

BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA

FILED
JUL 06 2012

<u>APPLICANT:</u>	PAYNE EXPLORATION COMPANY)	COURT CLERK'S OFFICE - OKC CORPORATION COMMISSION OF OKLAHOMA
<u>RELIEF SOUGHT:</u>	POOLING (HORIZONTAL UNIT))	CAUSE CD NO. 201102237
<u>LEGAL DESCRIPTION:</u>	W/2 OF SECTION 36, TOWNSHIP 17 NORTH, RANGE 5 WEST, LOGAN COUNTY, OKLAHOMA))

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Paul Porter**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 11th and 12th days of January, 2012, and the 1st and 2nd days of February, 2012, 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: **Richard Grimes**, attorney, appeared on behalf of applicant, Payne Exploration Company ("Payne"); **Karl Hirsch**, attorney, appeared on behalf of Husky Ventures, Inc. ("Husky"); 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 24th day of February, 2012, to which Exceptions were timely filed 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 4th day of May, 2012. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

HUSKY APPEALS the ALJ's recommendation to grant the pooling application of Payne and the designation of Payne as operator.

Payne is proposing to develop the Hunton formation in the 320-acre horizontal drilling and spacing unit consisting of the W/2 of Section 36, T17N, R5W, Kingfisher County. Payne owns 50% of the spaced unit and 50% is owned by Husky. Payne proposed a well on February 24, 2011 and the disputed issue is who will operate. They have both successfully operated wells in the area.

HUSKY TAKES THE POSITION:

(1) The Report of the Administrative Law Judge is contrary to the law, contrary to the facts and to the evidence presented in this case.

(2) The ALJ Report fails to achieve the goals of the State of Oklahoma and the Commission for the prevention of waste and the protection of correlative rights.

(3) Husky is the only respondent to the application. Testimony presented reflected that Husky's net revenue interest is 79.25, not 81.25. The ALJ's recommendation of \$400 per acre and a total 3/16th royalty does not reflect the facts and circumstances surrounding the interests of the respondent.

(4) The liens filed against Husky were discussed and resolved. In both cases, the liens were filed because of legitimate billing disputes. In neither case did the liens cost the working interest owners any money. In fact, Husky was able to negotiate one of the liens to save the working interest owners money. The decisions made that resulted in the liens were prudent decisions. Husky did spud two wells prior to the issuance of a drilling permit, but in both cases, the intent to drill was submitted as a "walk through" and the permits should have issued within a day or two. The wells were not spud until 10 days after the permits were walked through. Husky does have an enforcement action filed against it and accepts full responsibility for the rule violation, but the violation occurred due to the failure of a consultant to follow through as promised.

(5) In the Findings of Fact, paragraph G, subparagraph 5, the ALJ stated that production differences can be explained, not only by the completion method, but also by other functions. The only geologists to testify at the hearing were witnesses testifying on behalf of Husky. Both of them testified that the Payne wells were better geologically situated in the reservoir than the Husky wells, yet the Husky wells produced better than the Payne wells. Both

Gregg McDonald and Fletcher Lewis testified as to geological differences between the wells and that the geology favored the Payne wells, not the Husky wells, yet the Husky wells were better producers.

(6) Husky adequately explained why it was not the moving party and the fact that Payne filed the pooling application should not be considered in determining the operator under the pooling Order to issue in this cause.

(7) Husky presented extensive evidence that its completion methods are superior to those of Payne. Both Payne and Husky presented engineering evidence concerning the potential reserves and economics of the drilling of these wells. Payne did not present any methodology for its conclusions and Husky did present its methodology and that methodology was not contested by Payne. Husky's evidence conclusively showed that Husky's completion methods ultimately produced more oil and gas and increased the profitability and proved the economics for the drilling of horizontal Hunton wells in this area by the method employed by Husky.

(8) The ALJ stated that the operator should have the ability to choose its method of completing the wells, but to choose an operator that will use an inferior method of completion is not a protection of the correlative rights of the other 50% owner in the well.

(9) Wherefore, Husky respectfully requests the recommendation of the ALJ be reversed and that Husky be named operator under the Order to issue in this cause and for further relief as the Commission may deem just and proper.

THE ALJ FOUND:

(1) Each of the contestants own half of the 320 acre spaced unit, have a significant presence in the area and have drilled wells similar to the proposed well. These are all considerations when determining who should operate. The issue in this matter is operations.

(2) Payne has prevailed in the related spacing matter (Husky proposed 640-acre spacing). Payne has staked a location, negotiated surface damages with the owner and contracted a rig. They also have a Commission Intent to Drill that they will amend subsequent to receiving a location exception. Payne operates 130 wells, 112 of them active. They operate 55 wells, including 9 horizontal, in Logan and Kingfisher Counties. Payne has used different completion methods in the last two years and prefers packers plus. Husky favors a plug and perf completion. Payne finds the Hunton Lime holds its shape and is well suited to a packers plus completion.

(3) Payne has a drilling contract, bids from servicing companies, secured water for fracturing, staked a location, and has a gas sales contract. Payne first filed for pooling (Husky alleges this is because they thought they had negotiated a land swap with Payne and were surprised by the filing). Payne has been in business for 48 years and Husky for about 3 years. Husky operates significantly fewer wells than Payne. Payne has no liens filed against it and they have no Commission contempt proceedings filed against them.

(4) Considerable evidence and testimony was dedicated to proving which completion method allowed greater production. Both parties assembled statistical data to best show they offer the better completion method. However, many factors other than completion method affect production.

(5) Mr. Daniel testified production differences could be explained by different pressures or a choke or other factors. Husky presented engineering testimony from Mr. Ely who said he had not compared geologic differences in the wells and from Mr. Lewis who said the Corwin excellent production was due to, among other factors, the function of geology. Mr. Lewis could provide no study showing plug and perf completion caused production differences. Husky geologist, Mr. McDonald testified formation thickness, lithology, frac'ing porosity, and faulting as reasons for differing production in seemingly comparable wells. There are many factors to consider in trying to maximize recovery and that consideration and decision should be made by the operator.

(6) The Commission determines which party presents the most compelling evidence to deserve operations. After the operator designation has been assigned, it is up to that operator to conduct operations, including the type of completion method they use.

(7) Husky showed they had drilled the first horizontal well in the area and had gained experience using plug and perf completions, much of it gained through partial fracs on wells. They had a gas contract and a drilling contract in place. Husky believed they should operate because they had learned, from expert drilling and frac'ing advice, to use a plug and perf completion to increase ultimate recovery. They also presented expert testimony that preferred plug and perf completions. They presented testimony to show FMI logs allowed them to identify natural frac'ing and then perf those natural fracs. They said plug and perf allowed partial frac'ing and additional stimulation. Down hole issues were more easily addressed by using plug and perf. Mr. Lewis said he still believed 640-acre spacing was more appropriate even though the Husky Corwin well was drilled on a 320 acre unit. He did not explain the rationale for drilling a well believed to drain in excess of its spaced unit.

(8) Husky has two employees, an accountant and a secretary. All other business is performed by consultants. Both sides noted drilling and

production difficulties suffered by both contestants, and how those were addressed by both parties. Of particular note is that Husky has had two liens placed against it (they explained resolution), a Commission contempt citation (unresolved), soil farming before authorized, spud wells before authorized, and represented no logs were run when, in fact, they were (this was done on advice of a Commission employee). Mr. Long had not read all Commission rules but said he had no intention to violate them. Mr. Long took full responsibility for errors and said he had learned from these errors and would not repeat them.

(9) The ALJ believes Husky has gained knowledge and improved technique for plug and perf completions; and that Mr. Long and Husky will diligently address several errors with Commission rules and procedures. However, Payne has not made these errors, has no liens filed against it, has not spud a well without authorization, operates more wells and has been in business for almost 50 years. Payne has tried plug and perf completions and has chosen packers plus. Husky has tried packers plus and has chosen plug and perf. Reasonable operators may disagree about operations but this is no reason for excluding an operator from operating. In addition, the Payne AFE was significantly less expensive than the Husky AFE. The fact Husky relied on advice from a Commission employee does not mitigate its responsibility as an operator and, in addition, estoppel does not run against the State.

(10) Payne's pooling application should be granted under terms set forth by Ms. Reynolds (Payne AFE, Exhibit 1, 20 days to elect, 25 days to pay costs, 35 days to pay bonuses, and 180 days to drill for initial and subsequent wells, all from the date of a Commission order. A \$400 bonus retaining a 3/16 royalty interest is fair and reasonable and Payne owns 50% of the unit).

POSITIONS OF THE PARTIES

HUSKY

1) **Karl F. Hirsch**, attorney, appearing on behalf of Husky, asserts that this matter concerns a forced pooling, and as each party owns a 50% interest in each unit, ownership is not at issue.

2) Husky contends that it desires to be named unit operator; however, Payne was recommended as unit operator by the ALJ in the prior hearing to which Husky takes exception.

3) Husky asserts that the other terms of the pooling order were agreed upon; however, Husky also contends that the provision for delayed payment of well costs advanced by Payne's witness Ms. Reynolds was not included in the order. Husky cites Paragraph 10 of the Conclusions in the ALJ Report.

- 4) Husky contends that the ALJ improperly focused on the paperwork provided by the parties, rather than each party's respective ability to economically drill a well, in designating the unit operator.
- 5) Husky asserts that state statute provides that the operator designation should be just and reasonable to afford each owner the opportunity to recover or receive, without unnecessary expense, his just and fair share of the oil and gas. Husky cites 52 O.S. Section 87.1(f).
- 6) Husky reasserts that the operator ought to be designated according to their ability to fairly and economically drill and operate the well.
- 7) Husky contends that of the two liens filed against it, one lien was paid in full upon advice of counsel, and the other was negotiated to a lesser sum to the benefit of interest holders in the operation. Husky asserts that the fact that Payne has never had a lien filed against it displays only an ability to produce paperwork and does not evince an ability to drill and operate a well. Husky reasserts that the two liens filed against it did not affect the drilling or operating of the wells and did not harm the working interest owners in the wells.
- 8) Husky contends that the contempt charge filed against it for soil farming without a permit was due to a contractor's soil farming without a permit, despite contrary representations by the contractor. Husky asserts that the working interest owners were not adversely affected in either the drilling of the well or during production.
- 9) Husky asserts that for the wells it spudded before the issuance of the intent to drill, Husky had conducted a walkthrough of the well-site and mistakenly began drilling 10 days later under the impression that an intent to drill had been approved. Husky contends that the spudding was an earnest mistake, and that the intent to drill is typically approved within a 10 day window.
- 10) Husky asserts that issues arising from the submission of well logs are mutual to Husky and Payne, and that filings concerning well logs are not instructive in designating a unit operator.
- 11) Husky reasserts that state statute provides that the company that provides the owners the best opportunity to receive their just and fair share should be designated operator. Husky contends that issues associated with paperwork are not instructive in this determination.
- 12) Husky asserts that the parties each own a 50% interest in the unit, and that their disagreement centers upon the desired method of well completion. Husky employs the "plug and perf" method. Payne uses the "open hole with packers" method.

13) Husky contends that the evidence shows, despite the conclusions of the ALJ, that the "plug and perf" method of completion perfected by Husky is more productive than the Payne's packer plus method.

14) Husky asserts that Report of the ALJ at H5, page 15, is inconsistent with the facts presented. Husky contends that though there was geological testimony that thickness and lithology, frac'ing porosity, and faulting all contribute to disparate production from seemingly comparable wells, distinct evidence was presented that the Corwin and Hancock wells drilled by Husky were the two most productive wells in the area despite being geologically inferior to peer wells. Husky asserts that the "plug and perf" completion technique was responsible for the superior production of the Corwin and Hancock wells.

15) Husky contends that Mr. Greg McDonald, geologist, testified on behalf of Husky that the Corwin and Hancock wells had superior production despite having inferior pay zones to peer wells. Husky cites the Report of the ALJ at paragraph 22, page 7.

16) Husky asserts that Mr. Lewis, a geological and engineering witness, testified that despite the superior geology of the Payne Wakeman and Britt wells which had thicker pay zones, the Wakeman and Britt wells had inferior production compared to the Husky Corwin and Hancock wells. Husky contends that Mr. Lewis attributed the superior production of the Corwin and Wakeman wells to the "plug and perf" method.

17) Husky contends that Mr. Lewis testified that the Husky wells had a higher oil to gas ratio than the Payne wells. Husky asserts that this is an important factor given the relatively high price of oil and relatively low price of natural gas at present. Husky asserts that Mr. Lewis testified that a lower gas to oil ratio is preferred in well completion because it leaves more gas-in-place in the reservoir to aid in the production of oil. Husky contends that the "plug and perf" method is preferable to the "open hole with packers" method concerning a low gas to oil ratio.

18) Husky reasserts that though geology does affect production, when comparing Husky and Payne wells, the determinative factor is completion method.

19) Husky contends that Mr. John Ely, an eminently qualified expert witness in the field of frac'ing, attested to the superiority of the "plug and perf" method, compared to the "open hole with packers" method, because of the ability of the "plug and perf" method to perforate into the natural fractures of a reservoir.

- 20) Husky asserts that the higher expense of the Husky AFE is due to the imaging logs required in the "plug and perf" method to determine the locations of the fractures in the reservoir.
- 21) Husky contends that the "open hole with packers" method does not directly perforate into the natural fractures of the reservoir, and because the Hunton is a tight formation, it is difficult to frac the Hunton unless the stimulations enter the natural fractures of the formation.
- 22) Husky asserts that under the Husky method, unlike the Payne method, a reservoir can be re-stimulated when production becomes depleted.
- 23) Husky contends that it is easier to address down hole issues under the "plug and perf" method. Husky asserts that under the "plug and perf" method there is not duplication of frac'ing costs, and that the greater expense is due to equipment movement costs. Husky contends that under the "plug and perf" method, the reservoir is fractured twice, and that ultimate production will be double the production from the initial frac. Husky asserts that despite the greater expense of Husky's method, ultimate recovery under the operation of Husky will be greater and ultimately more economical.
- 24) Husky contends that the use of consultants is necessary for companies the size of Husky or Payne, and that the specialized expertise of each consultant benefits the operation. Husky asserts that Payne's contention that consulting is unreliable because consultants do not have an economic interest in the well is without merit. Husky contends that a consultant's continued business is based on the quality of his or her performance. Husky reasserts that the use of consultants is superior to in-house work for smaller companies like Husky and Payne.
- 25) Husky contends that Payne's engineering witness did not base his testimony on supportive data. Husky asserts that the testimony of Husky's engineering witness had a superior foundation in scientific data. Husky refers to Exhibit 29.
- 26) Husky reasserts that the operator should be designated on the basis of which party can provide the owners an opportunity to recover their fair share of oil and gas.
- 27) Husky contends that the ALJ ignored testimony regarding the efficiency of completion methods, basing his decision on the recordkeeping and paperwork of the parties.
- 28) Husky asserts that the evidence shows that Husky would be a superior operator and provide greater ultimate recovery.

29) Husky requests that the Report of the ALJ be reversed and that Husky be named unit operator.

PAYNE

- 1) **Richard Grimes**, attorney, appearing on behalf of Payne, asserts that operator appointment requires a balancing test inquiry from the Commission, under which great weight is given to percentage ownership.
- 2) Payne contends that the Commission regulates oil and gas companies, rather than the oil and gas industry, and that the Commission does not base its operator appointments upon the manner in which a potential operator will develop a unit.
- 3) Payne analogizes this matter to an operator dispute based upon the potential location of a vertical well. Payne asserts that in such situations the Commission has repeatedly refused to decide the matter based upon competing geological interpretation.
- 4) Payne further analogizes this matter to operator disputes concerning the size of the hole drilled for a vertical well. Payne contends that the Commission would not base its operator appointment in such a situation upon engineering, but rather upon a consideration of the totality of the facts.
- 5) Payne asserts that the development of horizontal drilling techniques has increased the volume of evidence and expert testimony presented at hearing.
- 6) Payne contends that the ALJ did not make a ruling on the superiority between the proposed completion methods, and that the method of completion is rightfully left to the discretion of the operator.
- 7) Payne asserts that if a non-operating party finds an operator's methods unacceptable, the non-operating party retains the option to not participate.
- 8) Payne contends that in making his recommendation, the ALJ followed standard procedure.
- 9) Payne reasserts that acreage is the primary consideration in operator designations, and that after acreage, the Commission considers costs, operations experience, the experience of employees or consultants, regional experience, ability to drill and operate, preparedness, and prior operations problems.

10) Payne references Exhibit 5, and asserts that that exhibit accurately summarizes the information presented to the ALJ at hearing.

11) Payne contends that it supports the "open hole" method as faithfully as Husky supports the "plug and perf" method.

12) Payne asserts that the cost advanced by Payne for completion is \$2.9 million and the cost advanced by Husky for completion is \$3.689 million. Payne contends that the Commission must consider cost in its decision to designate an operator.

13) Payne asserts that Payne has existed for 48 years, has drilled 130 wells in Oklahoma, and currently operates 112 wells in the state; Payne contends that Husky has existed for three years, has drilled 26 wells in Oklahoma, and operates 10 wells in the State. Payne asserts that Payne operates 55 wells in Logan County and Kingfisher County, eight of which are horizontal wells. Payne contends that Husky operates eight wells in the same area, all of which are horizontal wells.

14) Payne contends that Payne has ten full time employees as well as company pumpers. Payne asserts that it does not regularly use consultants. Payne contends that Husky has five employees and contract pumpers, and uses consultants regularly.

15) Payne asserts that it prevailed in both the spacing and pooling hearings for this unit.

16) Payne contends that it has taken the requisite preparations for drilling, e.g., obtainment of drilling rigs, negotiation of surface damages, procurement of water for fracing operations, staking location, filing an intent to drill, and execution of a gas contract, and that Husky has not made comparable preparations.

17) Payne asserts that mechanic's liens and materialman's liens cannot, as Husky asserts, be evidence of operator suitability. However, Payne contends that once a lien has attached an operator risks foreclosure upon its oil and gas lease. Payne contends that in its 48 years of operations, it has never had a lien filed against it.

18) Payne asserts that Husky bears the responsibility for Husky's contempt citation for soil farming, despite representations made to Husky by a contractor.

19) Payne contends that Husky has spudded one quarter of its wells in the area without a permit.

- 20) Payne asserts that the 1002A forms improperly completed by Husky's President, Mr. Chuck Long, evidence misrepresentations to the Commission and should be considered in the designation of an operator.
- 21) Payne contends that Mr. Chuck Long attempted to give expert opinion at hearing, despite his lack of qualifications as an oil and gas expert. Payne asserts that Mr. Chuck Long's education background is unrelated to the field of oil and gas, and that his testimony displayed his unfamiliarity with the industry. Payne asserts that Mr. Chuck Long admitted to all of his prior errors at hearing.
- 22) Payne contends that the ALJ recommended Payne as the unit operator after weighing all relevant factors.
- 23) Payne asserts whereas a trained engineer, Mr. Terry Daniel, prepared its AFE, Mr. Chuck Long prepared the AFE for Husky.
- 24) Payne asserts that Husky contracts with consultants out of necessity, as all of Husky's employees are administrative. Payne asserts that each company's internal structure ought to be considered in designating an operator.
- 25) Payne contends that its preference for the "open hole with packers" method was supported by engineering and geological evidence, and that the "plug and perf" method risks cementing over the natural fractures of the formation. Payne asserts that the "open hole with packers" method leaves an open hole and does not cement over fractures.
- 26) Payne reasserts that the ALJ did not make his operator recommendation based upon completion method, but rather upon total operator capability.
- 27) Payne references a paper entitled Open Hole Versus Cemented Completions for Horizontal Wells with Transverse Fractures, presented to the Society of Professional Engineers, paper 142279, which provides that it is impossible for a cemented completion to outperform an open hole completion for a horizontal well with transverse fractures. Payne contends that this paper contradicts the testimony of the engineering witness, Mr. John Ely, and displays disagreement in the industry.
- 28) Payne reasserts that the ALJ made his recommendation based upon an evaluation of all relevant factors.
- 29) Payne asserts that Commission regulates the oil and gas industry and should not base its operator designations upon competing and accepted completion methods.

RESPONSE OF HUSKY

- 1) Husky reasserts that the Commission should base its operator designation upon which party can most effectively drill and operate the well, rather than upon paperwork.
- 2) Husky contends that for a party to gain a fair return on its investment in a drilling prospect, it must participate in the drilling of a well.
- 3) Husky asserts that Husky has been in operation for more than ten years.
- 4) Husky contends that it drilled the first horizontal well in the Hunton in this area, and that Husky and Payne have drilled the same number of wells in the area. Husky asserts that Payne and Husky have equal experience in the area in the drilling of horizontal wells, and that Payne's experience exceeds Husky's experience only in the drilling of vertical wells.
- 5) Husky contends that it did not propose a well in the unit because it was under the impression and entered negotiations to the effect that Husky and Payne would undertake a "land swap," and therefore was taken by surprise by Payne's filing.
- 6) Husky asserts that Payne filed an intent to drill form in this matter for the sake of appearances alone.
- 7) Husky contends that liens do not necessarily result in foreclosure, and that a lien can be used as a negotiating tool.
- 8) Husky contends that Mr. Chuck Long contracted with a consultant to prepare the AFEs, and that the AFEs were only subject to his approval.
- 9) Husky contends that the great majority of testimony provided at hearing pertained to completion methods, which the ALJ largely ignored in his recommendation.
- 10) Husky asserts that the decision of the ALJ should have been based upon statute which provides that the party with the greatest ability to economically recover the oil and gas be designated operator.

CONCLUSIONS

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

1) The Referee finds that the ALJ's recommendation to grant the pooling application of Payne and designate Payne as the operator is supported by the weight of the evidence and free of reversible error. The ALJ wrote a well-reasoned report balancing the normal factors considered by the Commission in the award of operations under a pooling application.

2) It is the ALJ's duty as the initial finder of fact to observe the demeanor of the witnesses, assess their credibility and assign the appropriate weight to their opinions. *Grison Oil Corp. v. Corporation Commission*, 99 P.2d 134 (Okl. 1940); *Application of Choctaw Express Company*, 253 P.2d 822 (Okl. 1953); *Cameron v. Corporation Commission*, 414 P.2d 266 (Okl. 1966).

3) With regard to the weight to be given opinion evidence, the Oklahoma Supreme Court in *Palmer Oil Corporation v. Phillips Petroleum Company*, 231 P.2d 997 (Okla. 1951) stated:

At the hearing herein the testimony adduced was chiefly that of petroleum engineers and geologists who testified on the basis of both personal surveys made and of an interpretation of the accumulated data in the hands of the Commission. The testimony of these experts was in direct conflict but that of each was positive upon the issue. Under the circumstances the objection is necessarily addressed to only the weight of the evidence. Under the holding of this Court and that of courts generally, *Chicago, R.I. and P. Ry. Co. v. Pruitt*, 67 Okl. 219, 170 P. 1143; 22 C.J. 728, Section 823, 32 C.J.S., Evidence, Section 567, p. 378, the weight to be given opinion evidence is, within the bounds of reason, entirely for the determination of the jury or of the court, when trying an issue of fact, it taking into consideration the intelligence and experience of the witness and the degree of attention he gave to the matter. The rule should have peculiar force herein where by the terms of the Act the Commission is recognized as having peculiar power in weighing the evidence. Since the evidence before the Commission was competent and sufficient if believed, to sustain the order we must, and do, hold that the order is sustained by the evidence and that the contention is without merit. *Ft. Smith & W.Ry Co. v. State*, 25 Okl. 866, 108 P. 407; *Bromide Crushed Rock Company v. Dolese Brothers Company*, 121 Okl. 40, 247 P. 74.

4) The Referee submits that the Commission has always focused on a number of different factors in the award of operations. Charles Nesbitt in his article, *A Primer On Forced Pooling of Oil and Gas Interests in Oklahoma*, 50 Okl.B.J. 648 (1979) set forth a review of the factors considered and the importance that the Commission attaches thereto. Mr. Nesbitt states:

DESIGNATION OF OPERATOR

A deceptively important provision of the pooling order is the designation of the operator of the proposed well. In most cases the applicant already owns the majority interest in the spacing unit, and is routinely named operator. However, there are notable exceptions where a spirited battle occurs between lessees over operations. The working interest ownership of non-participating pooled owners inures to the operator, at least in absence of a claim by other participants to share therein. A lessee who is promoting the proposed well for a carried interest, or similar remuneration, has a significant financial stake in being designated operator.

Several factors are considered in the selection of the operator, the most important being working interest ownership. All other things being equal, the owner of the largest share of the working interest has the best claim to operations. However, this is not always true, and other factors can outweigh majority ownership.

Second in importance is actual bona fide exploration activity. This is not a simple race to the courthouse, with the earliest applicant getting the nod, but involves such matters as when a well was first proposed and by whom, whether the proposed well is part of a multi-well exploration program, whether a rig has been contracted for, and so on.

Other factors having a bearing on the final selection include the number of wells operated in the vicinity, the extent of developed and undeveloped lease ownership, the availability of operating personnel and

facilities, a comparison of proposed costs of drilling and operating the well, and, rarely, the relative experience and competence of the contenders for operating rights.

As noted in the above quoted Nesbitt article and by the ALJ, the ownership position of the parties, the actual bona fide exploration activity of the parties, and the experience of the parties are all factors of most importance.

5) The Referee notes that the ALJ addressed the factors usually considered by the Commission under the Nesbitt article. The ALJ states in his Conclusions:

2. Payne has prevailed in the related spacing matter (Husky proposed 640 acre spacing). Payne has staked a location, negotiated surface damages with the owner and contracted a rig. They also have a Commission Intent to Drill that they will amend subsequent to receiving a location exception. Payne operates 130 wells, 112 of them active. They operate 55 wells, including 9 horizontal, in Logan and Kingfisher Counties. Payne has used different completion methods in the last two years and prefers packers plus. Husky favors a plug and perf completion. Payne finds the Hunton Lime holds its shape and is well suited to a packers plus completion.

3. Payne has a drilling contract, bids from servicing companies, secured water for fracturing, staked a location, and has a gas sales contract. Payne first filed for pooling (Husky alleges this is because they thought they had negotiated a land swap with Payne and were surprised by the filing). Payne has been in business for forty eight years and Husky for about three years. Husky operates significantly fewer wells than Payne. Payne has no liens filed against it and they have no Commission contempt proceedings filed against them.

* * *

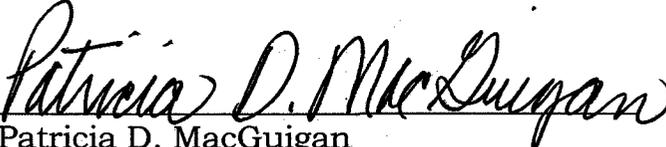
9. ...Payne has tried plug and perf completions and has chosen packers plus. Husky has tried packers plus and has chosen plug and perf. Reasonable

operators may disagree about operations but this is no reason for excluding an operator from operating. In addition, the Payne AFE was significantly less expensive than the Husky AFE....

6) The evidence thus establishes that Payne has been primary mover in development of both the unit and the area with regard to the Hunton formation. The ALJ also was faced with the fact that the Payne estimate of AFE costs was lower than that of Husky. Lastly, Payne operates the most wells in the vicinity with larger availability of operating personnel and facilities.

7) Therefore, the Referee finds the ALJ has adequately addressed the issues before the Commission and made a recommendation that should be affirmed.

RESPECTFULLY SUBMITTED THIS 6th day of July, 2012.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Murphy
Commissioner Anthony
Commissioner Douglas
Jim Hamilton
ALJ Paul Porter
Richard Grimes
Karl Hirsch
Office of General Counsel
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks – 1
Commission Files