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BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICANT: C. WILLIAM RICHTER)
)
RELIEF SOUGHT: DRILLING AND SPACING UNITS) CAUSE CD NO.
) 201202350
)
LEGAL DESCRIPTION: SECTION 2, TOWNSHIP 24)
) NORTH, RANGE 11 WEST,)
) ALFALFA COUNTY, OKLAHOMA)

FILED
DEC 17 2012

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CORPORATION COMMISSION
OF OKLAHOMA

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before Susan R. Osburn, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 30th day of August, 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: **Gregory L. Mahaffey**, attorney, appeared on behalf of applicant, C. William Richter ("Richter"); **David E. Pepper**, attorney, appeared on behalf of Continental Resources, Inc. ("Continental"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed her Report of the Administrative Law Judge on the 27th day of September, 2012, to which Exceptions were timely filed and proper notice given of the setting of the Exceptions.

The Appellate argument concerning the Exceptions was referred to **Patricia D. MacGuigan**, Oil and Gas Appellate Referee ("Referee"), on the 29th day of October, 2012. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

RICHTER AND CONTINENTAL TAKE EXCEPTION to the Report of the ALJ filed on September 27, 2012 which recommended that an interim order issue

in CD 201202350 stating that the cause will be set for reopening nine months from the date of the issuance of the interim order to determine whether or not Continental has taken appropriate action to further develop Section 2 based on results of offset wells. The ALJ further recommended that failure of Continental to obtain any regulatory orders necessary for further development of this unit plus the filing of an intent to drill and any further necessary action for continuing development of Section 2 will result in an order granting Richter's request to respace the Oswego on a 160-acre basis. The ALJ lastly recommended that upon reopening under the interim order the operator will provide evidence of their action in furtherance of developing this Section 2 or an order will issue respacing the Oswego consistent with Richter's request.

This is a case where Richter is requesting the Commission enter an order amending the provisions of Order No. 96691, which established 640 acre drilling and spacing units for the production of hydrocarbons from the Oswego common source of supply and to delete there from said common source of supply underlying Section 2-24N-11W, Alfalfa County, Oklahoma; extending the provisions of Order No. 124526 which established 80 acre lay down drilling and spacing units for the production of oil from the Oswego common source of supply to cover and include said Section 2; and designating the Norton #1 well has the unit well for the N/2 NE/4 of Section 2 for the Oswego common source of supply. At the time of the hearing Richter orally amended their application to seek establishment of 160 acre gas spacing units for the Oswego for Section 2 and designating the Norton #1 well as a unit well in the NE/4. Richter owns the minerals and surface in the SW/4, has shared in all the Oswego production from the existing Norton #1 well in the NE/4. The requested respacing would result in Ms. Norton, the NE/4 mineral owner, not being able to share in any future Oswego production from the other three quarter sections after sharing in the NE/4 Oswego production with owners in those quarter sections. Continental, the operator of the Norton #1 well, objects to the respacing as unfair to Ms. Norton and also on the grounds that they are awaiting the results of two offset horizontal wells being drilled to a number of zones including the Oswego in order to determine if further development should occur in Section 2. Continental will further develop Section 2 if those wells prove up the interest in Section 2. Both sides agree the Norton #1 well is nearing the end of its productive life, although each side disagrees about the Norton #1 well's remaining reserves and about its ultimate drainage.

CONTINENTAL TAKES THE POSITION:

1) The Report of the ALJ is contrary to law, is contrary to the evidence and fails to effect the means of prevention of waste and protection of correlative rights. The ALJ erred in establishing an interim order date to determine the viability of Continental commencing additional operations. There was no evidence to support a nine month interval. There is no evidence to support the

idea that if Continental receives adequate information on these wells, that they could have a rig available to commence operations within the time period.

2) The ALJ erred as a matter of law. The issues presented to her were a determination of the size of the drilling and spacing unit. The evidence clearly indicated that the existing well will drain in excess of 160 acres, even by Richter's standards, therefore, their requested spacing is inappropriate and should have been denied.

3) After notice and hearing as required by law, Continental respectfully requests that the Report of the ALJ be reversed and that the application be denied.

RICHTER TAKES THE POSITION:

1) The Report of the ALJ is contrary to the evidence, is contrary to the law and fails to protect correlative rights or prevent waste of hydrocarbons.

2) The ALJ erred in not granting 160-acre spacing for the Oswego common source of supply effective September 1, 2012. The overwhelming evidence is that the Norton #1 well will not substantially drain more than approximately 190 acres and that there is approximately 1.6 BCFG in the Oswego that will be left unrecovered in Section 2 absent drilling additional wells. Continental has owned this well and section for many years and has no plans to drill additional wells. Continental is asking the Commission to let them wait and speculate on the results of offset Mississippi wells not Oswego wells. As shown by Exhibits 1 and 7, offset units such as Sections 10, 11 and 12 to the south have had three or at least two Oswego wells to more adequately develop the unit.

Continental's only basis for objecting to 160-acre spacing is that they may lose leases. The Oklahoma Supreme Court has addressed this issue in *Union Oil Company of California v. Brown*, 641 P.2d 1106 (Okl. 1981). In that case the Supreme Court specifically found that granting of the despadding was merely reinstating the mineral owner's right to enforce the terms of their leases. Back when this section was spaced on 640-acres there had been no wells drilled in the immediate area. Had the Commission known that one well would not effectively drain more than 160 acres it would never have allowed 640-acre spacing. While there is one extremely good well in the area, the Baldwin well which has drained substantially more than 160 acres, Mr. Stromberg stated that the average drainage of all Oswego wells in this nine section area was only 132 acres; thus 160 acres is appropriate.

Where later development has shown that either a portion of the lands are not underlain or will not be effectively drained by an existing well, the Commission should vacate the 640-acre spacing and establish smaller spacing. *Union Texas Petroleum v Corporation Commission*, 651 P.2d 652 (Okl. 1981).

See also *Application of Peppers Refining Co.*, 272 P.2d 416 (Okl. 1954) and *Panhandle Eastern Pipeline Co. v. Corp. Com'n* 285 P.2d 847 (Okl. 1955).

Winter is not applicable here because Continental is not seeking density authority in the Oswego. *Winter, et al. v. Corporation Commission*, 660 P.2d 145 (OK.CIV.APP. 1983) In *Winter* the operator was seeking density authority. Continental is merely asking this Commission to allow it to speculate as to whether nearby Mississippi drilling is going to pan out so they can decide whether they want to drill a Mississippi horizontal well sometime in the future. This is not a basis for this Commission to abdicate its responsibility to prevent the waste that will occur if 1.6 BCF of Oswego gas is left in the ground underlying Section 2.

The ALJ also failed to note that there are no mineral owners objecting to the despadding. The fact that the mineral owners in the NE/4 will no longer participate in production in the other quarter sections is irrelevant because such mineral owners are not objecting to the establishment of 160-acre spacing. Such mineral owners will start getting four times the royalty that they have been receiving in the Norton well. In fact, Mr. Kyle McLinn, contract landman, testified that he had talked with most of the mineral owners in the section and that none of them were objecting to the despadding.

3) The ALJ erred in not making its order effective September 1, 2012. The only evidence of an effective date was the evidence of Richter that a September 1, 2012, effective date would better protect correlative rights and allow for orderly transition to 160-acre spacing including changing of the operator's pay decks.

4) The ALJ erred in not providing a date certain for Continental to commence another well for the Oswego. Although Richter strongly objects to the alternative decree/Interim Order recommended by the ALJ, should same be adopted by the Commission, it should provide a date certain by which Richter has to not only obtain regulatory authority and drilling permit for the additional well, but by which to actually commence operations, with a rig capable of drilling a well to the Oswego. Inasmuch as Continental has had over thirty years of time in which to develop the Oswego and has declined to do so, it would be appropriate if the ALJ's recommendation is affirmed to provide a date certain of June 27, 2013, which is nine months from the date of the ALJ's recommendation, by which Continental must actually commence drilling of an additional Oswego well with a rig capable of drilling to total depth, or to find that the Oswego should be despaced.

THE ALJ FOUND:

1) After taking into consideration all the facts, circumstances, evidence and testimony in this cause, it is the opinion of the ALJ that both sides have a legitimate issue. Continental has invested money to purchase their interest in the Norton #1 well and the unit and has spent money in further developing Oswego reserves in this unit. There are offset horizontal wells being drilled that will yield information that could prove valuable in Continental's further development of Section 2 reserves. It is reasonable for Continental to want an opportunity to see the outcome of these offset wells. It is also reasonable that Richter would seek to respace in order to release his interest in the hopes of getting some operator to develop reserves on a 160 acre basis should Continental fail to develop further. While Richter's witness believes respacing now will prevent waste, it is not absolutely clear that such would be true if horizontal drilling is proved up. If the offset wells do prove up development on a horizontal basis for the Oswego it might be hard to get an operator to drill a horizontal well on a 160 acre basis. Given that and given the fact that the mineral owner/Richter has shared for years in all the production from the Norton #1 well in the NE/4 and would not have to share any production from any proposed SW/4 Oswego well with Ms. Norton (the NE/4 mineral owner) it seems more fair to have an interim order, and to let Continental see the results of the offset wells which are currently drilling to numerous zones including the Oswego and then to respace if Continental fails to move forward in further development of Section 2. It is the recommendation of the ALJ that an interim order should issue setting this cause to be reopened in nine months from the date of the order for determination of whether Continental has taken appropriate action to further develop Section 2. This timeframe should give enough time to enable offset wells to be drilled, completed, and reviewed and for Continental to have obtained any necessary regulatory orders to further develop Section 2. If upon reopening, Continental has not moved forward in further development of Section 2 then Richter's application to respace the Oswego should be granted and an order respacing the Oswego should then issue. Such nine month delay may avoid disallowing the mineral owner in the NE/4 from sharing in Oswego production from the other three quarter sections after sharing production from the NE/4 with those owners in the other three quarter sections. It is the opinion of the ALJ that respacing this section prior to reviewing the results of the offset wells could result in failure to protect correlative rights and failure to prevent waste.

POSITIONS OF THE PARTIES

CONTINENTAL

- 1) **David E. Pepper**, attorney appearing on behalf of Continental, informs the court that before the initial hearing Richter changed his despadding request from an 80 acre oil spacing, to a 160 acre gas spacing. Continental was unaware of this change until the hearing and was not given an opportunity to prepare to defend against the changed respacing request.
- 2) Continental raises two assignments of error, the first of which being that they are unsure of the ALJ's ruling as to the nine month re-assessment of whether Continental has taken steps to develop Section 2. There is nothing to support a nine month re-assessment before the Commission. Continental is unsure of whether they would be able to get the well information and get a rig available to commence operations in that timeframe. Continental was not asked to give a more clear and concise timeframe.
- 3) Continental's second assignment of error is with regard to the engineering analysis. Continental's engineering analysis determined the existing well will drain over 500 acres. Contrarily, Richter's engineering analysis established that Mr. Stromberg believes the existing well would drain 190 acres. Continental argues that even with Richter's analysis the existing well would drain more than the 160 acre unit they want to set up currently.
- 4) Continental believes that the *Winter* case with regard to the development issue would take precedence here and allow Continental to keep the unit at 640 so they can drill a horizontal well.
- 5) Continental makes a two-fold request: a) The ALJ Report should be reversed to deny the application because the evidence brought by Richter does not support a respacing because the existing well drains more than what Richter is asking for in the application before the Commission; and b) If the ALJ Report is not to be reversed, then they request that some clarity be given on what is expected of Continental for the nine month re-assessment of the cause by the Commission.

RICHTER

- 1) **Gregory Mahaffey**, attorney, appearing on behalf of Richter, explains that Richter filed this application because they would like to see some development in the Oswego formation.

- 2) Richter also asserts that this application deals with the Oswego, and Continental looking into production of the Mississippi should not have an effect on this spacing application.
- 3) While Continental can take issue with the drainage calculations, what Continental can't take issue with is the evidence that there is going to be waste of hydrocarbons if additional wells are not drilled in Section 2.
- 4) Mr. Stromberg indicated that the Norton #1 well drainage would drain slightly more than 160, but when taking an average of the wells in the area he determined the average would be 132 acres.
- 5) The Continental witness acknowledged on cross-examination that they have no current pending proposals for development of Section 2.
- 6) Richter states that the Commission's primary charge is to prevent the waste of hydrocarbons and at the current time there is unrecovered gas that Continental currently has no plans to develop.
- 7) Continental is worried they might lose some vested rights if this application is granted, but Richter states even if this despadding is granted, Continental would still own 100% of the Norton #1 well.
- 8) Richter cites the *Union Texas Petroleum v. Corporation Commission*, 651 P.2d 652 (Okl. 1981) case to support that when a 640 acre spacing unit will not be effectively drained by one existing well, the Commission should vacate the 640 acre spacing and establish smaller spacing. Richter argues this case is analogous to the case before us.
- 9) Re-assessment of the cause in nine months is inappropriate. The Commission wants to re-evaluate what Continental has done after nine months, but Continental is interested in the Mississippi and not the Oswego. Richter wants the respacing solely for the Oswego. For these reasons Richter concludes that the Commission does not have a substantial reason to abdicate its responsibilities to prevent waste.
- 10) Richter declares that no mineral owner is opposing the application and only one, the NE/4 owner, was not spoken to by Richter's landman, Mr. McLinn.
- 11) Richter requests that if the ALJ Report is to be affirmed then he asks for a shorter time period than the nine months. Give them a 120 days or four months. Give them something shorter in duration than the nine months that is date certain.
- 12) Richter requests that the ALJ be reversed and that a 160 acre spacing be granted effective immediately. He also requests that if the ALJ is not to be

reversed in their favor, that the interim order be modified to provide a date certain of no later than June 27, 2013 for Continental to actually commence operations.

RESPONSE OF CONTINENTAL

- 1) Contrary to Richter's argument that Continental has sat on this for 30 years, they actually acquired the well at a later date and were not the initial drillers.
- 2) Continental asserts that they could test the Oswego when working on the Mississippi. Therefore, Richter's argument that Continental is not concerned at all with the Oswego is not valid.
- 3) Continental points out that the ALJ has come to a decision that allows Continental to develop the unit if they chose to do so instead of cancelling the leases now by granting the application.

RESPONSE OF RICHTER

- 1) Richter addresses Continental's point that they were not given time to prepare properly for the case because of last minute changes by Richter. They state that Continental could have asked for a continuance if they felt unprepared due to the circumstances and they did not.
- 2) Richter explains that Continental has had 24 years to further develop Section 2 and they have not done so, thus the Richter application should be granted so another company can develop the land.
- 3) The current 640 acre spacing is not going to protect correlative rights and prevent waste because Continental has no plans to drill any well, and by their own admission there's unrecovered gas in Section 2 by the Norton #1 well.

FURTHER RESPONSE OF CONTINENTAL

1) Continental disagrees with the contention by Richter that they are not interested in drilling a well. Continental is looking into drilling Mississippi wells, but they want to see if they will produce first.

FURTHER RESPONSE OF RICHTER

1) Richter argues that even though Continental may drill in the future, waste is currently happening with the unrecovered reserves while they wait on information.

CONCLUSIONS

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

1) In *Mustang Production Company v. Corporation Commission*, 771 P.2d 201 (Okla. 1989) the Oklahoma Supreme Court held:

The standard to be applied by the Corporation Commission when hearing an application to modify or vacate a prior, valid order is well known in Oklahoma. A prior, valid order may only be modified or vacated upon a showing by an applicant that there has been a change in conditions or a change in knowledge of conditions. *Phillips Petroleum Co. v. Corporation Commission*, Okla., 461 P.2d 597, 599 (1969). The applicant must make this showing by substantial evidence. *Phillips*, supra; *Anderson-Prichard Oil Corp. v. Corporation Commission*, 205 Okla. 672, 241 P.2d 363 (1951); Okla. Const. Art. IX §20. Without this showing, any attempt to vacate or modify a prior, valid order constitutes a prohibited collateral attack on that earlier order. *Application of Bennett*, 353 P.2d 114, 120 (Okla. 1960).

One author, commenting on the requirements of change of conditions or change in knowledge of conditions, writes:

What constitutes a change of condition sufficient to satisfy the requirement? As a logical proposition, three kinds of change of condition are theoretically possible. The first may be designated as an internal change of condition. It is characterized by an actual change in the physical behavior of the reservoir occasioned by development and depletion. Such a change may or may not be predictable in the early states of development....The second kind may be called an external change of condition. In this instance, the physical behavior of the reservoir remains constant, but the information gained through development or depletion experience demonstrates that the conclusions reached originally were incorrect....The third possible kind of change of condition defies tagging with an appropriate label. It can only be described. In this case no actual change in the physical behavior of the reservoir is experienced, and subsequent development and depletion of the reservoir confirm the original predictions so that no external mistake exists. Nevertheless, new scientific knowledge and technology may add new dimensions to the basic legal concepts of waste and correlative rights, or the statutes may be superseded by others which re-define these terms.

Harris, *Modification of Corporation Commission Orders Pertaining to a Common Source of Supply*, 11 Okla. L. Rev. 125 (1958).

2) The testimony reflected that there are offset horizontal wells being drilled which include among various formations the Oswego. While the offset wells target the Mississippi the applications for those wells include the Oswego and the results could support density development of the Oswego in Section 2.

3) The ALJ stated in her recommendations and conclusions:

...There are offset horizontal wells being drilled that will yield information that could prove valuable in Continental's further development of Section 2 reserves. It is reasonable for Continental to want an opportunity to see the outcome of these offset wells. It is also reasonable that applicant would seek to respace in order to release his interest in the hopes of getting some operator to develop reserves on a 160 acre basis should Continental fail to develop further. While

applicant's witness believes respacing now will prevent waste, it is not absolutely clear that such would be true if horizontal drilling is proved up; if the offset wells do prove up development on a horizontal basis for the Oswego it might be hard to get an operator to drill a horizontal well on a 160 acre basis.

4) The Commission has found that when multiple horizontal wells are needed to develop a 640 acre unit the larger unit is necessary to provide the necessary flexibility to properly locate the horizontal wells to develop the common source of supply. There is a definite need for flexibility which is created by establishing larger 640 acre horizontal units.

5) The Referee notes that there are drainage calculations differences between Continental and Richter. However, the evidence reflects that there is going to be waste of hydrocarbons if additional wells are not drilled in Section 2. The prevention of waste is paramount and overrides the protection of correlative rights. As stated by the Court in *Winter v. Corporation Commission of State of Oklahoma*, 660 P.2d 145 (Okla.App. 1983):

Prior spacing order No. 192841, entered on April 19, 1977, established Section 13 as a 640-acre drilling and spacing unit for the Mississippian (Mississippi Solid) common source of supply underlying Section 13 and authorized the drilling of only one well in the unit. Both Withrow, et al. and Winter, et al. sought to modify this spacing order and were required to prove initially that there had been a substantial change of conditions or substantial change in knowledge of conditions in the area since the prior order had been issued. If they were successful in establishing a substantial change of conditions or knowledge then they were required to prove that their particular method of modifying the spacing order would either prevent waste or protect correlative rights.

...Having been given a choice of remedies, it is incumbent upon the Commission to use the remedy which will best prevent waste and protect correlative rights. (footnotes omitted)

6) When the Commission considers its duties of prevention of waste and protection of correlative rights, the Commission must keep in mind that the prevention of waste is paramount and overrides the protection of correlative rights argument. The Court in *Denver Producing & Ref. Co. v. State*, 184 P.2d 961 (Okl. 1947) held:

...In most instances it is impossible to use a formula which will apply equally to all persons producing from a common source. In striking a balance between conservation of natural resources and protection of correlative rights, the latter is secondary and must yield to a reasonable exercise of the former.

7) The Referee agrees with the ALJ's recommendation that it would best prevent waste to have an interim order and to let Continental see the results of the offset wells which are currently drilling to numerous zones including the Oswego, and then to respace as Richter requests if Continental fails to move forward in further development of Section 2. The Conservation laws were enacted to encourage orderly development of the common sources of supply in the State for the benefit of the State and its citizens. In the present circumstances the Referee believes the ALJ's Report should be affirmed concerning the institution of an interim order which will provide and allow orderly development.

8) However, the Referee would recommend modifying the ALJ's Report to provide that the interim order should issue setting this cause to be reopened in six months from the date of the interim order to determine whether Continental has taken action by obtaining a rig and commencing operations to further develop Section 2. If upon reopening, Continental has not moved forward and obtained a rig and commenced operations targeting the Oswego common source of supply then Richter's 160 acre respacing application for the Oswego common source of supply should be granted.

9) For the above stated reasons, the Referee finds that the ALJ's decision should be affirmed as respacing this section prior to reviewing the results of the offset wells could result in failure to protect correlative rights, and more importantly, a failure to prevent waste.

RESPECTFULLY SUBMITTED THIS 17th day of December, 2012.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
Jim Hamilton
ALJ Susan R. Osburn
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