

BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA

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CORPORATION COMMISSION
OKLAHOMA

APPLICANT: TRIAD ENERGY, INC.)
)
RELIEF SOUGHT: POOLING) CAUSE CD NO.
) 201200215
)
LEGAL DESCRIPTION: N/2 NW/4 SECTION 4, T4N,)
) R2W, GARVIN 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 7th and 8th day of March, 2013, 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: **Russell Walker**, attorney, appeared on behalf of applicant, Triad Energy, Inc. ("Triad"); **Charles Helm**, attorney, appeared on behalf of Stesco Operating Co. ("Stesco"); and **Jim Hamilton**, Assistant General Counsel for the Conservation Division, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 20th day of May, 2013, 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 28th day of June, 2013. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

TRIAD TAKES EXCEPTION to the ALJ's recommendation that unrecovered well costs not be charged to new participants in the recompletion of the Patricia #2 well. The ALJ recommended granting Triad's application to pool an 80 acre

lay down spacing unit in the N/2 NW/4 of Section 4, T4N, R2W, Garvin County, Oklahoma for the Hoxbar, First Deese (Abernathy), Second Deese (Pharaoh), Third Deese (Gibson), Fourth Deese (Hart), and Viola.

The Patricia #2 well was drilled in this unit, but it was unproductive. Triad seeks to re-enter the well to test other formations. Triad was unable to reach an agreement with respondents shown on Exhibit A of its application and filed this pooling.

TRIAD TAKES THE POSITION:

- 1) The Report of the ALJ is contrary to law and contrary to the evidence.
- 2) The Report recommendations, if adopted, will result in injustice.
- 3) The ALJ's recommendation that unrecovered well costs not be charged to new participants is contrary to law and should be ignored by the Commission.

THE ALJ FOUND:

1) **Fair Market Value.** The evidence reveals four companies have been leasing in the area and nearby counties: GLB, SoDak, South Creek, and Newfield. There have been paid leases ranging from \$150 an acre to \$50 an acre with a 3/16th royalty, to \$100 and a 1/8th royalty, to \$75 an acre with a 1/6th royalty. None of this leasing activity has included a 21% royalty, except for the leases taken by Stesco. Stesco did send out proposals to pool some 80-acre units, proposing the 21% royalty. However, their applications for poolings were dismissed. The only parties to take leases with Stesco were the Boyer interests, the Justice interests, Essendee, LLC, and the JBN Trust. Stesco maintains these leases were the result of arms-length transactions concluded prior to the filing of the application by Triad. The undisputed evidence showed the entities were controlled by the mother, son and daughter of the owner of Stesco. One of the entities controlled by the son and daughter shared a common Post Office Box with Stesco. The Boyer and Justice interests are independent of the two entities, but the testimony was they went along with what the other entities would do. The Boyers and the Justices each wanted special provisions in their leases, including Pugh clauses, crop-related matters, and gravel sizes. The ALJ does not consider the transactions between Essendee, LLC, the JBN Trust, the Boyers, and the Justices to be arms-length transactions.

2) After taking into consideration all the facts, circumstances, testimony, and evidence presented in this cause, the ALJ recommends the application in

CD 201200215 be granted with fair market value established as \$150 an acre with a 1/8th royalty, or \$100 an acre with a 3/16th royalty.

3) **Well Costs.** Exhibit 1, the AFE, indicates it will cost \$547,000 to re-complete the Patricia #2 well in the Viola. Joe Stewart, a witness for Stesco, was cross examined regarding the costs shown on Exhibit 1. His testimony was that the costs seemed excessive, but not unreasonable. The issue was not further pursued by any of the parties.

4) As to the request by Triad to include the un-recouped costs for the drilling of the Patricia #2 well, this is an unreasonable request. Uncontroverted testimony was that to drill and complete a well to the Bromide, which is deeper than the proposed Viola re-completion, would cost between \$890,000 to \$925,000 for a new well. Triad is asking for the parties to share a cost of over \$1 million to re-complete a well in an up-hole zone. The evidence indicated there is some value to the well bore and there is some value to the logs from the well. The ALJ is not convinced the value of the well bore is the un-recouped money paid by the parties that drilled the Patricia #2. Those parties drilled their well and took their chances. It did not work out for them. To ask other parties to help them recoup their losses would be wasteful to the parties that would be pooled under this application. In addition, to utilize an existing well bore that would cost more than a new well is creating a waste of financial assets and is illogical.

5) After taking into consideration all the facts, circumstances, testimony, and evidence presented in this cause, the ALJ recommends the application in CD 201200215 be granted with the estimated costs for the re-completion of the Patricia #2 well set as \$547,000.

POSITIONS OF THE PARTIES

TRIAD

1) **Russell Walker** and **Stephen Clarke**, attorneys, appeared on behalf of Triad to request that certain portions of the Report of the ALJ be reversed and the un-recouped costs for the drilling of the Patricia #2 well be included.

2) This looks like a typical pooling. There are two, lay-down, 80 acre, drilling and spacing units for a number of different formations. Triad drilled two wells, one on each one of those 80 acre tracts. The Patricia #1 is the unit

well for the S/2 of NW/4, the Patricia #2 well is the unit well for the N/2 of NW/4. Both of these wells were drilled to and completed in the Bromide.

3) The Patricia #2 well never recovered the total cost of drilling to the Bromide. The well was temporarily abandoned while they negotiated to convert to a unitization. When those negotiations failed Triad proposed to move up hole from the Bromide to complete the Patricia #2 well in the Viola.

4) Mr. Don Boyer, his family, and some of his derivatives leased some of his interests to some companies that are affiliated with Joe Stewart of Stesco. Those leases both had a depth clause and a Pugh clause. Starting in 2008, the lease expired for the depth clause and in 2009 for the Pugh clause. Triad filed a forced pooling to re-enter the Patricia #2 well and complete it in the Viola. Thereafter, Stesco took leases from every one of the persons named as a respondent in the pooling case except Robert Cantrell, who leased to Triad, and then Stesco filed three applications.

5) Stesco filed an application to reorient the drilling and spacing units from lay downs to stand-ups, and then two pooling applications for the two 80 acre tracts. Eventually Stesco dismissed all those matters and Triad proceeded with this pooling application.

6) Stesco's only concern at the pooling hearing was fair market value. In the ALJ's Report the fair market value issue is resolved against Stesco and they have taken no exception to that.

7) Another element of the matter that became an issue was that there was testimony that there was \$512,912 worth of unrecovered costs from the Patricia #2 well. Mr. Perry, the land man for Triad, testified to that number he had been given by the accounting department. The ALJ seemed to not believe the number, but it was given by the two men that own Triad, and they are very well-known in the oil business, and are known to be honest. They would not have sent a witness out to court with a number that is not correct. Triad just didn't know that they were going to have to prove by accounting that there was \$512,912 in unrecovered cost in this well.

8) The ALJ erred when he said that "Triad cannot charge this \$512,000 as part of the well cost." If Triad can't charge that amount as part of the well cost, then they are giving Stesco 30% of the well bore. Triad believes they shouldn't be forced to do that. Triad should be entitled to recover the cost that they have in the well.

9) Triad believes the ALJ misinterpreted *Wood Oil Co. v. Corporation Commission*, 239 P.2d 1023 (Okl. 1950). In that case, the \$50,000 was not recoverable because it was not an actual expenditure by Wood Oil and was spent on drilling a well before the 40 acre spacing unit was established. Those facts were sufficient to preclude any right for Wood Oil to have the amount or

any part thereof included as a cost of the development and equipment for the recompletion of this well.

10) The *W. L. Kirkman, Inc. v. Oklahoma Corporation Commission*, 675 P.2d 283 (Okl.App. 1983) talks about the difference between actual cost and reasonable costs. You can charge the actual cost not to exceed the reasonable cost. Stesco never challenged the validity of the claim that \$512,912 was unrecovered. The ALJ seemed very concerned that Triad couldn't actually show where that number came from. Triad offered a late file exhibit that would show why that number would be accurate, but the ALJ didn't accept it.

11) Triad explains that the unrecovered cost was incurred by Triad in drilling this well bore after the drilling and spacing unit had been created. It's the exact opposite of the fact situation in the *Wood Oil case* and *Wilcox Oil Company v. Corporation Commission*, 393 P.2d 242 (Okl. 1964).

12) If somebody wants to participate in this well other than Triad, and Triad is not permitted to charge that unrecovered cost for the recompletion of the well in the Viola and to the participants in this pooling, then Triad will be forced to give to Stesco 30% of this well bore. Pooling cases are all about equity and that is not equitable. It is also directly in conflict with the conclusion one can draw from the *Wood Oil case* and *Wilcox Oil case*. Actual costs are allowed and should be allowed if reasonable.

CONCLUSIONS

The Referee finds the Report of the Administrative Law Judge should be affirmed in part and reversed in part.

I.

FAIR MARKET VALUE

1) Triad nor Stesco has appealed the recommendation of the ALJ that the present pooling application should be granted with fair market value established as \$150 per acre with 1/8th royalty or \$100 an acre with 3/16th royalty. Therefore, the Referee would affirm the ALJ's decision concerning fair market value and granting of the Triad pooling application.

II.

WELL COSTS

1) The Referee finds that the ALJ's recommendation that the costs concerning the unrecovered acquisition costs of the Patricia #2 well requested by Triad should be denied is contrary to the evidence and contrary to the law. Stesco protested this pooling application of Triad concerning the issue of fair market value. The ALJ's Report resolved the fair market value issue against Stesco and Stesco took no exception to the ALJ's fair market value conclusion. Stesco did not appear at the appellate argument concerning the well cost issue on June 28, 2013. Thus, Stesco has taken no position concerning the well cost issue before the appellate Referee at the present time.

2) The estimated costs of re-entry and recompletion of the Patricia #2 well in the Viola would be \$547,000 according to Exhibit 1, Triad's AFE. Triad testified that there would be an additional cost for the recompletion of the Patricia #2 well which is the unrecovered acquisition cost of the Patricia #2 which Triad intended to re-enter. The testimony was that Triad had not gotten their costs back on the prior drilled Patricia #2 well and those costs were left to be recovered and charged to this particular re-entry and recompletion operation. The Triad testimony was that the amount was approximately \$512,912. The original cost of the Patricia #2 well was paid out to a certain extent via/by production leaving a balance of \$512,912.

3) The Referee believes *Wood Oil Company v. Corporation Commission*, 239 P.2d 1023 (Okl. 1950) and *Wilcox Oil Company v. Corporation Commission*, 393 P.2d 242 (Okl. 1964) are inapplicable to the present case. The Supreme Court in *Wood Oil Company v. Corporation Commission*, supra at 1025 states:

In view of the express limitation in the law, the fact that the \$50,000 represents no actual expenditure by Wood Oil is sufficient to preclude any right in Wood Oil to have same or any part thereof included as cost of development and equipment.

4) However, the case of *W. L. Kirkman, Inc. v. Oklahoma Corporation Commission*, 676 P.2d 283 (Okl.App. 1983) is relevant to the present case. The Court stated:

The Commission's responsibility to determine proper costs is an extension of its power to pool the

interests of owners in a well spacing unit. Title 52 O.S. 1981 § 87.1 (e), provides in part:

All orders requiring such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil and gas. The portion of the production allocated to the owner of each tract or interests included in a well spacing unit formed by a pooling order shall, when produced, be considered as if produced by such owner from the separately owned tract or interest by a well drilled thereon. Such pooling order of the Commission shall make definite provisions for the payment of cost of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, including a reasonable charge for supervision. In the event of any dispute relative to such costs, the Commission shall determine the proper costs after due notice to interested parties and a hearing thereon.

The statute requires a determination on the Commission's part as to the proper costs whenever disputes occur. An evaluation of proper costs encompasses two determinations. First, the Commission must determine whether an actual expenditure was required to be made. Secondly, the Commission must examine that expenditure to determine whether it is in excess of what is reasonable. Thus, a proper cost is one that is both required and reasonable.

The statute clearly authorizes the Commission to retain jurisdiction to settle disputes concerning costs. Participants may challenge an expenditure as one which was either not required or if a required expense, one which may have been incurred at unreasonable cost. Certainly the Commission cannot contend that its power is limited to perfunctory approval of every invoice submitted by an operator.

Such a contention would render the statutory language totally meaningless.

* * *

The Commission cites three cases in support of its refusal to determine the reasonableness of Funk's expenditures. The Commission uses *Wood Oil Co. v. Corporation Commission*, 205 Okl. 537, 239 P.2d 1023 (1950), to support its statement that the \$850,832.09 expended by Funk was not questioned. However, in *Wood Oil*, the cost of developing the well was not challenged. The court stated, "The correctness of this amount as representing the actual outlay by Wood Oil is not questioned." Wood Oil had wanted the Commission to include a \$50,000 expenditure incurred by a third party who had been a previous lessee as part of the costs of completion. The Commission determined that the \$50,000 did not represent an actual expenditure by Wood Oil. It should be noted that there was no challenge to the reasonableness of Wood Oil's expenditures.

Likewise *Wood Oil Co. v. Corporation Commission*, 268 P.2d 878 (Okl. 1953), is also inapplicable. *Wood Oil II* deals with the finality of the Commission's orders and its authority to set out actual expenditures required for completion. In *Wood Oil II*, the Commission subtracted certain costs for completion to determine the amount one of the participants was required to pay. Both parties had presented conflicting evidence. The Commission based its findings on a determination of actual market values. In *Wood Oil II*, there is no doubt that the Commission determined the appropriate costs and apportioned these costs to the interest owners.

* * *

Finally, the Commission uses *Stipe v. Theus*, 603 P.2d 347 (Okl. 1979), as a statement to support its contention of limited power. In *Stipe*, the court answered the question concerning the power of the district courts to determine costs in the event of a dispute arising from forced pooling. *Stipe*, as an interest owner, had refused to pay certain expenses

incurred by Davis Oil, and was sued in district court. Subsequently, Stipe applied to the Commission for an order to determine proper costs. The supreme court determined that Stipe was entitled to a stay of the proceedings in district court until the Commission determined proper costs. The court noted that Stipe's rights as a pooled interest owner, included "the right for the Commission to determine the proper costs in the event of a dispute."

Where parties disagree as to required and reasonable costs the Commission must examine those costs in reaching its determination. Both operator and interest owner are entitled to a definitive statement concerning the necessity and reasonableness of costs incurred.

5) The drilling of the Patricia #2 well to the Bromide was an actual expenditure by Triad. Stesco took leases from every one of the persons named as a respondent in this pooling case except Robert Cantrell who leased to Triad. Stesco never challenged the validity of the claim that \$512,912 was unrecovered from the drilling of the initial Patricia #2 well by Triad. The unrecovered costs were incurred by Triad in drilling the Patricia #2 wellbore after the drilling and spacing unit had been created. Thus, the *Wood Oil Company v. Corporation Commission* case, supra, and the *Wilcox Oil Corporation v. Corporation Commission* case, supra, are inapplicable. The Referee finds that the Commission must determine the actual costs of the completion of the original Patricia #2 well and determine if those costs are reasonable.

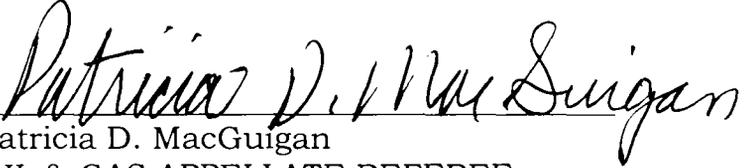
6) In the *Wood Oil Company v. Corporation Commission* case, supra, the Supreme Court states at 1025:

It is contemplated by the law that the owners of the working interest shall bear the cost of development and equipping a well in proportion to their respective interests in the production to be had therefrom. Hence, the proportionate share of Toklan and Catlett in the cost of completing and equipping the well must be determined in the relation that the acreage owned by them bears to the total acreage in the spacing unit, without deduction for any production prior to the date of the pooling.

7) Thus, the Referee pursuant to the case law cited above would reverse the recommendation of the ALJ to deny Triad's unrecovered costs of drilling the Patricia #2 well. The Referee would recommend that this cause must be

remanded for determination of actual and reasonable costs concerning the drilling, development and equipping of the completion of the Patricia #2 well.

RESPECTFULLY SUBMITTED THIS 3rd day of September, 2013.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Douglas
Commissioner Anthony
Commissioner Murphy
Jim Hamilton
ALJ Michael Porter
Russell Walker
Charles Helm *
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