Delibs
JAN 22 2013

FILED
JAN 14 2013
OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICANT:	**CHESAPEAKE OPERATING, INC. AND CHESAPEAKE EXPLORATION, LLC**	)	
RELIEF SOUGHT:	**ESTABLISH IRREGULAR 640-ACRE HORIZONTAL DRILLING AND SPACING UNITS**	)	**CAUSE CD NO. 201104681**
LEGAL DESCRIPTION:	**E/2 OF SECTION 20 AND E/2 OF SECTION 29, W/2 OF SECTION 20 AND W/2 OF SECTION 29, TOWNSHIP 11 NORTH, RANGE 10 WEST, CANADIAN 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 28th, 29th and 30th days of March, 2012, the 25th day of April, and the 16th day of May, 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 Books**, attorney, appeared on behalf of applicant, Chesapeake Operating, Inc. and Chesapeake Exploration, LLC. ("Chesapeake"); **Charles Helm**, attorney, appeared for Crawley Petroleum Corporation, Rhino Resources, and PDI, Inc. (collectively "Crawley"); **J. Fred Gist**, attorney at Law, appeared for Kaiser-Francis Oil Company ("Kaiser-Francis"); **John Moricoli, Jr.**, attorney, appeared for Red Hawk ("Red Hawk"); **James White**, attorney, appeared for Pearl Power, Inc. ("Pearl"); **Christina Foster**, Land Tech, requested a Pro Se appearance for interested party Chaparral Energy, LLC ("Chaparral"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the ALJ on the 25th day of July, 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 31st day of August, 2012. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

CHESAPEAKE TAKES EXCEPTION to the ALJ's recommendation to deny Chesapeake's application to establish irregular 640-acre horizontal drilling and spacing units in the E/2 of Section 20 and the E/2 of Section 29, W/2 of Section 20 and the W/2 of Section 29, T11N, R10W, Canadian County, Oklahoma. Chesapeake filed an application to create irregular 640-acre horizontal spacing units to overlay existing spacing in Sections 20 and 29. Chesapeake requests this new spacing for the Skinner common source of supply. Chesapeake believes the deposit is a relatively narrow incised valley with channel facies. Chesapeake believes the thickest part of the deposit is straddling the center lines of Sections 20 and 29 and the dividing line between the two sections. Crawley believes the Skinner was laid down on part of a deltonic tributary and is wider than an incised valley deposit, thus covering a larger area. Crawley also believes the thickest portion of the Skinner deposit lies within Section 29 and re-spacing is therefore not necessary to recover the hydrocarbons in the Skinner formation.

CHESAPEAKE TAKES THE POSITION:

1) The ALJ Report is contrary to the law, not supported by substantial evidence, is arbitrary and capricious, and is not upon terms which are fair, just, and reasonable to all parties.

2) The evidence of both parties showed, and the ALJ correctly found, that the thickest portion of the Skinner underlies the S/2 of Section 20 and the N/2 of Section 29. The current spacing will result in waste of this, the best portion of the reservoir. Under the current spacing, even if location exceptions were allowed in Sections 20 and 29, there would be no significant recovery from the thickest portion of the reservoir within Sections 20 and 29 because, as found by the ALJ, no significant recovery occurs beyond the end of each well's lateral. Under the current spacing, waste will occur near the boundary between Sections 20 and 29 where no lateral will be located, even under a location exception order. The proposed spacing will prevent waste by allowing a lateral to be drilled, completed, and produced from the area closest to the boundary between Sections 20 and 29 - where all parties admit, and where the ALJ

found, the best portion of the reservoir is located. The denial of the application will result in waste, and the ALJ should be reversed.

3) The granting of the application will prevent economic waste by allowing for the longest possible lateral for the least amount of cost in drilling to the reservoir. The denial of the Application will result in waste, and the ALJ should be reversed.

4) The ALJ correctly concluded that the Commission's first duty is to prevent waste. The ALJ thereafter committed error, however, in concluding that the correlative rights of some owners (which owners have not drilled a well to the Skinner in more than 20 years) should outweigh the Commission's duty to prevent waste. Moreover, the ALJ's ruling takes into account the correlative rights of owners within old vertical wells near the end of their productive life, and ignores the correlative rights of owners like applicant, who wish to further develop the Skinner, and who are willing to spend millions of dollars to efficiently develop the formation and prevent waste, rather than sit idly by.

5) Having correctly found that the Commission's first duty is to prevent waste, the ALJ concluded that the waste would be prevented with less harm to correlative rights through the three scenarios set forth in his Report. There is absolutely no evidence whatsoever that any party will undertake development of the Skinner under any of the scenarios created by the ALJ. Indeed, the evidence is clearly to the contrary. Because no party will undertake development under the scenarios created by the ALJ, waste will not be prevented. The application should be granted in order to cause development of the Skinner and thereby prevent waste.

a) First, the ALJ suggests, "The possibility exists for a long lateral between (sic) (evidently meaning across) the two existing units." The only evidence in the record shows clearly that neither Crawley nor Chesapeake intends to take the risk of a cross-unit lateral here, where the assistance of a cross-unit statute (similar to the Shale reservoir statute) is not available. The evidence clearly shows that, in the absence of such a statute, litigation risks are too high. Moreover, there is no reasonable belief that parties would agree to amendment of the pertinent poolings. There is absolutely no evidence that any cross-unit wells would be drilled by any party. Indeed, the uncontroverted evidence is that, without a cross-unit statute, no such well will be drilled. Because no well will be drilled, there will be waste.

b) The ALJ next suggests, "Another possible scenario is for the parties to drill horizontal wells in the existing units." Not only is there no evidence that any party is willing to undertake this scenario, the ALJ suggests no way in which this scenario would prevent the waste of hydrocarbons in the best portion of the reservoir near the boundary between Sections 20 and 29.

c) The ALJ next suggests, "Finally, the units could be reshaped to include the S/2 of Section 20 and the N/2 of Section 29." There is no indication in the Report (probably because there is no logical explanation) (1) why this scenario would disturb correlative rights less than the instant Application, (2) how this scenario would prevent the waste of hydrocarbons in the N/2 of Section 20 and the S/2 of Section 29 which, under this scenario, would be "orphaned," or (3) why this scenario, not requested by any party to the proceedings, would in any way prevent waste or protect correlative rights.

6) The three scenarios invented by the ALJ do not prevent waste, and do not protect correlative rights. In addition, they are totally unsupported by the evidence, since the evidence does not show any party is willing to drill a well under any of these scenarios. Without additional drilling, there will be waste. The ALJ should be reversed.

THE ALJ FOUND:

1) No matter which isopach map is used, Chesapeake's or Crawley's, both show the thickest net portions of the Skinner to be in the S/2 of Section 20 and the N/2 of Section 29. The question becomes how best to secure the hydrocarbons located in the Skinner. All parties agree the Skinner underlies the entire subject area.

2) Chesapeake's geologist showed a thick area of pay along the border-line between Sections 20 and 29. This thickening ran from east to west the entire width of the sections. This geologist indicated this area is an incised valley system with steep sides, limiting the coverage of the thickest portion of the reservoir.

3) Crawley's geologist shows the thickest area of the Skinner lies in the N/2 of Section 29. From there the reservoir thins to the north. Crawley's geologist said it was his interpretation that the Skinner in this area is a result of distributary channels in a delta environment and not incised valley channels.

4) The engineers only real area of disagreement centers on what happens at the end of a lateral. Chesapeake's engineer believes that drainage will not extend very far from (north/south) from the enhanced (by fracing) east-west fractures. The Crawley engineer believes the gas molecules will flow towards the fractures similar to the way cool air will flood a room. The ALJ is not convinced the hydrocarbons would move in this manner. The ALJ acknowledges that a limited amount of hydrocarbons may migrate into the enhanced fracture zone, but believes it to be a minimal amount. This is because the parties are in agreement the natural "fractures" in the reservoir run east and west. There would be a small number that ran north and south into these "fractures", even after a fracing job has been done.

5) Chesapeake noted there is no recent Skinner development in the two sections. Chesapeake has indicated a willingness to develop the Skinner in the two sections. Chesapeake asserted throughout the hearings that preventing waste was the main function of the Commission and the protection of correlative rights was a secondary concern. While this describes the priorities, it does not prevent the Commission from considering various methods to prevent waste and protect correlative rights. The Commission is charged with preventing waste and protecting correlative rights. Chesapeake wants to have a standup 640 acre unit to drill extremely long laterals. A majority of the lateral would run through the middle of the thickest portions of the reservoir, as interpreted by Chesapeake. The requested standup 640 would eliminate the problems associated with crossing the section lines between Sections 20 and 29. The new spacing would have a significant effect on the correlative rights established by the current spacing. The proposed spacing would also have an effect on owners in another well located in Section 29 that could be re-completed in the Skinner as the deeper formations play out.

6) Crawley wants to maintain the status quo. Crawley did not set forth a plan of development to retrieve the hydrocarbons located in the subject area, nor was it required of them to do so.

7) While Chesapeake's proposed spacing will aid in the prevention of waste, it comes at a cost as to correlative rights. Those rights have been established for many years and multiple parties are affected. Prevention of waste is the top priority of the Commission. The protection of correlative rights is second to the prevention of waste. However, sound judgment will allow the prevention of waste with minimal impact on established correlative rights. There are at least three other scenarios that would prevent waste and would have less of an impact on the established correlative rights than the proposed spacing scheme. Two of the scenarios would require no change in spacing.

8) As this is not a shale or unconventional reservoir, the new multi-unit horizontal well rules are not applicable to this section. However; the possibility exists for a long lateral between the two existing units. This could be and has been done using existing location exception rules. This can be done with no changes to spacing or ownership rights in the existing wells. This would allow for a long lateral to go through the heart of the thickest portion of the reservoir, regardless of whose geological mapping is the most accurate. Based on the testimony, laterals in the Skinner seem to be more difficult to drill as they approach 4,000 feet. It is understood there are only two other Skinner wells in the section and the difficulties encountered may be unique to those two well bores. Using a method that basically keeps the lateral only in the reservoir would prevent drilling a 8,000 foot lateral when perhaps a lateral near 5,000 feet is sufficient to exploit the reservoir.

9) Another possible scenario is for the parties to drill horizontal wells in the existing units. Based on the testimony received, the E/2 and W/2 of Section 29 each have sufficient reserves to justify horizontal wells. The E/2 of Section 20 also has sufficient reserves to justify a horizontal well. The W/2 of Section 20 does not have reserves to support a horizontal well due to the anticipated drainage of an existing well. Regardless of whose map is used, it is apparent the NW/4 of Section 20 has very little, if any, reserves to contribute to a well. The estimates of drainage area for the House #1-20 in the SW/4 of Section 20 range from 90 acres to 130 acres., thus it would be wasteful to drill a horizontal well to recover 30 to 70 acres of drainage.

10) Finally, the units could be reshaped to include the S/2 of Section 20 and the N/2 of Section 29. This spacing would be essentially spacing the reservoir. It would prevent waste and would have a lesser impact on established correlative rights than the requested spacing.

11) After taking into consideration all the facts, circumstances, testimony and evidence presented in this cause, the ALJ recommends the application in CD 201104681 be denied.

POSITIONS OF THE PARTIES

CHESAPEAKE

1) **Richard K. Books**, attorney, appearing on behalf of Chesapeake, stated the ownership in the E/2 of both Sections 20 & 29 breaks down to Chesapeake - 472 acres; Crawley - 18 acres; and Kaiser-Francis - .1 acre; in the W/2 of both Sections 20 and 29, Chesapeake - 267 acres; Crawley - 10 acres; and Kaiser-Francis - 7.3 acres. There are also various ownerships within the existing vertical wells in these two proposed units.

2) Chesapeake notes the protestants acquired these wells already drilled 20 years ago. Chesapeake notes neither drilling monies nor well proposals for Skinner zone have been initiated by the protestants during that time. Chesapeake notes that Kaiser-Francis has made offers to Chesapeake and others to sell their interests in the House #1-29 well. No one has tried to develop the Skinner in these sections within the last 20 years.

3) Chesapeake admits if both the West and East irregular units were approved, the protestants' interests would be modified.

4) Chesapeake notes under regular spacing units there would be undrained areas due to the laterals being too short to justify the drilling of a

well. Chesapeake believes no wells should be drilled to either the E/2 of 29 or W/2 of 20 because there is a large area that is not underlain by a regular section.

5) Chesapeake notes the best place to drill is in the thick which involves less risk. Chesapeake notes all parties show the thick on their maps near the boundary line between these two sections. Chesapeake notes that based upon the FMI logs that the natural fractures run east-west direction. Due to that, Chesapeake believes there is poor communication beyond the ends of the laterals.

6) Chesapeake notes the requested irregular spacing units to develop the Skinner reserves would prevent waste.

7) Chesapeake notes both Crawley's Exhibit 6 and Chesapeake's Exhibit 4 show the thick near the boundary line between the two sections. Chesapeake's Exhibit 4 maps the channel facies that produces here whereas Crawley's Exhibit 6 maps both the channel and the Delta facies. Chesapeake notes Exhibit 6 makes the reserves look underlain by the channel facie when actually they are not underlain.

8) Chesapeake notes it was not proper to indicate the location of the target zone and the areas where the target zone is not underlain. Chesapeake believes wells drilled on irregular units will have the thick portion drained.

9) Chesapeake notes the engineering evidence closely followed that of the geologic evidence. Chesapeake notes that vertical Skinner wells are not economic wells here. Chesapeake noted if the regular unit was granted, there would be some areas included in the drilling and spacig unit which would not be underlain. Chesapeake notes drilling on regular spacing and stopping the lateral at the unit boundary would result in reserves being lost, i.e. approximately 2.2 BCF and 100,000 BO.

10) Chesapeake reiterated that no one would likely drill a well in the E/2 of 29 or the W/2 of 20 on regular spacing because the laterals would be too short. Chesapeake notes that beyond the end of the lateral there will not be significant drainage to warrant regular units be established.

11) Chesapeake points out that Chesapeake has experience in drilling horizontal wells in the immediate area compared to Crawley's experts with no experience.

12) Chesapeake notes that the Skinner formation/zone consists of two facies: a Delta facie and a channel facie. Chesapeake's witness testified the channel facie had low permeability, was laminated and also compartmentalized. Chesapeake notes that horizontal wells are more successful in areas of low porosity and low permeability.

13) Chesapeake feels it is important to map the channel facie due to it is the zone producing and the current target zone here. Chesapeake notes that horizontal wells would connect the laminations and compartments. Chesapeake notes without horizontal drilling, the hydrocarbons in these laminations and compartments would be lost. Chesapeake notes the Delta facie is not within the target zone here, hence, would be unaffected by the development had in the channel facie.

14) Chesapeake notes if a lateral was to be drilled across a unit there would be no method of allocating unit production, as currently had in the multi-unit cross unit lateral statute of 52 O.S. Section 87.9. Chesapeake notes the multi-unit, cross unit lateral statute does not apply here.

15) Chesapeake notes it will not accept the liability that comes when a lateral is drilled across multi-units unless there was a statute that allowed for cross unit well development.

16) Chesapeake will not drill multi-unit laterals in the absence of a statute allowing such. Chesapeake notes there are no lateral statutes that apply to this situation here. Chesapeake notes the ALJ did agree that the multi-unit lateral only applies to certain reservoirs, but not in the present case.

17) Chesapeake notes that a cross unit alternate is not an option for Chesapeake as the evidence clearly does not support a cross unit here. Further Chesapeake notes it would not be possible to get the necessary lateral length to drill horizontal wells in the existing units.

18) Chesapeake agrees with the ALJ's statement that Chesapeake's proposed spacing will aid in the prevention of waste yet will come at a cost as to correlative rights.

19) Chesapeake agrees with the ALJ's statement that since this is not a shale or unconventional reservoir that the new multi-unit horizontal well rules are not applicable here.

20) Chesapeake however believes the ALJ's statement of a possibility existing for a long lateral between the two existing units is error. Chesapeake notes this could have been done using existing Commission location exception rules. Chesapeake believes the ALJ is implying that there is no statute that applies herein to obtaining a location exception and to then drill a well across the two sections. Chesapeake believes past cases have allowed such relief yet Chesapeake asserts such cannot be done here.

21) Chesapeake doubts if the protestants will proceed with future development, based on their past 20 years actions.

22) Chesapeake notes the Oklahoma Legislature enacted the multi-unit horizontal well rules in order for operator to be allowed to drill wells without additional liability.

23) Chesapeake simply cannot drill these wells without a statute in place that limits their liability. Chesapeake reiterates that it could be possible to grant their relief by way of using the existing location exception rules. However, Chesapeake notes that in this case, getting 100% agreement of all the working interest owners would be impossible.

24) Chesapeake notes that hypothetically Chesapeake could drill a well in the existing unit. Chesapeake notes however in two areas some of the Skinner zone is not underlain. Chesapeake notes that waste would occur in both the W/2 of 20 and the E/2 of 29.

25) Chesapeake believes their irregular spacing request is proper for several reasons: a) Chesapeake would be allowed to use long laterals which would prevent economic waste and allow hydrocarbon recovery that would be further lost if regular drilling and spacing units were created; b) Chesapeake could drill a well in the thick and recover these hydrocarbons along the section boundary line that would otherwise be lost if regular drilling and spacing units were created; c) Chesapeake would be able to drill just two wells with one long lateral rather than drill 4 wells; and d) Chesapeake notes under regular spacing units there would be undrained areas due to the laterals being short to justify the drilling of a well and thus there would be stranded reserves. Thus, Chesapeake believes the irregular units should be granted.

26) Chesapeake notes of the two burdens, prevention of waste and protection of correlative rights, Chesapeake believes the ALJ chose the wrong burden to apply here. Chesapeake asserts that the Commission's paramount duty is to prevent waste. Chesapeake believes under the circumstances here, that the prevention of waste overrides the protection of correlative rights.

CRAWLEY

1) **Charles L. Helm**, attorney, appearing on behalf of Crawley, stated the 640 acre Skinner spacing for Sections 20 and 21 was established in the 1960s. Crawley notes the rights here have vested in the Skinner since that time, with several poolings had over the years.

2) Crawley notes the protest was lodged by the Section 29 owners to prevent the adverse effect on the correlative rights that most assuredly will occur if one allows this new spacing to be created on an irregular basis.

Crawley believes the evidence here shows without a doubt that existing Skinner horizontal wells can be drilled in the current spacing unit. Crawley notes this has occurred at the Commission on at least three occasions.

3) Crawley notes of the four wells in Section 20, three Skinner wells produce from deeper horizons and one well produces from the same zone which Chesapeake is attempting to respace here. Crawley notes the SW/4 House #1-20 well was recompleted from the deeper Morrow Springer into the Skinner.

4) Crawley notes the House #1-20 well owners have not consented to Chesapeake's present application here.

5) Crawley notes in Section 29 there are two drilled wells, one producing in the SW/4, the House #1-29 well from the Morrow Springer, also a candidate for the recompletion into the same Skinner zone that produces in the House #1-20 well. Crawley notes here the Skinner is behind pipe and the owners wish the opportunity/chance to recomplete that zone.

6) Crawley notes most of the wells shown on Exhibit 6 are drilled to about 13,000 feet, and target the Red Fork and Morrow Springer, which are the most prolific reservoirs in the area. Crawley notes there are 8 Skinner vertical wells and 2 Skinner horizontal wells.

7) Crawley notes the longest lateral to date to the Skinner was the Chesapeake well in Section 14 to 3,782 feet, drilled within the last year. Crawley notes that these 3 horizontal Skinner wells have all had drilling problems due to the complex Pennsylvania sand and lithology.

8) Crawley notes that Chesapeake discussed the different deltas, channels and laminations. Crawley notes the lateral lengths that have been completed now range from 2,651 to 3,782 feet.

9) Crawley notes the spacing in Sections 20 and 29 gives the owners here the right to drill the longest lateral ever drilled for the Skinner without having to change the spacing. Crawley finds there is evidence here that supports the ALJ's decision.

10) Crawley notes the evidence suggested the laterals could run from the south to the north line and get about a 5,000 foot lateral on the existing spacing. Crawley agrees with the ALJ's statement that one can drill a long lateral without changing the spacing. Crawley believes the evidence supports the fact one can drill in the existing drilling and spacing units here.

11) Crawley notes there are about 6.4 BCF in Section 20 with about 9.4 BCF in Section 29. Crawley noted the ALJ found that the existing 640 acre drilling and spacing unit have more than enough reserves to allow for horizontal development without modifying to an irregular unit.

12) Crawley noted the existing units have more gas than any horizontal well could ever recover. Crawley notes one cannot drill enough laterals to produce all this underlying gas in these two units. Crawley further notes one cannot drill one well on a new irregular unit and produce all the reserves.

13) Crawley notes the granting of the Chesapeake application would merely rearrange the current ownership, without recovering anymore gas that's already in place. Crawley notes that the Section 20 owners would be taking all the reserves from Section 29 by the creation of irregular units.

14) Crawley notes there is significantly greater volume of reserves in Section 29 under any party's interpretation than in Section 20. Crawley disagrees with Chesapeake's witness that a super lateral could produce 8.2 BCF. Crawley thinks that 4 BCF is more feasible. Crawley notes if Chesapeake's goal is to drill one well for 4 BCF, then that will leave 4.2 BCF lost, which is waste.

15) Crawley notes Chesapeake's claims there would be waste unless one drills right across the unit boundary. Crawley notes the reserves will be in place, regardless of whether the spacing is changed or not or whether one drills a super lateral.

16) Crawley notes to get 8.2 BCF the W/2 of 29 would contribute 6.1 BCF and the W/2 of 20 2.1 BCF. Crawley further notes while the owners in the W/2 of 29 would contribute 74% of its reserves, the owners would only get 50% of the revenue. Crawley notes the owners in the W/2 of 20 would contribute 26% of the reserves and receive 50% of the income. Crawley notes this fact difference alone is sufficient reason to deny Chesapeake's application as it is an obvious abuse of the Section 29 owners' correlative rights.

17) Crawley notes there is no Skinner under Chesapeake's mapping that would contribute to a horizontal well. Crawley notes the NW/4 of 20 owners would not be contributing anything yet receive half the revenue.

18) Crawley notes the House #1-20 well is producing from the same Skinner zone that Chesapeake is wanting to space. Crawley notes if this irregular spacing is granted, the Section 20 owners will still produce their Skinner well. Crawley notes with an irregular unit in place some owners will contribute 6.1 BCF and others 2.1 BCF. Crawley does not believe this to be fair.

19) Crawley notes it is wholly unreasonable to allow a re-allocation of existing reserves under the theory of "we need to do it so we can drill across these unit boundaries". Crawley urges that this was the pitch that was presented to the ALJ.

20) Crawley notes that the interest owners on the House #1-20 well completed this well in the Skinner zone. Crawley notes the owners in the House #1-29 well wish to recomplete their well in the Skinner zone. Crawley believes though that if the Commission grants Chesapeake's irregular spacing request here, the Section 29 owners will not be allowed to recomplete that well in the Skinner because horizontal spacing precludes vertical development.

21) Crawley believes Chesapeake's application here was nothing more than a re-allocation of the existing reserves to new owners. Crawley notes in Section 29 Chesapeake owns 244 acres and owns 506 acres in Section 20. Crawley notes the Section 20 owners stand to gain a lot of value at the expense of Section 29 owners' correlative rights if Chesapeake's request for irregular spacing is granted.

22) Crawley notes the ALJ found the Chesapeake request was a violation of correlative rights. Crawley notes further that it is a tremendous abuse to the correlative rights of the Section 29 owners when these owners must contribute all their reserves yet are not allowed to share in the existing well production nor to recomplete their own well in the Skinner zone.

23) Crawley references testimony on pages 8 and 9 of the ALJ report per Exhibit 4. Crawley notes if Chesapeake's Exhibit 4 was correct, even Chesapeake's own evidence would not support Chesapeake's proposed spacing request. Crawley notes also since the NW/4 of Section 20 has no Skinner reserves, there was no reason to create an irregular drilling and spacing unit here. Crawley submits one cannot create a new unit around an area where one has no reserves, and then turn around and give the same parties ownership rights in the new unit, whether they will contribute or not to the new unit's reserves. Crawley submits that Chesapeake did not meet their burden of proof under the Exhibit 4 map.

24) Crawley believes any owner in Section 20 or 29 can drill a long horizontal Skinner lateral and use the current established spacing in place. Crawley disagrees with Chesapeake that a spacing change is necessary here to continue development. Crawley notes there is neither a need to disrupt the established correlative rights in this area nor a need to re-allocate any owner's reserves here in the Skinner.

25) Crawley notes that the three wells here are dilled on conventional vertical spacing. Crawley notes that horizontal drilling is not new to Chesapeake. Crawley notes that Chesapeake created a 640 acre conventional spacing which resulted in the Section 14 Savannah #1-14 horizontal well.

26) Crawley believes Chesapeake's statement that if you don't grant our proposed irregular spacing request Chesapeake won't develop the area is hogwash. Crawley notes not all approved applications to drill get a well drilled

on them. Crawley does not care if Chesapeake's witnesses may have been involved in 50 well applications. Chesapeake notes the Chesapeake expert had only been involved in one Skinner well in Section 14 where conventional 640 acre spacing was deemed proper by the Commission. Crawley notes a review of the ALJ's Report will show that information in his findings and recommendations.

27) Crawley notes the ALJ is the trier of fact. It is the ALJ's duty as the trier of fact to observe the demeanor of the witnesses, assess their credibility and assign the appropriate weight to their opinions. *Grison Oil Corporation v. Corporation Commission*, 99 P.2d 134 (Okl. 1940); *Palmer Oil Corp. v. Phillips Petroleum Co.*, 231 P.2d 997 (Okl. 1951); and *Haymaker v. Oklahoma Corporation Commission*, 731 P.2d 1008 (Okl. App. 1986). Crawley notes the ALJ wrote a well reasoned report in his denial of Chesapeake's application.

28) Crawley believes the ALJ made two important findings herein: a) that horizontal development can occur on the existing 640 acre Skinner spacing without modifying the unit to an irregular drilling and spacing unit; and b) that the proposed irregular spacing would significantly alter the owner's correlative rights in both sections.

29) Crawley believes the ALJ's decision was supported by the testimony, by the evidence and was consistent with Oklahoma law. Crawley respectfully requests the Referee to uphold the ALJ's denial of Chesapeake's request for creation of irregular 640 acre drilling and spacing units for the Skinner.

KAISER-FRANCIS

1) **J. Fred Gist**, attorney, appearing on behalf of Kaiser-Francis, adopts/supports the arguments presented by Crawley.

2) Kaiser-Francis disagrees with Chesapeake's belief that there had not been any Skinner development here. Kaiser-Francis notes the House #1-20 well was recompleted in the Skinner in November of 2010. Kaiser-Francis thinks it is important the Court knows there is an existing Skinner well in Section 20.

3) Kaiser-Francis notes Chesapeake is wishing to drill laterals around the House #1-29 well not yet completed in the Skinner zone. Kaiser-Francis believes the proposed wells by Chesapeake would drain reserves capable of being recovered by the existing unit wells. Kaiser-Francis believes the House #1-29 well could be completed in the Skinner to recover those reserves.

4) Kaiser-Francis notes this application seeks to merge two different sections and all the various owners and thus germandering these two units into irregular spacing units. Kaiser-Francis agrees this is a land grab by Chesapeake. Kaiser-Francis agrees with Crawley that the Chesapeake spacing application clearly disrupts the existing equities and require the interest owners in the House #1-20 well to share on a 640 acre basis with their neighbors in Section 20.

5) Kaiser-Francis believes there is not enough data to support Chesapeake's extraordinary relief request. Kaiser-Francis finds no evidence that a 10,000 foot lateral in the Skinner is even feasible, much less desirable. Kaiser-Francis thinks if the Chesapeake's horizontal application is granted, the House #1-29 owners will not be allowed to recover these reserves. Kaiser-Francis also firmly thinks Chesapeake wishes to experiment with unproven techniques at others expense.

6) Kaiser-Francis states there was discussion that horizontal spacing may exist with current wells. Kaiser-Francis notes OCC-OAC 165:5-7-6H requires written consent of at least 50% of the owners and provides for a waiver request of the consent requirement upon showing of good cause to do so. Kaiser-Francis notes OCC-OAC 165:5-7-6H is very specific that no order of the Commission authorizing a horizontal well, which overlies an existing well, will become effective until at least 50% of the ownership having the right to drill have consented in writing. Kaiser-Francis notes the horizontal rule OCC-OAC 165:5-7-6(h) states that if there is any existing production from a zone then there is a requirement of 50% written consent of owners to form a new horizontal unit.

7) Kaiser-Francis notes there was no written consent of any of the Section 20 well owners. Kaiser-Francis notes the rule clearly states one cannot have an effective order without that 50% written consent or without the order granting a waiver. Kaiser-Francis would consider Chesapeake's application here to be putting the cart squarely before the horse.

8) Kaiser-Francis believes the Chesapeake irregular spacing application should be denied.

RESPONSE OF CHESAPEAKE

1) Chesapeake agrees there were two wells drilled here on regular spacing units. Chesapeake notes the first well drilled here was the McClain #1-15 well and the second well was the Savannah #1-14H well.

2) Chesapeake notes the channel facie corresponds with the lateral of the well and would allow the recovery of zones on a regular unit. Chesapeake notes this situation does not arise in Sections 20 and 29 as the thick of the channel facie goes across the section boundary. Chesapeake's witness pointed out the same facts. Chesapeake notes the Savannah spacing unit had geological conditions that justified a regular unit.

3) Chesapeake asserts that here the circumstances justify an irregular spacing unit. Chesapeake notes that the other parties here did not address the issue of waste. Chesapeake notes there will be no wells drilled in either the W/2 of 20 or the E/2 of 29 unless Chesapeake's request for irregular spacing is granted. Chesapeake finds the primary issue here to be waste.

4) Chesapeake notes Crawley claims to have vested rights which should not be subject to change. Chesapeake wonders if this claim of Crawley's is true and if true, why did the Commission change the rules for horizontal wells.

5) Chesapeake notes the Commission rules specifically allow where it is appropriate for horizontal units to be of different sizes and configuration than for vertical wells. Chesapeake notes the Commission rules provide the party must get consent or such can be waived. Chesapeake asserts the real question here is whether it is appropriate to do that here on the basis of correlative rights only.

6) Chesapeake disagrees with the protestants that this is a land grab for 28 acres which was acquired over 20 years ago by the protestants. Chesapeake has 732 acres in the two sections to the protestants 28 acres. Chesapeake notes that Kaiser-Francis has 7.4 acres or approximately 1/100th of Chesapeake's interest which Kaiser-Francis had offered to sell to Chesapeake.

7) Chesapeake considers the idea of its application being a land grab to be a bit disingenuous. Chesapeake notes that the 28 acres from Crawley and the 7.4 acres of Kaiser-Francis are parties who have no plans for doing any drilling here.

8) Chesapeake agrees with Crawley that if new units are created here, there will be some areas of land included which are not underlain by the formations. Chesapeake notes also these areas mentioned by Crawley are already included in the existing regular unit. Chesapeake notes a spacing change will not change any maps.

9) Chesapeake notes Crawley states if Chesapeake's application here is denied, Chesapeake will not drill any wells here. Chesapeake agrees that until the existing unit is modified, that Chesapeake will be unable to drill any horizontal wells. Chesapeake reiterates the protestants have no intention of drilling here.

10) Chesapeake does agree with Crawley that there have been recent cases over spacing disputes where verbal consent had yet to be complied with prior to filing a horizontal spacing application.

11) Chesapeake's position is that the correlative rights will be disturbed for the 35.4 acres controlled by the protestants however waste can be prevented by the granting of this irregular spacing request.

12) Chesapeake believes that the two alternative scenarios raised by the ALJ will not occur, based upon the evidence. Chesapeake respectfully requests the ALJ be reversed and that Chesapeake's application for irregular spaced units be granted.

CONCLUSIONS

The Referee finds the Report of the Administrative Law Judge recommending the denial of Chesapeake's application to establish irregular 640 acre horizontal drilling and spacing units should be reversed.

1) The Referee finds the ALJ's recommendation to deny Chesapeake's spacing application to establish irregular 640 acre horizontal drilling and spacing units in the E/2 of Section 20 and the E/2 of Section 29, the W/2 of Section 20 and the W/2 of Section 29, T11N, R10W, Canadian County, Oklahoma, for the Skinner gas common source of supply is contrary to the weight of the evidence, contrary to law and constitutes reversible error.

2) The Commission derives its jurisdiction under the state's conservation laws primarily from the spacing statute, 52 O.S. Section 87.1, which provides in relevant part:

> (a) To prevent or to assist in preventing the various types of waste of oil or gas prohibited by statute, or any of said wastes, or to protect or assist in protecting the correlative rights of interested parties, the Corporation Commission, upon a proper application and notice given as hereinafter provided, and after a hearing as provided in said notice, shall have the power to establish well spacing and drilling units of specified and approximately uniform size and shape covering any common source of supply, or prospective common source of supply, of oil or gas within the State of Oklahoma;...

3) 52 O.S. Section 86.1(3) defines the term "common source of supply" as it pertains to the spacing statute and provides:

> 3. "Common source of supply" comprises and includes that area which is underlaid or which, from geological or other scientific data, or from drilling operations, or other evidence, appears to be underlaid, by a common accumulation of oil and gas or both...

4) It is clear under conservation laws that Chesapeake, as an owner with 732 acres in the two sections, has the right to apply for spacing of either the actual or prospective Skinner common source of supply so that development of this common source of supply can be pursued, waste prevented, and correlative rights protected. *May Petroleum, Inc. v. Corporation Commission of State of Oklahoma*, 663 P.2d 716 (Okl. 1982); 52 O.S. Section 87.1; and *Cameron v. Corporation Commission*, 418 P.2d 932 (Okl. 1966).

5) The ownership in the E/2 of both Sections 20 and 29 is Chesapeake – 472 acres; Crawley – 18 acres; and Kaiser-Francis - .1 acre. In the W/2 of both Sections 20 and 29 Chesapeake owns 267 acres; Crawley – 10 acres; and Kaiser-Francis – 7.3 acres. There are also various ownerships within the existing vertical wells in these two proposed units. The protestants acquired the House #1-29 well which is a prospective Skinner producing well and the Merit House #1-20 well which has been recompleted to the Upper and Lower Skinner. These wells were already drilled 20 years. The testimony reflected that it would take 45 years to get the reserves from the Merit House #1-20. The Merit House #1-20 is estimated to recover 865,278 MCF and 19,833 BO.

6) The evidence of both Chesapeake and the protestants demonstrated that the thickest portion of the Skinner underlies the S/2 of Section 20 and the N/2 of Section 29. The current spacing will result in waste of the best portion of the reservoir even if location exceptions were allowed in Sections 20 and 29 as there would be no significant recovery from the thickest portion of the reservoir within Sections 20 and 29 because as pointed out by the ALJ there is no significant recovery beyond the end of a well's lateral. Under the current spacing, waste will occur near the boundary between Sections 20 and 29 where no lateral will be located, even under a location exception order. The proposed irregular spacing will prevent waste by allowing a lateral to be drilled, completed and produced from the area closest to the boundary between Sections 20 and 29 where all the parties admit that the best portion of the reservoir is located. Chesapeake estimated that stopping the lateral at the unit boundary would result in reserves being lost of approximately 2.2 BCF and 100,000 BO.

7) The evidence also reflected that no one would likely drill a well in the E/2 of Section 29 or the W/2 of Section 20 on regular spacing because the laterals would be too short and beyond the end of the lateral there will not be sufficient drainage to warrant regular units be established.

8) Chesapeake presented evidence that their irregular spacing request was proper because: a) Chesapeake would be allowed to use long laterals which would prevent economic waste and allow hydrocarbon recovery that would be further lost if regular drilling and spacing units were created; b) Chesapeake could drill a well in the thick and recover these hydrocarbons along the section boundary line that would otherwise be lost if regular drilling and spacing units were created; c) Chesapeake would be able to drill just two wells with one long lateral rather than drill four wells; and d) Chesapeake notes under regular spacing units there would be unclaimed areas due to the laterals being short to justify the drilling of a well and thus there would be stranded reserves.

9) The protestants raised an issue stating that vested rights should not be subject to change and the protection of correlative rights is an important issue. Protestants assert that this is a taking of land which was acquired over 20 years ago by the protestants. However, Chesapeake has 732 acres in the two sections to the protestants 28 acres with Kaiser-Francis having 7.4 acres which Kaiser-Francis apparently attempted to sell to Chesapeake. Chesapeake notes that the 28 acres from Crawley and the 7.4 acres from Kaiser-Francis are parties who have no plans for doing any drilling on these two sections.

10) As was pointed out by the ALJ the Commission's first duty is to prevent waste. In the opinion of the Referee the ALJ committed error however in concluding that the correlative rights of the protestants who have not drilled a well to the Skinner in more than 20 years should outweigh the Commission's duty to prevent waste. Granting the application will prevent economic waste by allowing for the longest possible lateral for the least amount of cost of drilling to the reservoir. The old vertical wells will take a very long time to reach the end of their productive life and the correlative rights of owners like Chesapeake who wish to further develop the Skinner and who are willing to spend millions of dollars to efficiently develop the formation and prevent waste would be prevented from proceeding in this area.

11) The Supreme Court in *Denver Producing and Refining Company v. State*, 184 P.2d 961 (Okl. 1947) found:

> 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.

In the present case the Commission is presented with a choice between which remedy should be granted, the three "scenarios" suggested by the ALJ in his Report, or the proposed Chesapeake irregular 640 acre horizontal drilling and spacing units. The Commission must choose the relief that will best prevent waste and protect correlative rights. As stated in *Winter v. Corporation Com'n of State of Oklahoma*, 660 P.2d 145 (Okl. 1983):

> ...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.

12) The ALJ in his Report suggested that waste would be prevented with less harm to correlative rights through three scenarios set forth in his Report. Chesapeake addresses these three scenarios suggested by the ALJ in their exceptions to the Report of the ALJ filed on August 2, 2012. Chesapeake states:

> a) First, the ALJ suggests, "The possibility exists for a long lateral across the two existing units." The only evidence in the record shows clearly that neither Crawley nor Chesapeake intends to take the risk of a cross-unit lateral here, where the assistance of a cross-unit statute (similar to the Shale reservoir statute) is not available. The evidence clearly shows that, in the absence of such a statute, litigation risks are too high. Moreover, there is no reasonable belief that parties would agree to amendment of the pertinent poolings. There is absolutely no evidence that any cross-unit wells would be drilled by any party. Indeed, the un-controverted evidence is that, without a cross-unit statute, no such well will be drilled. Because no well will be drilled, there will be waste.
>
> b) The ALJ next suggests, "Another possible scenario is for the parties to drill horizontal wells in the existing units." Not only is there no evidence that any party is willing to undertake this scenario, the Administrative law Judge suggests no way in which this scenario would prevent the waste of hydrocarbons in the best portion of the reservoir near the boundary between Sections 20 and 29.

c) The ALJ next suggests, "Finally, the units could be reshaped to include the S/2 of Section 20 and the N/2 of Section 29." There is no indication in the Report (probably because there is no logical explanation) (1) why this scenario would disturb correlative rights less than the instant Application, (2) how this scenario would prevent the waste of hydrocarbons in the N/2 of Section 20 and the S/2 of Section 29 which, under this scenario, would be "orphaned," or (3) why this scenario, not requested by any party to the proceedings, would in any way prevent waste or protect correlative rights.

13) The Referee agrees with Chesapeake that the three scenarios presented by the ALJ do not prevent waste and there was no evidence presented by any party that they were willing to a drill a well under any of these scenarios.

14) For the above stated reasons, the Referee finds that there is substantial evidence showing that the prevention of waste will be better accomplished by the granting of Chesapeake's application to establish irregular 640 acre horizontal drilling and spacing units in the E/2 of Section 20 and the E/2 of 29, the W/2 of Section 20 and the W/2 of Section 29, T11N, R10W, Canadian County, Oklahoma. Thus, the Referee finds the Report of the ALJ should be reversed.

RESPECTFULLY SUBMITTED THIS 14th day of January, 2013.

Patricia D. MacGuigan

Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
Jim Hamilton
ALJ Michael Porter
Richard Books
Charles Helm
J. Fred Gist
John Moricoli, Jr.

James White
Christina Foster
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks – 1
Commission Files