

The ALJ filed her Report of the Administrative Law Judge on the 4th day of April, 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 31th day of May, 2013. After considering the arguments of counsel and the record contained within these Causes, the Referee finds as follows:

STATEMENT OF THE CASE

CITATION TAKES EXCEPTION to the ALJ's recommendation that the application of Range in CD 201207076 seeking authority for a density well in the W/2 of Section 30, T25N, R1E, Kay County, Oklahoma be granted and that the application in CD 201207077 of Range seeking authorization for a location exception in W/2 of Section 30, T25N, R1E, Kay County, Oklahoma, be granted for the Mississippian common source of supply and that the requested restriction on the completion of the proposed well's lateral be denied.

These are applications of Range seeking authorization for drilling a single horizontal increase density/location exception well to the Mississippian in the W/2 of Section 30 as an exception to Order Nos. 588579 and 592518. While Citation does not agree with the analysis Range presented to support their request, Citation has done their own review and consequently do not object to the density relief for one well. They also do not object to the location exception so long as certain restrictions are applied to completion areas along the lateral, which they believe will protect their well from harm. Range does not agree to the requested restrictions on certain areas of completion along their well's lateral.

CITATION TAKES THE POSITION:

1) The ALJ Report is contrary to both the law and the evidence, and also is arbitrary, unreasonable and discriminatory and fails to effect the ends of the prevention of waste and the protection of correlative rights as is required by the applicable rules of the State of Oklahoma.

2) Citation did not protest the issuance of an increased density order or a location exception order for the requested Range Balder #2 well as Citation's witness agreed that there are reserves in the W/2 of Section 30 that will not be recovered by the existing wells. The protest of Citation merely revolved around a requested reasonable limitation on the manner of completion of the Balder #2 well in the Mississippian. Citation merely asked that the orders for increased

density and location exception contain a limitation on the area which Range could perforate and fracture stimulate.

3) Citation requested a reasonable "window" or "box" which would help mitigate the loss of reserves to the Balder #2 well. Citation requested that Range not be allowed to complete the Balder #2 lateral over an area 660 feet in length, beginning 1,980 feet FNL and running south to the half-section line or 2,640 feet FSL. The lateral Range is requesting would run, according to the Application in CD 201207077, from 165 feet FNL to 660 feet FSL, or a total length of 4,455 feet. All Citation is requesting is that a mere 660 feet of that lateral not be perforated or stimulated and produced until its Caughlin B#3 well is plugged in the Mississippian. In this way the correlative rights of all owners in the W/2 of Section 30, including those of Citation, are protected.

4) The ALJ was correct in finding that "no well has dedicated reserves and that all wells in this unit should have the right to compete for any remaining reserves". But, the ALJ failed to take into account that the statutory scheme in place in Oklahoma to assure that each owner has a fair and equitable right to compete for its share of reserves is the spacing law and allowables as established by this Commission. The spacing statutes specifically provides, as do Commission rules, that the Commission may adjust the allowable production from any well not drilled at the permitted location or in compliance with the spacing in order to protect the correlative rights of owners in the common source of supply. All Citation is trying to do with the limitation on the completion of the Balder #2 well is to protect its correlative rights and ability to compete for any remaining reserves.

5) The ALJ failed to take into account, in deciding to rely on Range's volumetric calculations, that even the Range engineer reflected that the Citation Caughlin B#3 well would make an additional 30,000 BO (Exhibit 3), consistent with the calculations of Citation's witness (Exhibit 9). Therefore, any action by Range in completing its proposed Balder #2 well in a manner which will negatively impact the ability of Citation to effectively compete for hydrocarbons in the Mississippian reservoir, is subject to review by the Commission.

6) Wherefore, Citation respectfully requests that this Commission enter orders in each of the captioned causes authorizing the requested well but restricting the completion of same such that it cannot be perforated, stimulated or open to production in the Mississippian common source of supply over an area 660 feet in length, beginning 1,980 feet FNL and running south to the half-section line or 2,640 feet FSL, until such time as the Citation Caughlin B#3 well is plugged in the Mississippian common source of supply.

THE ALJ FOUND:

1) After taking into consideration all the facts, circumstances, evidence, and testimony presented in these causes, it is the recommendation of the ALJ that the application of Range requesting authorization for a single increase density well in CD 201207076 be granted with said well to be drilled at the requested location stated in CD 201207077 in an irregular unit comprised of the W/2 of Section 30, T25N, R1E, Kay County, Oklahoma, for the Mississippian common source of supply as an exception to Orders 588579 and 592518. The protestant, Citation, in these causes did not accept Range's calculation and study for the causes, but did not object to the density/ location exception well based on their own study. Citation's only issue is a belief that the proposed well will harm their Caughlin B#3 well to the east of the proposed well. They first argued based on their study that there would be about 30,000 BO remaining for their well, and they should be able to produce those reserves unimpeded and that the way to ensure that would be to impose a restriction on the completion along part of the proposed Range Balder #2 well's lateral. In response, Range noted this is a law of capture state, not a reserves in place state, and to so restrict the completion in their well would restrict their right to compete. At this point, Citation then argued that in order to fairly compete, the restriction should be applied, otherwise they would not get their fair share. Using Citation's logic, Range pointed out that they had produced a great deal of reserves outside their unit, and that if they are speaking of a fair share they have received more than that. Citation then argued that under the law of capture they could produce more reserves than underlie their lease. It is the opinion of the ALJ that under the law of capture that no well has dedicated reserves and that all the wells in this unit should have the right to compete for any remaining reserves.

2) Citation is concerned about their Caughlin B#3 well being watered out when the proposed well is completed, and they point to the history of the Caughlin B#3 production after the completion of the initial horizontal well here, the Balder #1. The Caughlin B#3 history has been erratic even before the stimulation of the Balder #1 well in 2012. Additionally, Range's rebuttal witness called into question the impact of that completion on the Caughlin B#3, noting there was no showing of an increased water production after the frac job. He also noted that the Caughlin B#3 well, when it came back on line, was at a better rate of production, and within three months made up all but 39 BO of the production they would have obtained if production had been at a continued, steady, non-declined rate over the period of time the Caughlin B#3 was down. It is the opinion of the ALJ that granting Range's applications as requested and without restriction of completion along the lateral would prevent waste and protect correlative rights. The new issue is the Citation engineer's use of a recovery factor based on his standard use of a recovery factor value equal to the formation's porosity value. He has used this in the past and has made his own study to determine if he would find this reasonable. Clearly from

his testimony ~~this is not~~ consistent with the Daubert standard. This engineer is a qualified ~~expert~~ at the Commission, and while there is no issue of his expertise in this area, it is the opinion of the ALJ that reliance in this cause must be placed on Range's calculations for recoverable oil in place since Citation's recovery factor for recoverable oil in place does not appear to meet the Daubert standard.

POSITIONS OF THE PARTIES

CITATION

1) **Roger A. Grove**, attorney, appearing on behalf of Citation, requested reasonable limitations on the orders. Citation asks that the order be reasonably limited by the manner of completion of the Balder #2 well in the Mississippi. They ask that the orders for the density and location exception include a limitation on the area in which Range could perforate and fracture stimulate its proposed Balder #2 well on its initial completion of the wellbore.

2) Citation's concerns about the impact of the proposed Balder #2 well on its Caughlin B#3 well occurred when the Range Balder #1 well was drilled and fracture treated. The distance between the two wells is about 1,320 feet. The Caughlin B#3 well was watered out two days after Range's Balder #1 well was fracture treated. Thus, the Balder #1 fracturing completion had a negative impact on the Caughlin B#3 well. The proposed Balder #2 well in this case would be twice as close to the Caughlin B#3 well as the Balder #1. Citation's concerns are that if the Balder #1 well watered out the Caughlin B#3 well and the Balder #2 well will be closer to the Caughlin B#3 well, all reserves might be lost upon completion. Citation believes that the ALJ failed to take into account that the Range engineer reflected that the Citation Caughlin B#3 well would make an additional 30,000 BO if it does not become watered out.

3) Exhibit 12 shows an area that Citation suggests Range be prohibited from perforating and fracture stimulating. The area is 660 feet in length and less than 15% of the total lateral length that Range has requested in its location exception application. Citation's request to prohibit this area is only for the duration that their well is producing. Citation's proposed limitation on the completion of the Balder #2 well is to protect their correlative rights and their ability to fairly compete for any remaining reserves.

4) The Commission should craft some methodology to protect the owners and the rights of the owners in the vertical wells and their opportunity to fairly compete for the hydrocarbons that they have helped discover with their well or wells. Citation believes their solution is the reasonable thing to do in this case because it allows Range to drill its horizontal well to recover additional

hydrocarbons in the W/2 of Section 30 while at the same time protect the correlative rights of Citation and its ability to fairly compete under the law of capture for those reserves which would otherwise be produced from Citation's Caughlin B#3 well.

5) Citation respectfully requests that this Commission issue orders in each of these causes authorizing the requested Range Balder #2 well, but restricting the completion of same, such that it could not be perforated, stimulated or open to production in the Mississippian common source of supply over an area 660 feet in length, beginning 1,980 feet FNL and running south to the half section line, or 2,640 feet FSL until such time as the Citation Caughlin B#3 well is plugged in the Mississippian common source of supply.

RANGE

1) **Richard K. Books**, attorney, appearing on behalf of Range, requests that the Report of the ALJ be upheld. Citation admits density and location exception are necessary, but they want the Commission to tell the operator how to operate a well, how to complete it, and where to complete it. This is something that the Commission has never done, and now is not a good time to start.

2) The statutory scheme in this case is that there is a 320-acre horizontal spacing and a unit pooling. The Caughlin B#3 well was never spaced. Range owns 86% of the working interest in the unit, and International owns the rest of the working interest in the unit. International supports the applications of Range. So, 100% of the working interest wants this to take place and supports the Range position. Citation did have some interest in the unit, but they elected out of it and Range paid for their part. In the unit pooling Citation gave up their rights throughout the entire unit except for the Caughlin B#3 wellbore.

3) In Section 31 to the south there is a vertical well and horizontal well within 150 feet of each other. The Commission issued an interim order allowing that horizontal well. That horizontal well ended up being 357 feet from the producing Cecil #1 vertical well upon completion and there was no evidence that the horizontal well affected the Cecil #1 well. If authorized, the horizontal well in this case would be almost twice that distance from the Caughlin B#3 well. Another example is the Oden well in Section 31. It is 200 feet from the horizontal well in that section and there is no evidence of an impact.

4) The Caughlin B#3 well that Citation wishes to protect has been producing off and on for 50 years. Its current rate is a little less than 5 BOPD, but there are years where it was producing zero barrels.

- 5) Citation mentioned that the Balder #1 well impacted their Caughlin B#3 well, but considering the Caughlin B#3 well has been offline many times, the Balder #1 may or may not have been the cause. There is no evidence that the Caughlin B#3 well has been damaged. The evidence was to the contrary and indicated that it is going to produce the same or perhaps more than before the Balder #1 was worked on.
- 6) Citation's argument is that the Caughlin B#3 well has 30,000 BO left if nothing happens to that well. Citation doesn't want to allow Range to compete for those reserves even though those very reserves are underlying the spacing unit and are the reserves involved in the unit pooling. Citation wants to limit what is in that box and not consider it a part of the unit. They want to not have to compete for those reserves. Thus, if Citation's solution is adopted then Range's correlative rights are not protected.
- 7) The statutory and regulatory scheme provide for a unit pooling and a horizontal drilling and spacing unit that does not affect Citation's Caughlin B#3 wellbore. Citation gave up their rights. Range is not affecting Citation's wellbore, but they do have the right to compete for reserves. The ALJ correctly noted that. Range respectfully requests that the Report of the ALJ be affirmed.

CAUGHLIN

- 1) **Richard A. Grimes**, attorney, appearing on behalf of Caughlin, requested that the Report of the ALJ be upheld.
- 2) Mr. Davis' discussion of his study of oil recovery factors fails all four elements of the Daubert standard based on his testimony. The ALJ came to this result and thus Davis' study must be ignored. This means that there is no expert testimony which can be relied on by Citation.
- 3) Caughlin Mineral Management and Caughlin Brothers are mineral owners in this case and they are worried that their right to compete will be taken away if Citation's solution is adopted.
- 4) Citation's framing of correlative rights and their definition of competition is very flawed when they want no competition within that area of that box.

RESPONSE OF CITATION

- 1) There are two reasons why Citation didn't appeal the ALJ's comments on the Citation engineer's failure to meet the Daubert standard. First, there

are no cases that have held the Daubert standard applies to a Corporation Commission matter. Second, this doesn't mean that all of what the Citation engineer said in his testimony is irrelevant, just his use of the recovery factor being equal to porosity which affects the volumetric amount of oil originally in place.

2) Citation did not give up their rights in their vertical well when they elected not to participate in the development of the horizontal unit.

3) All Citation is asking is in some way to protect their wellbore so that it doesn't get flooded out the first time this Balder #2 well is completed and maybe never comes back on. If Citation's well was allowed to compete within the law of capture and let the oil that would flow to it, flow to it, it would have made about 30,000 more BO, if it isn't damaged. That is \$2.5 million worth of value to Citation.

4) Citation has a right to have that value protected, and they believe their proposed accommodation is reasonable.

CONCLUSIONS

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

1) Citation does not protest the issuance of an increased density order or a location exception order for the requested Range Balder #2 well as Citation agrees that there are reserves in the W/2 of Section 30 that will not be recovered by the existing wells. Citation is requesting a limitation on the area which Range could perforate and fracture stimulate in the Balder #2 well in the Mississippian. Citation requested that Range not be allowed to complete the Balder #2 lateral over an area 660 feet in length, beginning 1980 feet FNL and running south to the half section line or 2640 feet FSL.

2) *Kingwood Oil Co. v. Hall-Jones Oil Corp.*, 396 P.2d 510 (Okl. 1964) states:

...The term "correlative rights" embraces the relative rights of owners in a common source of supply to take oil or gas by legal operations limited by duties to the other owners (1) not to injure the common source of supply and (2) not to take an undue proportion of the oil and gas.

That concept is embodied in Professor Kuntz's Treatise, Kuntz, Oil and Gas, Section 4.7, page 102 (1962) as follows:

The right to a fair opportunity to extract oil or gas from a common source of supply has been clearly

recognized as a correlative right which must be protected when conservation regulations are imposed which limit the operation of the Law of Capture. **When the right to produce oil and gas is denied or curtailed by conservation regulation, measures must be taken to assure owners equal opportunity to enjoy their fair share of production, and a denial of such equal opportunity would amount to confiscation.** (Emphasis added)

The Court, in *United Petroleum Exploration v. Premier Resources*, 511 F. Supp. 127 (1980), discusses Kuntz's concept and states:

However, the denial of the correlative right to extract oil or gas, which is referred to by Professor Kuntz, does not mean that the operator of an oil and gas well violates the correlative rights of other interest owners when it obtains a disproportionate share of the production. What Professor Kuntz has stated is that a governmental entity, such as a state, cannot restrict the right of a mineral interest owner from obtaining its **fair share** of the actual production from a pooled well when the amount of oil or gas permitted to be reduced to possession through that well is restricted for conservation purposes. (Emphasis added)

Certainly, the above concept must be examined in relation to Kuntz's finding in his Treatise, *Oil and Gas*, at Section 4.7:

At an early date, it was observed that proprietors have "coequal" or correlative rights to extract oil and gas from a common source of supply and that such right may be protected by legislation designed to secure a "just distribution" of the oil or gas and to prevent one proprietor from taking an "undue proportion". **Whatever was meant by such early observation, it is now clear that what is sometimes referred to as the correlative right to a fair share of oil or gas from a common source of supply does not mean that each owner is entitled to a proportionate share of the substances, but it means that owners have a right to a fair opportunity to extract oil or gas.** (Emphasis added)

3) There is a 220 acre horizontal spacing and a unit pooling covering the W/2 of Section 30. Citation's Caughlin B#3 well was never spaced. Range owns 86% of the working interest in the 320 acre horizontal spacing unit and,

International owns the rest of the working interest in the unit. International supports the applications of Range. Therefore 100% of the working interest agrees with the applications of Range. Citation did have some interest in the 320 acre unit but they elected out of it under the pooling. Range paid for their part and took the risk. Once the property rights of nonparticipants are transferred by operation of law under the pooling order, those rights are vested rights which cannot be extinguished in violation of substantive due process. *Amoco Production Company v. Corporation Commission*, 751 P.2d 203 (Okla.Ct.App. 1986)(adopted by the Supreme Court February 9, 1988); *Ranola Oil Company v. Corporation Commission*, 752 P.2d 1116 (Okla. 1988); and *Inexco Oil Company v. Corporation Commission*, 767 P.2d 404 (Okla. 1988).

4) Citation has argued that the Caughlin B#3 well would potentially be able to produce about 30,000 BO and that Citation should be able to produce those reserves unimpeded by imposing a restriction on the completion. The evidence also reflected that the Caughlin B#3 well has produced over 50 years and has produced a great deal of reserves outside their unit. The Caughlin B#3 well is now producing a little less than 5 BOPD.

5) There was also argument by Citation that the Balder #2 well would most likely water out the Caughlin B#3 well when the Balder #2 well is fracture treated. The Caughlin B#3 well has been off line many times. The Caughlin B#3 well when it came back on online after the stimulation of the Balder #1 well in 2012 made up all but 39 BO production that they would have obtained if the production had been continued.

6) The Referee believes that under the law as reflected above no well has dedicated reserves and all wells in this unit should have the right to compete for any remaining reserves.

7) The Referee further agrees with the argument presented by Caughlin that Citation's expert witness testimony did not meet the Daubert test. Citation's expert witness stated that recovery factor equals porosity in oil reservoirs. Caughlin's lawyer asked Citation's engineering witness whether there was a scientific basis for his assumption. Citation's witness responded that he knew of no papers published concerning his assumption and had never seen a published paper addressing oil recovery factors. The Supreme Court in *Christian v. Gray*, 65 P.3d 591 (Okla. 2003) stated:

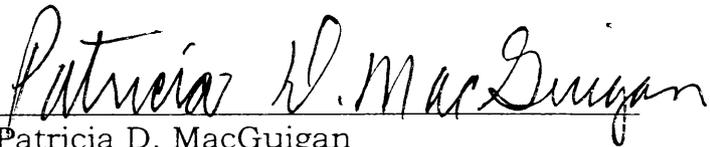
Daubert provided a list of factors for the trial judge to consider when determining the admissibility of evidence. They conclude: 1. Can the theory or technique be, or has it been, tested; 2. Has the theory or technique been subjected to peer review and publication; 3. Is there a "known or potential rate of error...and the existence and maintenance of standards controlling the technique's operation," and 4. Is there widespread acceptance of the theory or

technique within the relevant scientific community.
Daubert, 509 U.S. at 593-594.

Citation's witness answered no to these questions. Thus, there is no scientific basis to support Citation's witness and thus there was no expert testimony which can be relied upon by Citation.

8) Thus, based on the preceding law, rationale and reasons, the Referee recommends that the Report of the ALJ should be affirmed.

RESPECTFULLY SUBMITTED THIS 15th day of July, 2013.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

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Commissioner Anthony
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