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BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICANT:	**DEVON ENERGY PRODUCTION CO., L.P.**	
RELIEF SOUGHT:	**HORIZONTAL SPACING**	**CAUSE CD NO. 201202300**
LEGAL DESCRIPTION:	**SECTION 10, TOWNSHIP 24 NORTH, RANGE 1 EAST, NOBLE COUNTY, OKLAHOMA**	

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

This Emergency application came on for hearing before **Michael L. Decker**, Administrative Law Judge for the Oklahoma Corporation Commission, at 9 a.m. on the 29th day of May, 2012, 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 purpose of taking testimony and reporting to the Commission.

APPEARANCES: **Michael D. Stack,** attorney, appeared for applicant, Devon Energy Production Co., L.P. ("Devon"); **Richard J. Gore**, attorney, appeared for Davis Garry Oil, LLC, successor by farmout agreement to the interests of Frances C. Edwards and Cow Creek Resources Inc., Respondent/Movant (collectively "Garry"); 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 1st day of June, 2012. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

GARRY APPEALS the ALJ's recommendation to deny the emergency application giving Garry authority to commence drilling operations, completion, testing and production of a vertical well to the Mississippian, Woodford, Sylvan and Misener-Hunton common sources of supply in Section 10. Devon opposes the granting of the emergency application.

Devon filed its horizontal spacing application in the present cause on April 12, 2012 requesting the Commission to establish 640 acre drilling and spacing horizontal oil units for the Mississippian, Woodford, Sylvan and Misener-Hunton common sources of supply underlying Section 10. Commission records indicate no spacing in Section 10. Devon requests that 640 acre units be established with the following well patterns:

a) 640-acre horizontal conventional units of no closer than 660 feet to the boundary lines of the unit; and

b) 640-acre non conventional horizontal unit of no closer than 330 feet to the boundary lines of the unit.

Garry alleges that an emergency exists because of rig availability. Garry states that it is necessary for it to commence operations for the drilling of a well in said Section 10 prior to June 27, 28 and 29, 2012, the dates of the protested hearing in the present cause. Garry states it will suffer financial loss unless it is authorized to commence said well prior to the entry of a final order in this cause. Garry cites the legal authority of OCC-OAC 165:5-9-3 and 165:10-24(h).

REPORT OF THE ADMINISTRATIVE LAW JUDGE

ALJ Michael L. Decker reported that he recommended denying the Garry emergency application. The emergency application hearing involved the presentation of four witnesses. Garry is an operator which took a farmout agreement from Cow Creek Resources which is a family business, an oil and gas operating company that Mr. Bob Edwards who is the property owner has organized. Mr. Edwards had farmed out the interest in the N/2 of Section 10 to Garry who has developed these properties with the Cow Creek Resources operating company and Garry has drilled 13 wells in association with Bob Edwards in 2011 and the plan is to drill 13 more wells in the general area in 2012. Bob Edwards is the property owner who is a farmer and owns the minerals in the N/2 of Section 10. He does not own any minerals in the S/2 of Section 10. The N/2 320 acre area of Section 10 is part of the greater Edwards

Ranch which owns many 1000s of acres in this part of Oklahoma. There are approximately 10 locations in this area which would still be on the plan for 2012, four of those locations would potentially be in the N/2 of Section 10. What he was proposing to do with the application for emergency order was to commence one of these four wells.

There is an existing well in the N/2 of Section 10 known as the Edwards #1 which is operated by Cow Creek Resources. It is a vertical well and it produces from the Mississippian. Garry has a plan in the vicinity to drill additional vertical wells to test the Mississippian.

In March of 2012 Devon notified Mr. Edwards by letter (Exhibit "A"), indicating the plan that Devon proposes for drilling horizontal wells on a 640 acre basis affecting Section 10. Devon proposed a horizontal well in the Mississippian which would have a price of $3.8 million. Mr. Edwards decided that he wanted to then drill additional wells to test the Mississippian in the N/2 of Section 10 on his acreage with the farmout agreement with Garry. These would be vertical wells. The emergency application requested the right to commence one of these wells. The proposed well under the emergency application would be 700 feet away from the existing Edwards #1 well which is an oil well which makes about 1400 BO a year and made 500 MMCFs in 2011. Garry requested a 90 day term in the emergency order. Mr. Edwards testified on cross examination that they filed the emergency application for Section 10 because they received the proposal from Devon and Mr. Edwards decided he was going to drill more wells in the N/2 of Section 10 to try to protect his acreage in that quarter on that part of his ranch. He was very disturbed about the proposal for horizontal development on a 640 acre basis where he might potentially have to be a participant under a pooling order which would affect the N/2 of Section 10 where he owns all the minerals. His objective was to exclude the N/2 of Section 10 from any proposal by Devon because he owns the minerals and wanted to develop them as he chose. Mr. Edwards testified that he decided to drill on an emergency basis in the N/2 of Section 10 because of Devon's proposal. Garry could drill on another location on the ranch, but decided to move this rig to Section 10 instead of to other proposed place on the ranch. Mr. Edwards testified they made a discretionary move and could have drilled on other alternate locations. However in Mr. Edwards' opinion Section 10 was the best location because of the efforts by Devon to propose a well to test the Mississippian on a horizontal basis.

The actual drilling contract Garry has is with a company out of Kansas called Barretts Drilling. There is a $9,600 a day standby rate that they pay to keep the rig. This has been a long term agreement with a $12,000 mobilization fee that is affixed to this particular situation. The testimony reflected that Garry could have drilled another particular location and they chose to go to Section 10 because of the spacing proposal by Devon.

Many of these equitable arguments that were being presented about the affect on the mineral interest in the N/2 of Section 10 by the proposed horizontal spacing were really merit dispute issues in that they could be resolved in a hearing to determine whether the plan for developing the Mississippian should be approved as vertical spacing with several different wells or using horizontal drilling across a section.

If Devon decided to drill just in the S/2 of Section 10, Garry would have no objection. Garry simply does not want any drilling to happen in the N/2 of Section 10. Devon testified however that there could not be any successful drilling for the Mississippian on a horizontal basis using a lateral that would only transverse north to south across the 320 acre unit. Devon testified that it would not be feasible to drill a horizontal well for the Mississippian east to west. The primary method of development for the Mississippian on a horizontal basis is north and south and that at least a 4000 foot lateral would be required to do this. It would cost essentially the same to drill the shorter lateral if it was limited to the S/2 of Section 10, however the results that they knew from experience in developing the Mississippian in this vicinity were that the production rate would be less and the cost of the well would be essentially the same as if they were given the authority to drill the 4000 foot lateral.

Devon had made several communications by their broker to Mr. Edwards prior to the filing of the spacing application. Once the application had been filed Mr. Rayburn who is the in-house landman for Devon on this particular project contacted Mr. Edwards himself. There were several contacts with Mr. Edwards where there was never any indication that he planned to try to get vertical wells drilled. Mr. Edwards simply stated they were objecting and they would not agree to anything, but there was no indication given that there was going to be an emergency application to drill a vertical well.

On May 7, 2012 when Devon's survey crew went to the site to stake a location in the N/2 of Section 10, Mr. Edwards stopped them from accessing the ranch that day. On the Prehearing Conference Agreement ("PCA") which was signed and set in the case on the protest docket on June 27, 28, and 29, there was an indication on the face of the PCA that there was no emergency application expected. The date of the PCA was May 7, 2012.

After listening to all of the testimony it was the ALJ's recommendation that the emergency application be denied as the ALJ determined that the arguments being made about the inequitable circumstances faced by Garry and the Edwards family can be addressed in the hearing on the merits. There is already a producing well from the Mississippian present in the N/2 of Section 10 and thus Garry can make their argument based upon the fact that there is a well and that their needs to be exclusion of already drilled wells and exclusion of any vertical wells which are drilled in the N/2 of Section 10.

The ALJ did not see that there was an emergency circumstance as Garry admitted they had ongoing plans to drill a variety of wells in the vicinity but they had decided to go ahead and drill the location in Section 10 because of the Devon proposal. They could have easily gone to another location in the area to use the rig. Garry admitted this several times at the hearing. The ALJ determined that there really was not an emergency because there is a producing well already present in the N/2 of Section 10 and Garry can make their arguments and request a remedy concerning vertical wells drilled in Section 10 at the merit hearing. Garry cited the OCC-OAC rule 165:5-15-3(g) which states the ability to exclude existing wells with production from a formation which is affected by the horizontal development. Garry can make those arguments at the hearing and it can be determined on all of the evidence as to the best method for development of the Mississippian in this section.

POSITIONS OF THE PARTIES

GARRY

1) **Richard J. Gore**, attorney, appearing on behalf of Garry, stated that Garry owned 100% of the surface and minerals in the N/2 of Section 10. It has been in the Edwards family for generations. This has been an area of where shallow to medium depth oil drilling has historically been done and spacing has never been a factor in Mr. Edwards' experience because he essentially owns quarter sections, half sections and full sections. He owns 1000s of acres.

2) The statutory exclusion on oil spacing is 40 acres for 4000 feet or less and 80 acres between 4000 feet and 9999 feet. That is the vast majority of the Mississippian drilling between those depths. Mr. Edwards has never been concerned about having the spacing any differently. Mr. Edwards is not familiar with Commission rules as he has never dealt with the Commission because he has drilled everything in his own space because he owns such large amounts of land and minerals. There has never been a 640 acre oil spacing before horizontal spacing came along. He was shocked when he found out that someone could take his property away from him when he owns 100%, by just filing a case with the Commission, preventing Mr. Edwards from drilling a well. He thought that he did not have to make a deal with Devon because they could not space their way into his area. The reason he was not drilling any more wells in the N/2 of Section 10 is because he was saving it for his children. He wanted to have something he could provide his children, who could then drill three more wells in the N/2 of Section 10. There is one old well that has been there since 1988 but he would like to get at least one more well in the NE/4 of Section 10.

3) After Garry became aware of OCC-OAC Rule 165:5-15-3(g) he realized if he could get a well drilled and producing, it would be excluded and he wouldn't have to participate in the horizontal well. The horizontal well cost is $3,770,000 according to Exhibit "A". His half would cost $1,885,000 and Mr. Edwards wants to keep what he already has free and clear. It was explained to him that if he doesn't participate in the pooling order of the horizontal well he would lose any rights to drill. It would cost him a $1,885,000 just to keep what he already owns free and clear. He is not inclined to spend $1,885,000 to keep what he already owns, but he would like to have one more new well on his property. He wants to drill one more well in the NE/4 near the one he already has and Devon wants to drill one lateral which they could do in the W/2 of the section and it wouldn't have any affect on Garry and Garry wouldn't have any affect on Devon.

4) Garry does plan to drill 13 wells this year and Garry has only drilled three of those wells which means he has 10 other locations. Garry testified that four of those locations were in the N/2 of Section 10. The testimony of the technical witness for Garry stated that they actually just had one location that was actually drillable at the current time. The rig was actually on the proposed location in the N/2 of Section 10 on Tuesday, May 29th because Garry did not know there was a pending spacing. The $9,600 a day standby rate was paid for about a week and then they filed this emergency. They paid the $9,600 a day for a week and had the emergency application hearing on Tuesday, May 29th. If they lost on Tuesday they were going to go ahead and move the rig to the one other location. After Tuesday May 29th when they were not granted their application for emergency they paid the $12,000 mobilization cost and moved it to the one other location.

5) Garry believes this situation results in waste because vertical wells are capable of testing multiple formations. There are Skinner, Red Fork, Tonkawa, Misener to name a few formations that Garry has located and produced from. If you take the Mississippian away from Garry by drilling this horizontal well so that Garry can't drill a well and produce from the Mississippian or any other formation, it destroys Garry's drilling program in the N/2 of Section 10. There's potential for other formations to produce in the area in the N/2 of Section 10 and those hydrocarbons will be left in the ground. Nobody will drill a well if you cannot produce the Mississippian out here in a vertical well. These other formations Devon is not going to get by drilling a horizontal well.

6) Devon argues that all of these issues are merit issues, but if you wait for the merit hearing you can't drill at that point. The OCC-OAC Rule 165:5-15-3(g) states that a well has to be in existence and producing in order to be excluded. If we lose the merit hearing we lose it all, whereas we can drill the emergency well and produce the well and it is not like we are taking something away from Devon. There is already a producing well in the NE/4. Garry seriously doubts that Devon wants to put their horizontal well where Garry has

been producing for 24 years. Garry assumes that Devon is going to be drilling in the W/2 where there's been no drilling. So in Garry's opinion this vertical well would not deter Devon from drilling their horizontal well, so both parties would have what they want.

7) The real emergency in Garry's view is the waste that is created by the situation where you can have one more vertical shot at all these formations and if the horizontal spacing is granted, that opportunity for Garry is gone. It is protecting the little guy from the giant.

8) Devon argues that Garry manufactured their emergency. There would not be an emergency if Devon hadn't filed a horizontal spacing. Devon's filing of a horizontal spacing says that Devon is going to take away all of Garry's rights. Garry has owned this property for generations and it is an emergency in Garry's view that Devon is going to take away Garry's chance of finding other hydrocarbons and producing from the Mississippian in the N/2 of Section 10 where they own 100%. Garry considers it an emergency having to spend $1,885,000 just to keep what Garry already owns free and clear. Garry would like to do some extra exploring that will never get done any other way.

DEVON

1) **Michael D. Stack**, attorney, appearing on behalf of Devon, argues that the determination of whether an application to justify an emergency ruling is a question of a fact for the ALJ, the initial trier of fact. It is the ALJ's duty to listen to the expert opinions espoused before him and assign the appropriate weight to that opinion.

2) Devon has leased the S/2 and has spent $216,000 to lease the S/2. Devon has therefore the same amount of interest that Garry does. The producing well is in the NE/4 NE/4 and Garry wants to put a second well about 700 feet from the producing well. When you want to drill horizontal wells you have to have 640 acre spacing with the latitude to drill the wells. The Devon engineer testimony was that you had to drill north-south because of the way the fracing is. You have to have a 4000 foot lateral. What about the owners in the southeast half of Section 10. Again, this addresses the merits of the case and should be decided at the merit hearing. Devon feels the best way to develop Section 10 is by horizontal development and Garry thinks the best way to develop Section 10 is by vertical development. Garry has asked to have Devon's horizontal spacing application denied completely and if it's denied then Garry gets to drill the vertical wells. This is what the Commission should

decide on the merits. This is not an emergency. If the ALJ says at the merit hearing that the Section 10 should be developed horizontally, then by allowing a well to be drilled on an emergency basis, which was manufactured, you have taken away an area from Devon. If the merit hearing case is denied then Garry can still drill the vertical wells. It will be based on what Garry puts on in their merit case and what Devon puts on in its merit case.

3) Devon believes that Garry has manufactured its emergency. Devon filed its application and proceeded to talk to Mr. Edwards but could not reach an agreement. Garry then tries to create an emergency to try to drill some wells and to circumvent the Commission's authority. The testimony of Mr. Edwards was that he had already drilled three wells with the rig and was going to drill ten more in 2012. These wells weren't in this section. His testimony was that he had one location that was available at the present time, so therefore he has a place for this rig and has no financial loss.

4) The Commission prescribes that there should be orderly development in a unit for the prevention of waste and protection of correlative rights. Devon cited *Winter v. Corporation Commission of State of Oklahoma,* Court of Appeals case, 660 P.2d 145 (Ok.Civ.App. 1983) and *Denver Producing & Refining Company v. State,* 184 P.2d 961 (Okl. 1947). The Court said in the *Denver Producing & Refining* case that between conservation of natural resources and the protection of correlative rights the latter is secondary and must yield to a reasonable exercise of the former. The result is you don't drill too many wells and this is something that should be dealt with in the merits of the case.

RESPONSE OF GARRY

1) Mr. Gore argued further that this was not a standard run of the mill emergency. The situation here is that Garry has been developing this area and Mr. Edwards has been doing this virtually his entire life and has been extremely successful in what he has accomplished. He has produced hydrocarbons from many formations in addition to the Mississippian. However, the Mississippian is his bread and butter. Thus, this horizontal program by Devon destroys his drilling program. Devon's primary objective is the Mississippian. The emergency concerns waste and as the *Denver Producing & Refining Company v. State* case, supra, provides, waste overrides the protection of correlative rights. Devon is going to leave hydrocarbons in the ground by drilling horizontally.

2) Devon wouldn't put a horizontal well in the center of the W/2 as there is already a producing well which has been there for 24 years. Why would they want to put a lateral over here near the Edwards #1 well. Garry wants to drill a

well as close as he could to the present vertical well but far away enough to find new hydrocarbons.

3) The whole point is that Garry is trying to take advantage of OCC-OAC Rule 165:5-15-3(g) and the only way to do that is to have the well drilled and produced when the horizontal spacing order is entered. You can't wait until the hearing on the merits to get a decision, because then it's too late. Devon could still drill their lateral and obtain their 640 acre horizontal spacing. Garry could have a brand new well as opposed to just the old one and would get to explore several formations that Devon will not explore. This emergency will prevent waste.

CONCLUSIONS

The Referee finds the Oral Report of the Administrative Law Judge should be affirmed and the emergency application denied.

1) The Referee finds that the ALJ's recommendation to deny the Garry emergency application is supported by substantial evidence, free of reversible error and should be affirmed. The determination of whether a certain and definite financial loss was established under the emergency application to justify the ruling is a question of fact for the ALJ, the initial trier of fact. It is the ALJ's duty to listen to the expert opinions espoused before him and assign the appropriate weight to that opinion. *Grison Oil Corp. v. Corporation Commission*, 99 P.2d 134 (Okl. 1940). The ALJ found that the Garry evidence pertaining to his claim of financial loss was not compelling. The ALJ concluded that Garry simply did not present substantial evidence to justify the granting of the emergency application. The issues presented concerning waste, and whether vertical wells would better prevent waste because additional formations could be produced other than the Mississippian, or whether horizontal spacing would better prevent waste for the Mississippian can be better addressed at the merit hearing.

2) As the Supreme Court stated in *Palmer Oil Corporation v. Phillips Petroleum Company*, 231 P.2d 997 (Okl. 1951):

> 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, sec. 823, 32 C.J.S., Evidence, § 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.

3) The determination of whether a certain and definite financial loss was established under the emergency application to justify the ruling is a question of fact for the ALJ, the initial trier of fact. The evidence presented by Garry was that they plan to drill 13 wells this year in 2012 and they had only drilled three. Garry therefore had ten other locations available to be drilled. The testimony was that four of those locations were in the N/2 of Section 10. The testimony of the technical witness for Garry said that they actually just had one location that was drillable at the current time. Because Garry didn't know there was a pending spacing application the rig was already on the location anticipated by Garry in its emergency application on Tuesday, May 29, 2012, the date of the emergency application hearing. Garry paid $9,600 a day standby rate for about a week. After Garry found out that Garry was denied its emergency application to drill the vertical well 700 feet from the producing Edwards #1 well in the NE/4 NE/4, Garry then moved the rig to the other available location spending the $12,000 mobilization costs. Thus the ALJ found that the Garry evidence pertaining to his claim of financial loss was simply not present and concluded that Garry simply did not present substantial evidence to justify the granting of the emergency application. The Referee agrees with the determination of the ALJ.

4) In addition, Garry argued that there was potential for other formations to produce in this area if vertical wells were allowed. Thus, waste would be prevented if vertical drilling was permitted. In *Denver Producing & Refining Company v. State,* 184 P.2d 961, (Okl. 1947) the Court found in striking a balance between the protection of correlative rights and prevention of waste that conservation of natural resources is primary and the protection of correlative rights is secondary and must yield to the reasonable exercise of the former. The Oklahoma Court of Civil Appeals found in *Winter v. Corporation Commission of State of Oklahoma,* 660 P.2d 145 (Ok.Civ.App. 1983):

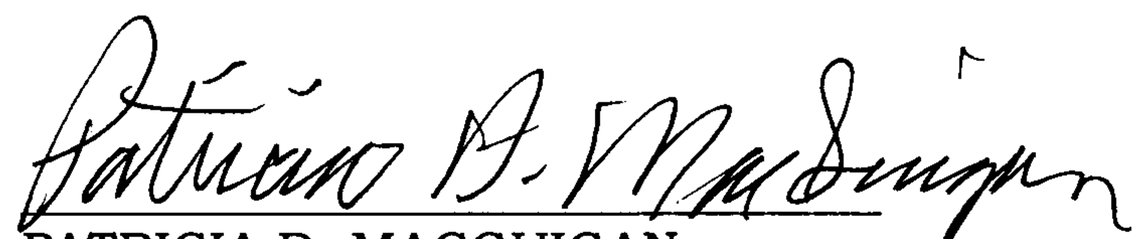
> ...we are of the opinion that the order appealed from in this case indicates an exercise by the Commission of its skill and technical experience in refusing to give its approval to spacing that might result in much economic waste by the drilling of unnecessary wells.

See also *In re Continental Oil Co.,* 178 P.2d 880 (Okl. 1947). The Referee believes that the question of whether to develop Section 10 on a horizontal basis or on a vertical basis consistent with preventing economic waste by the

drilling of unnecessary wells is an issue that should be presented at the merit hearing. Garry also can present its argument that the producing Mississippian Edwards #1 well in the NE/4 NE/4 of Section 10 is a vertical well and should be excluded if Garry should elect not to participate in development of the horizontal spacing pursuant to OCC-OAC Rule 165:5-15-3(g).

5) Under the above listed circumstances, the Referee can find no reason to vary the recommendation of the ALJ and the ALJ should be affirmed.

RESPECTFULLY SUBMITTED THIS 8th day of June, 2012.



PATRICIA D. MACGUIGAN
OIL & GAS APPELLATE REFEREE

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Office of General Counsel
Michael L. Decker, OAP Director/ALJ
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