that JMA would be protesting the location exception and filed the protest and entry of appearance on January 10, 2011. This present application was filed on December 22nd after the drilling contract was entered into in November of 2010. There is a contract that apparently is ten years old which involves SM's use of a rig and this rig has been under contract for over ten years. SM apparently has the ability to renew the contract at will. In November 2010 they renewed the contract for a three well package. The three well package wasn't specified insofar as any particular well locations. It just simply said that you will use this rig to drill three wells. If SM doesn't drill three wells there was a penalty provision. SM would then have to pay a penalty of \$250,000. JMA does not know when they have an obligation to use the rig for the third well. The protested case is currently scheduled the week after spring break on January 23, 24 and 25, 2011. On February 23rd, SM filed an emergency application in this case. On that date they also filed another emergency application in another proceeding and it was to be heard at the same time before ALJ Johnson. The other emergency that they filed was in 201005528-T and it likewise was a location exception filed by SM that was protested by JMA. That matter was heard uncontested on March 9, 2011, yesterday, and was recommended by ALJ Johnson. This was the merit proceeding not an emergency proceeding. The emergency application in 201005528-T location exception was withdrawn by JMA.

2) The first of the three wells was drilled in Section 27 for the Bill well. SM at the time they entered into this three well drilling contract actually had five location exception wells where the regulatory authority had been approved. They decided to use that drilling contract to drill the Bill well in Section 27 along the W/2 and then when it finished drilling they moved it directly south to the Norma well in Section 34. The Norma well was drilling at the time of the emergency hearing and SM wants to take that rig from Section 34 and move it to Section 26. They informed the ALJ that SM could not move the rig to any other location in the State of Oklahoma. One of the reasons that they stated that they couldn't move the rig anywhere else was that JMA was protesting

other cases, however JMA was also protesting in Section 26 which didn't prevent them from trying to move the rig to Section 26.

3) However, on cross examination it was pointed out to the SM witness that SM had their regulatory work approved in three other sections in this area. Section 36 has a location exception approved for SM by Order No. 581910. We also know that SM has regulatory work done to drill a well in Section 1, and also regulatory work done in Section 6. Thus, the rig could move over to Section 36, Section 1 or Section 6. SM's response was that they were re-evaluating the economics for any wells in those sections. SM has also an application pending in Section 27 for the Missouri and SM was asked if they were re-evaluating the economics in Section 27. He said yes.

4) JMA is stating that just saying something is economical or noneconomical is not a reason for an emergency, and if that's the purpose behind the emergency proceeding JMA objects because in November they had plenty of locations to take this rig to. JMA believes there is no emergency now as they can take this rig to four sections. We know that they can take it from Section 34 to 27 if they want to or they can take it to Section 36 or Section 1 or Section 6.

5) It does not appear under the facts of the case that there is an emergency. And it doesn't appear that the Commission should allow a company to allege an emergency by simply stating that they want to re-evaluate the economics of locations that are already available to drill and are viable candidates to drill when they entered into the drilling contract. You can create your own emergency by stating that everything is undrillable. That is creating your own emergency. For those reasons JMA objected to SM's request for the emergency. JMA believed that with all of the available locations available to drill, if SM truly wants to keep the rig for a third well, they can move the rig to one of numerous locations that are uncontested that they have already told the Commission they want to drill and have regulatory authority for.

6) In November 2010 SM didn't have the regulatory authority to drill the well that they are proposing now in Section 26. They should have filed or could have filed anytime before they entered into the drilling contract this proposed location exception in Section 26, but they did not. When they chose to extend the drilling contract they had multiple locations already approved, but Section 26 location exception had not been asked for or approved. They didn't file for this location exception until December 22, 2010. In November 2010 SM knew they couldn't drill this well in Section 26. They had multiple locations they knew they could drill. They thus created their own emergency. You can't wait until right at the time when the rig is about to move off a location and then go file an emergency. There's nothing that distinguishes Section 26 from all of the other cases they have in this area that are being protested.

7) There also is no direct evidence as to the time limit of the drilling contract with Unit Drilling. There is no time limit in the drilling contract from the time a rig finishes one location to when it has to start a new location before there is a penalty. There is also no evidence in the record that this rig will be available in a "handful of days" as SM argued. There is also no evidence that SM proposed a well in Section 26. There is no evidence that SM has negotiated surface damages. There is no evidence that SM has begun construction of any kind of location. A company shouldn't be allowed to create their own emergencies. There is no evidence in the record as to what the economic criteria is. There is thus no evidence of an emergency and the ALJ should be reversed.

SM

1) **John C. Moricoli, Jr.**, attorney, appearing on behalf of SM, stated that his version of the facts is somewhat different. There's been ongoing three well drilling packages for a number of years. When you find drilling contractors that are efficient and work well together you want to retain them. In November of 2010 another three well drilling contract was executed. Under the contract Unit Drilling would provide this particular rig for the drilling of three wells. You really cannot pick and choose when these wells can be drilled when the rig comes off of one location it has to go to another drilling location. If we cannot take it to the next location SM has a penalty they have to pay of \$250,000. The rig is coming off of a location right now and will be available for the next well quickly within handful of days. In fact when ALJ Johnson gave his recommendation SM sent out the crew to begin the location in Section 26. SM has no other place to move this rig.

2) JMA produced no witnesses, introduced no testimony. They did nothing to rebut the testimony that SM provided at the emergency hearing. Mr. Helm cross examined SM's witness and cross examination revolved around other locations that might be available and other regulatory orders that SM had already obtained. The wells that have been previously authorized are not economically viable under current economic conditions. The economic factors and considerations vary with time caused by fluctuating product prices or increase or decrease in cost of services. We have low gas prices and that particular factor has adversely impacted economics. That may change in the future as oil and gas prices increase in the future.

3) SM filed at the end of December 2010 approximately 10 applications. Some of them were multiple applications covering the same unit. These are the wells that SM planned to drill in the first half of this year and they all were set for hearing in the middle part of January, 2011. Every one of them was

protested by JMA. Yesterday SM and JMA appeared before ALJ Johnson to try the case in Section 27. They finally settled this case and that well falls within the category of re-evaluation economically. Because the orders are good for a year, SM went forward with the application in order to be prepared to drill it if and when economic factors indicate that it is appropriate to do so. That well may even be drilled within the next 60 days or 90 days, but one thing that has to happen on that unit is the well has to be proposed to the working interest owner and an operating agreement in place has to be proposed. All those people have a minimum of 30 days to elect what they want to do as SM cannot start a multi-million dollar well and carry everybody. Thus in Section 27 the well is not ready to be drilled. All the preparatory work necessary to putting it together and getting commitments in and getting money in, etc. has not been accomplished. In addition at the present time the well is not economical to drill. All of the other wells that SM planned to drill in the first half of 2011 are all being protested by JMA. In order to avoid the \$250,000 payment under the rig contract SM has to pursue the most viable option which is Section 26.

4) Another consideration is that we do not want to lose Unit Drilling as they are an efficient crew and company. SM does not want to let them go. Also, writing a check for \$250,000 is totally a waste of money.

5) There was no evidence introduced by JMA to controvert anything that was introduced by SM for this particular application. SM understands that the entry of this emergency order is subject to the final merit proceeding. SM might lose the case, but they are willing to take that risk.

6) In the nine section area surrounding Section 26 there is no production of significance except in Section 23 which is operated by Apache. Apache has a horizontal well in the middle of the section that is producing at 1,000 BOPD. They just drilled another well horizontally in the W/2 W/2 of Section 23. They are rigging up on another well to be drilled in Section 23 of the E/2 E/2. JMA and SM are fighting about who will be operator and drill a well in Section 24. The operator that might have cause to complain about this present SM location exception in Section 26 is Apache the Operator in Section 23. They have had no objection to our drilling in Section 26.

7) SM has made out a prima facie case in the present emergency application which stands un rebutted. SM has not created its emergency as any regulatory orders we have obtained for other sections are not usable at this time because of economics and current prices. There is simply no other place for this rig to go in order to avoid paying the \$250,000 penalty. We would therefore recommend that the ALJ's decision be affirmed as he was the one who is the trier of fact and observed the demeanor of the witnesses.

CONCLUSIONS

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

1) The Referee finds that the ALJ's recommendation to grant the Emergency Application should be affirmed as it is based upon substantial evidence and free of reversible error.

2) The ALJ is the initial finder of fact and had the opportunity to observe the witnesses and assess their demeanor in determining the issues presented before him. *Grison Oil Corp. v. Corporation Commission*, 99 P.2d 134 (Okl. 1940). The ALJ as the trier of fact determined that a financial loss existed.

3) The present application for the location exception was filed by SM by fax on December 22, 2010 and filed at the Corporation Commission in Tulsa in the Court Clerk's office on December 27, 2010. The location exception was protested by JMA on January 10, 2011. SM has had this particular rig under contract for ten years. SM entered into extensions to the original contract for three wells at a time with the latest three well contract extension being signed in November of 2010. SM renewed the contract for three additional wells with a penalty provision that would pay \$250,000 if SM did not use the rig for the three wells. The first well drilled by the rig under the November contract with Unit Drilling was the Bill #1-27H in Section 27 of 11N-26W. The second well that was used by the rig under the Unit Drilling contract was the Norma #1-34H of 11N-26W. The rig moved directly from the Bill to the Norma. The Bill was spudded on February 15, 2011. SM has known since January that the present location was being protested by JMA.

4) SM has regulatory work already in place for location exceptions in Sections 1 and 6 but SM believes that at the present time these wells are not economical to drill with the present prices and offset well information. SM does not believe that those location exceptions granted will produce efficiently to justify any further development at the present time.

5) SM believes the present well is needed to be drilled as there is a rather prolific horizontal well in the offset unit Section 23 which is being produced by Apache Corporation in the Missouri. Section 23 of 11N-23W is directly to the north of the proposed Section 26. The Apache well came on making 1,000 BOPD and some gas and continues to produce in that range. SM therefore believes that the present Section 26 unit needs to be explored hoping to create the same good production.

6) The protested location hearing in this matter will not be presented until March 23, 24 and 25, 2011. Thus, SM will not be able to present the location

exception, obtain a report, go through the appellate process and ultimately obtain a final order in time to utilize the rig in order to avoid a \$250,000 penalty. The referenced three well rig contract has one more well commitment to drill and if SM does not drill the third well, they will owe a \$250,000 penalty. SM is trying to protect the correlative rights of the owners in Section 26 and drill a well to compete with the prolific offset in Section 23. There are other locations being proposed by SM in the immediate area, but JMA is protesting those location exceptions.

7) JMA argues that SM created its own emergency by contracting with Unit Drilling in November of 2010 and at that time they knew they would have to come up with three locations or suffer the economic loss associated with the contract. At the time they drilled their first well SM apparently knew they were being protested in Section 26 as the protest was entered in January of 2011 and nonetheless SM went ahead and spud the second well on February 15, 2011 knowing at that time they wouldn't have any place to put the 3rd location since they stated that SM had no other locations in the State of Oklahoma. JMA therefore argues that SM has created their own emergency.

8) The Referee notes the ALJ as the trier of fact determined that a financial loss existed. The ALJ found the financial loss was substantial under the evidence presented and was sufficient to justify the granting of the application. The ALJ pointed out that SM has utilized Unit Drilling and their crew and drilled many wells within the immediate area. The rig crew has gained experience in drilling these type of wells. The ALJ also considered the fact that a well is being produced effectively in the northern adjoining Section 23 to Section 26 by Apache and thus the proposed location exception by SM in Section 26 has economic potential. The Referee therefore can find no reason to vary the ALJ's determination.

9) SM is aware that the emergency application is a temporary order and will not prejudice the hearing on the merits. Hence, SM is willing to take the risk that the Commission may either deny the proposed location or establish a substantial penalty on production of the well at the proposed location under the merits of the application. In these circumstances, the ALJ should be affirmed.

RESPECTFULLY SUBMITTED THIS 11th day of March, 2011.


PATRICIA D. MACGUIGAN
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Murphy
Commissioner Cloud
Commissioner Anthony
Jim Hamilton
ALJ Curtis Johnson
John C. Moricoli, Jr.
Charles L. Helm
Office of General Counsel
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks - 1
Commission Files

PM:ac

xc: Commissioner Murphy
Commissioner Cloud
Commissioner Anthony
Jim Hamilton
ALJ Curtis Johnson
John C. Moricoli, Jr.
Charles L. Helm
Office of General Counsel
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks - 1
Commission Files