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BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

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CORPORATION COMMISSION
OF OKLAHOMA

APPLICANT:	**EQUILIBRIA ENERGY SERVICES**	)
RELIEF SOUGHT:	**POOLING-CALES #1-22**	) **CAUSE CD NO. 201103341**
LEGAL DESCRIPTION:	**SECTION 20, TOWNSHIP 27 NORTH, RANGE 4 EAST, KAY COUNTY, OKLAHOMA**	)

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Michael Porter**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 2nd day of September, 2011, 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 Gore**, attorney, appeared on behalf of applicant, Equilibria Energy Services, L.L.C. ("Equilibria"); **William Huffman**, attorney, appeared on behalf of Barton Land Consultants and Arlin Cales ("Barton"); 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 27th day of October, 2011, 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 9th day of December, 2011. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

EQUILIBRIA APPEALS the ALJ's recommendation to deny their pooling application because there was not a bona fide effort made to come to an agreement with the parties prior to filing the pooling application.

Equilibria sent out proposal letters to the respondents on or about June 27, 2011. Equilibria filed its pooling application on July 7, 2011. Equilibria included an estimate of the dry hole and completed well costs. Equilibria also indicated the options available to the parties if they chose not to participate in the well. Barton protested Equilibria's application claiming they were not contacted prior to the filing of the application in July. Barton also claimed they did not know what Equilibria was planning to do in the unit.

EQUILIBRIA TAKES THE POSITION:

(1) Equilibria alleges the Report of the Administrative Law Judge ("ALJ") is both contrary to the law and the evidence.

(2) The ALJ's Report 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.

(3) The ALJ's recommendation that the pooling be denied because Equilibria did not make a bona fide effort to reach an agreement with Barton, due to their belief that Equilibria did not provide enough information about salt water disposal ("SWD"), is not supported by the evidence or the law.

(4) Equilibria's proposal letter is in compliance with the ESCO case (ESCO Exploration, Inc. CD 108743), which the ALJ cites. The ESCO case does not require any information about SWD, except in the cases of dewatering where SWD is a certainty.

(5) Equilibria never proposed that the pooling respondents be obligated to pay for the development of a SWD well. The ALJ's statement that this is "needed information to make an informed decision" is inapplicable to this case. The evidence in this case is that there may not be any salt water produced since this is the first Mississippi well drilled in this area.

(6) The law is that an operator can charge non-operators the actual cost of SWD not to exceed what is reasonable and the cost of SWD is based on the volume produced (which could range from zero to thousands of barrels). Since the volume in this case is a complete unknown, it is impossible to estimate and

include SWD costs in either an AFE or proposal letter as the ALJ would require of Equilibria in this case.

(7) Barton did not request that the application in this case be denied, only that Barton be given additional time to consider Equilibria's proposal, therefore, the ALJ exceeded the relief requested by Barton. Since Barton will have had plenty of time to consider the proposal in light of the appeal, the decision of the ALJ should be reversed and a pooling order entered.

(8) If the ALJ is denying the pooling because protestant claims not to have received the proposal letter, it should be noted that the proposal letter was sent to the same address as the pooling application which Barton received. Barton's proposal letter was not returned to Equilibria as undeliverable by the post office. Barton is the only respondent who claims not to have received the proposal letter.

(9) When Equilibria called Barton, Barton did not request that Equilibria send Barton a proposal letter. While Barton claims to be an ignorant respondent in need of lots of information to make an informed decision, it should be noted that Barton is an active operator in Oklahoma. Barton has already received more well information then is typically available in a pooling where no well has been drilled.

(10) Lastly, it should be noted that the ALJ failed to take into consideration that Equilibria has drilled a wildcat well, bearing all of the risk while Barton has ridden the well down while holding a top lease (which through the delay caused by the protest of this case Barton hopes will vest) during which time Barton has requested well information to which it is not entitled.

(11) Equilibria simply requests that a pooling order issue so that it can he determined who will be involved in the existing well.

THE ALJ FOUND:

(1) After taking into consideration all the facts, circumstances, testimony and evidence presented in this cause the ALJ recommends the application in CD 201103341 be denied because there was not a bona fide effort made to reach an agreement with each respondent as to how the unit would be developed.

(2) OAC 165:5-7-7 requires that every pooling application include a statement by the applicant that a bona fide effort was made to reach an agreement with each respondent. The applicant is to present evidence to this effect at the hearing. Webster's *New Universal Unabridged Dictionary* 1996 Edition defines bona fide as "made, done, presented, etc., in good faith; without

deception or fraud." Equilibria testified they sent out a "proposal letter" to each respondent. The testimony was that no "proposal letters" were returned to Equilibria. One respondent, Barton, claims they did not receive the proposal letter. Barton indicated they did receive the application for pooling.

(3) In spite of this lack of a proposal letter, Barton was in contact with Equilibria in June 2011. There was testimony of who called who and who returned or did not return phone calls. What is agreed is Barton and Equilibria did have some discussions via telephone. The conversations primarily concerned the top lease Barton had taken on the Cales property. The Cales property constituted the majority interest Equilibria had in the unit. Barton remembers asking for an AFE from Mr. Sheets, the Manager of Equilibria. Mr. Sheets of Equilibria does not remember if that was part of their conversations or not. Barton indicated they did not receive an AFE from Equilibria. An AFE was submitted into evidence showing estimated and actual costs. The AFE (Exhibit 2) is dated August 26, 2011 and shows actual costs of $637,569.22 to date. The estimated well costs were shown as $592,190 on Exhibit 2. The actual costs do not reflect any costs for a SWD well. The proposal letter gave an estimate of completed well costs of $588,390. There was no mention of any of those costs being allocated to develop a SWD well. At the time of the hearing it was unknown if this well was going to produce large quantities of water.

(4) The letter also advised the parties that water disposal costs were expected. The letter advised that the operator GT&L LLC would be able to charge a reasonable rate for disposal of the water. It also advised that the operator owns a Non-Commercial Disposal Well facility in this area. Mr. Sheets during cross examination admitted that the operator did not own a disposal well. The evidence later showed, that at best, the operator owned a well bore that could be converted to a SWD well. There was no evidence that the operator had a permitted SWD well in the area at that time or as of the date of the hearing.

(5) The proposal letter does not mention the costs to develop a disposal well will be borne by the participants in the well. The AFE accepted as Exhibit 2 at the hearing is dated August 26, 2011. It shows actual costs spent as of that date of $637,569.22. The AFE does not reflect any costs for a SWD well. Mr. Huffman during his cross examination of Mr. Sheets showed none of the costs, shown on the AFE, were for any other well or wells in the unit.

(6) An order issued by the Commission in 1984 (ESCO Exploration, Inc. CD 108743) clearly set out what efforts should be undertaken to constitute a bona fide effort. While the ALJ understands the ESCO cause is not binding, it is persuasive in determining what constitutes a bona fide effort. The Commission in its order, in ESCO, said a proposal should include the dry hole and

completed costs for the proposed well, the cash bonus and royalty, and other options in lieu of cash bonus. The proposal should also give the respondents a reasonable time to reply to said proposal letter prior to the filing of the application. Implicit in giving a party a reasonable time to reply is the idea that they are reviewing the information provided by the proposer to make a decision. This is especially true for a party who owns nearly a third of the unit.

(7) Clearly, knowing what the estimated costs are to be for developing a SWD well would be needed information to make an informed decision. This information is not shown as a part of the proposal letter. The parties were led to believe their costs would be actual costs of disposing of water in the operator's well. This was not the case as the operator has no SWD well where the operator could charge actual costs. It does not appear to be a good faith effort when necessary information is not described as accurately as possible. Potential participants need accurate information to make their informed decision.

(8) The potential costs to develop a SWD well are different than those of merely paying the actual costs to dispose of salt water in a well owned by the operator. The information needed to make an informed decision was not in the proposal letter. It would be hard to reply without being fully aware of future liabilities. If the operator said they planned to dispose of the water in a commercial SWD well in their proposal letter, or they said they planned to develop a non-commercial SWD well (along with its estimated costs), a bona fide effort would have ensued.

POSITIONS OF THE PARTIES

EQUILIBRIA

1) **Richard J. Gore**, attorney, appeared on behalf of Equilibria taking exceptions to the October 27, 2011 Report of the ALJ denying the Equilibria's pooling application.

2) Equilibria contends that the ALJ's report denied the pooling of the Cales #1-22 well (Section 20, T27N, R4E, Kay County, Oklahoma) because of a failure to make a bona fide effort to reach an agreement. Equilibria contends that the denial was based upon the omission of SWD expenses from the proposal letter. Equilibria also notes that a landman misrepresented that a SWD well already existed on the land to be pooled. Equilibria contends that SWD costs and methods cannot be ascertained by the commencement of drilling. Equilibria contends that these expenses are not included in the

proposal letter or the AFE because they are operating expenses and that operating expenses are not typically included in these documents.

3) Equilibria asserts that provisions for disposal costs are appropriate in operations such as dewatering, which is dissimilar to the present matter.

4) The ESCO Exploration, Inc. Commission case (CD No. 108743) holds that the necessary elements of a proposal letter are the statement that a well is to be drilled; dry hole and completed well costs; cash bonus and royalty; and any other recommended options. Equilibria asserts that the proposal letter, provided as Exhibit 3, complies with the holding of *Esco* by providing dry hole and completed well costs and cash and royalty to be offered in lieu of participation.

5) Equilibria asserts that the distinction between having an operational SWD well and a well-bore capable of being converted into a SWD well is unimportant. Equilibria asserts that the landman's false representation that the unit to be pooled already contained a SWD well was an immaterial misrepresentation.

6) Equilibria contends that, to present knowledge, the well in this matter is a dry gas well.

7) Equilibria asserts that the three leases taken by Equilibria in July after the proposal letter was sent in June, shows a bona fide effort to reach an agreement.

8) Equilibria asserts that Barton received the proposal letter, despite claims to the contrary. Equilibria asserts that Barton's acceptance of the certified mailing of the pooling application lends credence to Barton's receipt of the prior proposal letter.

9) Equilibria claims that the protestant said, in a phone conversation, that the protestant had no desire to participate in a vertical well.

10) Equilibria contends that the protestant's objective in this proceeding is delay, as the protestant has taken a top lease for 320 of the 360 acres covered by Equilibria's lease. Equilibria asserts that the protestant only sought a delay to consider estimated costs of SWD once provided, therefore, the appropriate outcome was to delay the pooling order, rather than to deny it. Equilibria claims Barton was uncooperative in the matter, noting the protestant's failure to seek information from Equilibria, the protestant's delay in setting the matter for hearing, and the protestant's failure to communicate with Equilibria concerning their protest.

11) Equilibria reasserts that the proper outcome in the matter was a delay or continuation, rather than a denial of Equilibria's Application.

BARTON

1) **William Huffman**, attorney, appeared on behalf of Barton, stated Barton notes that the proposal letter did not contain an AFE. Barton asserts that though the *Esco* case does not strictly require an AFE be included with the proposal letter, this inclusion has become industry practice.

2) Barton asserts that the respondent in a pooling application is not under any statutory duty to respond prior to hearing. Barton maintains that the statutory duty is placed upon the applicant by 52 O.S. Section 87.1.

3) Barton asserts that Mr. Barton did not receive a phone call from Mr. Roberts in this matter, but that Mr. Barton did speak to Mr. Tom Sheets. Barton claims that at that time Mr. Barton requested an AFE from Mr. Sheets that was not received until the date of the hearing.

4) Barton states that ALJ Porter noted the discrepancy between the costs in the AFE and the proposal letter. Barton asserts that this distinction is particularly curious, as the applicant claimed that the numbers in the proposal letter were taken from the AFE.

5) Barton notes ALJ Porter's comments on the evasive nature of Mr. Sheet's testimony. Barton also notes the discrepancy between the cost estimate in the AFE ($637,569.22) and the cost estimate given by Mr. Sheets in his testimony (at least $700,000 to $800,000).

6) Barton contends that Equilibria is attempting to cordon off their working interest in the unit by first drilling an economically unsound vertical well and drilling a horizontal unit afterward, leaving out all non-participants in the vertical well.

7) Barton notes Equilibria's lack of drilling experience, stating that the applicants have never drilled a well (and have only operated four to six wells) and that they did not make a bona fide effort to come to an agreement with the parties they attempted to pool.

8) Barton contends that Equilibria drilled their well before seeking an appropriate pooling, and reasserts that the applicants did not make a bona fide effort to come to an agreement with the parties prior to the pooling application.

9) Barton contends that the Report of the ALJ should be upheld.

RESPONSE OF EQUILIBRIA

1) Equilibria contends that Mr. Rick Shatz, principal in both GT&L and Equilibria, has the requisite experience to drill and operate the well.

2) Equilibria reasserts that Barton ought to be under a duty to communicate with Equilibria and that Barton was only interested in delay.

3) Equilibria reasserts that Barton was not interested in participation in a vertical well, which influenced their behavior (*i.e.,* their failure to provide information).

4) Equilibria contends that the discrepancy between the AFE and the proposal letter noted by the protestants and the ALJ was due only to temporal factors and was not a deliberate act of dishonesty. Equilibria contends that any impropriety was committed in good faith due solely to a lack of experience in Commission regulations and state statutes.

5) Equilibria contends that though a subsequent horizontal well is planned, the purpose of the original vertical well drilled was to save the lease.

6) Equilibria reasserts that the proper resolution to the matter was a delay, rather than a denial.

CONCLUSIONS

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

1) OAC-OCC 165:5-7-7(a) provides:

> a) Each pooling application shall include a statement by the applicant that the applicant exercised due diligence to locate each respondent and that a bona fide effort was made to reach an agreement with each such respondent as to how the unit would be

> developed. The applicant shall present evidence to this effect at the time of hearing.

2) It is clear that the Corporation Commission has exclusive jurisdiction to determine whether an owner has properly elected to participate under a Commission issued force pooling order. *Tenneco Oil Company v. Oklahoma Corporation Commission*, 775 P.2d 296 (Okl. 1989) states:

> The issue before the Corporation Commission was whether a respondent to a Forced Pooling Order has elected to participate in the drilling of a well in compliance with the terms of the Forced Pooling Order. We have held that when a party's right to participate in a well flows from a Corporation Commission Forced Pooling Order, rather than from private agreement, the Corporation Commission has exclusive jurisdiction to determine whether the party has elected to participate in compliance with the Forced Pooling Order. In *Samson v. Oklahoma Corporation Commission*, 742 P.2d 1114 (Okla. 1987), we held that absent a private agreement, the Corporation Commission is the proper forum to determine disputes over the status of elections under pooling orders. We have consistently held that the Corporation Commission has jurisdiction to construe and clarify its previous orders to determine compliance with said orders under the authority of 52 O.S. 112. *Nilsen v. Ports of Call*, 711 P.2d 98 (Okla. 1985). Conversely, absent a change or challenge of a public rights issue of conservation it is the exclusive jurisdiction of the district courts to adjudicate a party's status of elections when the party's right to participate flows and arises from private agreements. *Samson v. Oklahoma Corporation Commission*, 742 P.2d 1114 (Okla. 1987).

3) In the present case the Commission's jurisdiction has been invoked to determine/clarify whether the actions of the parties have satisfied the election provisions of the proposed pooling order. Said determination is a matter for the Commission to determine under the public issues concerning conservation of oil and gas. Equilibria sent out proposal letters to respondents on or about June 27, 2011. Equilibria filed its pooling application on July 7, 2011. Equilibria included an estimate of the dry hole and completed well costs. Equilibria also indicated the options available to parties if they chose not to participate in the well. Barton protested Equilibria's application claiming they

were not contacted prior to the filing of the application in July. Equilibria testified that they sent out a proposal letter to each respondent and that no proposal letters were returned to Equilibria. Barton however claims they did not receive the proposal letter, however, Barton indicated they did receive the application for pooling. Barton was, however, in spite of the lack of a proposal letter, in contact with Equilibria in June, 2011. Mr. Barton testified that he requested an AFE from the manager of Equilibria but did not receive an AFE from Equilibria. An AFE was submitted into evidence as Exhibit 2 dated August 26, 2011 and shows actual costs of $637,569.22 to date. The estimated well costs were shown at $592,190 on Exhibit 2. The actual costs do not reflect any costs for a SWD well. The proposal letter sent to respondent gave an estimate of completed well costs of $588,390. There was no mention of any of these costs being allocated to develop an SWD well. The Cales #1-22 well had already been drilled, but at the time of the hearing it was unknown if this well was going to produce large quantities of water.

4) The proposal letter sent out by the operator, GT&L Operating, LLC, on June 27, 2011 to Barton states:

> If this operation is successful, we expect to produce water at high rates that could exceed 300-1000 barrels per day. GT&L owns a "Non-Commercial" Disposal Well facility in this area and all produced water will be disposed into that well. As operator, GT&L is allowed to charge all working interest participants a reasonable rate for disposal of their share of the water.

5) Equilibria's witness on cross examination admitted that this was false information as GT&L did not own a disposal well. The evidence showed that at best the operator owned a wellbore that could be converted to a SWD well.

6) A recent case by the Oklahoma Court of Civil Appeals, *New Dominion, L.L.C. v. Mason*, 217 P.3d 138 (OkCivApp 2009) states:

> Mason appeals from the Commission's order, contending the Commission erred in allowing the operator to charge force-pooled participants a fee for salt water disposal instead of its actual cost. We agree.

* * *

> In the present case, the designated unit operator is New Dominion. New Dominion, in exercising the Commission-conferred police power and managerial responsibility, may not charge the force-pooled participants in excess of its actual expenditures, plus a reasonable charge for supervision, for the development and operation of the well.

7) In an order issued by the Commission in 1984 in the Esco Exploration Inc. case of CD No. 108743 it was clearly set forth what efforts must be undertaken to constitute a bona fide effort to reach an agreement with each respondent as to how the unit would be developed. The Commission in its order in the Esco case stated:

> The facts presented in this case would indicate that the following efforts should be made.
>
> a. A proposal to all respondents should be made stating that a well is going to be drilled in the drilling and spacing unit. Said proposal should include:
>
> (1) The dry hole and completed well costs for said proposed well.
>
> (2) A cash bonus and royalty to be offered in lieu of participation; and
>
> (3) Any other options which will be recommended at the hearing as fair market value in lieu of the cash bonus.
>
> (b) A respondent should have a reasonable time to reply to said proposal prior to the filing of the pooling application.

8) The Referee agrees with the ALJ that knowing what the estimated costs are to be for developing a SWD well would be needed information for Barton to make an informed election. Contrary to the actual facts, the Bartons were led to believe that their costs would be actual costs of disposing of water in the

operator's well, when in fact the operator has no SWD well where the operator could charge actual costs. The Referee agrees with the ALJ's statement that:

> It does not appear to be a good faith effort when necessary information is not described as accurately as possible. Potential participants need accurate information to make their informed decision. The potential costs to develop a salt water disposal well are different than those of merely paying the actual cost to dispose of salt water in a well owned by the operator. The information needed to make an informed decision was not in the proposal letter.

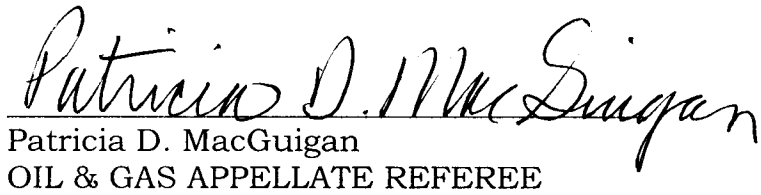
9) In *Union Texas Petroleum, A Division of Allied Chemical Corporation v. Corporation Commission of State of Oklahoma,* 651 P.2d 652 (Okl. 1981) the Supreme Court stated concerning substantial evidence that :

> The Commission has a wide discretion in the performance of its statutory duties, and this Court may not substitute its judgment upon disputed factual determinations for that of the Commission but is restricted to a determination of substantial evidentiary support for the order issued under authority of the statutes. *In Re: Application of Continental Oil Company,* 376 P.2d 330 (Okl. 1962). Searching a record for substantial evidence supporting the order appealed does not entail a comparison of the parties' evidence to determine that which is most convincing but only that the evidence supportive of the order be considered to determine whether it implies a quality of proof inducing a conviction that the evidence furnished a substantial basis of facts from which the issue could be reasonably resolved. *Chenoweth v. PanAmerican Petroleum Corporation,* 382 P.2d 743 (Okl. 1963). Substantial evidence has been additionally outlined as something more than a scintilla; possessing something of substance and of relevant consequences carrying with it a fitness to induce conviction, but remains such that reasonable men may fairly differ on the point of establishing the case. A determination of substantial evidentiary support does not require weighing the evidence but only a measurement of the supportive points to determine whether the criterion of substantiality is

present. *Central Oklahoma Freight Lines v. Corporation Commission*, 484 P.2d 877, 879 (Okl. 1971).

10) The Referee for the above stated reasons finds the ALJ's determination that Equilibria's application should be denied because there was not a bona fide effort made to reach an agreement with Barton as to how the unit would be developed, is supported by the weight of the evidence and should be affirmed.

RESPECTFULLY SUBMITTED THIS 10th day of January, 2012.



Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

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