DH
4-22

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

FILED
APR 10 2014
COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

APPLICANT:	**FAIRWAY RESOURCES PARTNERS II, LLC AND FAIRWAY RESOURCES OPERATING, LLC**	
RELIEF SOUGHT:	**POOLING**	**CAUSE CD NO. 201304039**
LEGAL DESCRIPTION:	**SECTION 19, TOWNSHIP 27 NORTH, RANGE 11 WEST, ALFALFA COUNTY, OKLAHOMA**	

APPLICANT:	**CHESAPEAKE OPERATING INC., AND CHESAPEAKE EXPLORATION, L.L.C.**	
RELIEF SOUGHT:	**POOLING**	**CAUSE CD NO. 201304886**
LEGAL DESCRIPTION:	**SECTION 19, TOWNSHIP 27 NORTH, RANGE 11 WEST OF THE IM, ALFALFA COUNTY, OKLAHOMA**	

REPORT OF THE OIL AND GAS APPELLATE REFEREE

These Causes came on for hearing before **Paul E. Porter**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 13th and 14th day of November and the 4th day of December, 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: **Gregory L. Mahaffey**, attorney, appeared on behalf of applicant, Fairway Resources Partners II, LLC and Fairway Resources Operating, LLC ("Fairway"); **Richard K. Books**, attorney, appeared on behalf of applicant, Chesapeake Operating, Inc. and Chesapeake Exploration, L.L.C. ("Chesapeake"); **William A. Hadwiger**, P.O. Drawer H, Alva, Oklahoma 73717, appeared Pro Se ("Hadwiger"); and **Jim Hamilton**, Deputy General Counsel for Deliberations, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 17th day of January, 2014, 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 7th day of March, 2014. After considering the arguments of counsel and the record contained within these Causes, the Referee finds as follows:

STATEMENT OF THE CASE

FAIRWAY TAKES EXCEPTION TO the ALJ's recommendation that Chesapeake be awarded operations. Fairway is carrying the cost for the Pike interest and this may unduly influence Pike's decision to support Fairway's application for operations. Although by a narrow margin, Chesapeake has the majority support of working interest owners in this project.

This is an operations contest between Fairway and Chesapeake. They are both competent operators, have ongoing operations, and no reason has been presented to believe they would not competently operate this lease. Both have operated Mississippian horizontal wells and both are experienced with the complexity of a Mississippian horizontal project.

This is a short section containing 630.26 acres. Fairway has the support of the ownership of 310.26 acres. This includes Pike's interest and Fairway is paying their cost to participate. Fairway testified that fair market value is $1,600 bonus and 1/5th royalty interest or no cash and a quarter royalty interest. Fairway had testified to lesser values in a prior hearing but now offers this greater value. The 20 days to elect; 25 days to pay their share of cost if participating; 35 days for bonus; and 60 days to drill were undisputed as proper timing. For subsequent wells the only difference would be 180 days to drill. Although Fairway has drilled 21 Mississippian horizontal wells in Oklahoma, has leased about 21,000 acres, and has four SWD wells in the area, there is no doubt that Chesapeake has much more substantial operations.

Fairway was the first in the area that completed Commission paperwork and the first to propose a well. Fairway has a drilling permit, has contracted for a rig, and is negotiating for a surface location. Fairway has a working interest in about 12 Chesapeake operated wells. Fairway is the single largest working interest owner, but Chesapeake, with its support, is the largest working interest. The Mississippian is lined with possible lithologic changes and widely varies its geologic footprint. Horizontal projects are seeking porosity development and natural fracing. Chesapeake has proprietary seismic to assist them in targeting wells.

FAIRWAY TAKES THE POSITION:

1) The ALJ erred in failing to following the mandate of 52 O.S. Section 87.1(e) which mandates that pooling orders be on such terms as to allow all owners to obtain their fair share of oil and gas without unnecessary expense.

a. Fairway, operator of the east offsetting unit, Section 20, was the first to propose drilling of a horizontal Mississippi well in this unit on June 4, 2013; was the moving party to obtain spacing Order No. 613932 in July 2013; was the first to obtain a location exception Order No. 614174 in July 2013 permitting drilling of an approximate 5,000 foot horizontal lateral for the Mississippian; was the first to have filed a pooling application in this unit; and the first to obtain a drilling permit for such well from the Commission.

b. Fairway's pooling Cause CD 201304039 was heard and recommended on July 8, 2013 with Fairway as operator. Chesapeake failed to appear. Thereafter, Chesapeake filed a Motion to Reopen resulting in these combined causes being heard as protested matters. Fairway and its supporting working interest owner, Pike, will pay 49.22% of all drilling, completion and operating expenses in this unit. Fairway is the single largest owner in Section 19 and will actually pay 49.22% of the drilling, completion and costs itself, because Pike has a carried interest to the tanks of approximately 5%. Fairway's interest is almost twice as large as the interest owned by Chesapeake.

c. The single most important function of the Commission is to prevent "waste." *Application of Peppers Refinery Co.*, 272 P2d 416 (Okl. 1954) and *Denver Producing & Refinery Company v. State*, 184 P2d 961 (Okl. 1947) Waste includes economic waste. Economic waste and waste of hydrocarbons will occur with Chesapeake as operator. The overwhelming evidence demonstrates that Fairway will drill and complete the initial well in this unit for substantially less money than Chesapeake; that Fairway will operate a producing well for substantially less money than Chesapeake; and that Fairway will obtain substantially higher prices for oil and gas than Chesapeake. The table below shows the economics of having Fairway versus Chesapeake as operator:

	Fairway	Chesapeake
Drilling and Completion Costs	$3,286,300	$3,457,650
Operating Expenses	$11,640/MO	$21,830.MO
Average Oil Price (4/13)	$89.41	$86.99
Average Gas Price (4/13)	$4.54/MCF	$2.777/MCF

d. Clearly working interest owners will save almost $200,000 in drilling and completion costs based upon current AFEs. If you look at empirical data for wells drilled in 2012 and early 2013, Fairway's average actual costs for four wells in the general area was $3,682,000. During a comparable time period, Chesapeake's actual cost to drill and complete four wells was $4,640,000. Almost a million dollars difference per well. Granted, Chesapeake's cost to drill and complete horizontal Mississippi wells in Alfalfa County have lowered in the last six months; however, Fairway's costs have also lowered in the last six months with the average cost for its last four wells being $3,110,000 versus Chesapeake's average cost for its most recent wells of $3,485,529 for its last 50 wells and $3,348,394 for its last 25 wells. Chesapeake's costs continue to range between $250,000 to $350,000 per well more than Fairway's costs.

e. Even more dramatic is the difference in oil and gas prices. Over the last six months prior to the trial, Fairway has consistently obtained substantially higher oil prices and gas prices than Chesapeake. It was the testimony of Matt Eagleston, President and CEO of Fairway and a 31 year experienced petroleum engineer, the typical well drilled in this area has an ultimate recovery of 247,000 BO and 1.65 BCFG at a price of $95 per BO and $2.75 per MCFG. The following table represents a comparison of the difference in net oil and gas proceeds that working interest royalty owners in the State of Oklahoma will receive with Fairway as operator versus Chesapeake:

	Fairway	Chesapeake	Gain with Fairway
Future Net Revenue	$24,669,000	$18,940,000	$5,729,000
Net to Working Interest	$13,523,000	$6,553,000	$6,970,000
Net to Royalty Owners	$4,650,000	$3,598,000	$1,052,000
State of Oklahoma	$1,420,000	$949,000	$471,000
Economic Life of Well	31.3 years	20.3 years	11 years

f. Mr. Eagleston calculated that waste of approximately 60,000 BO equivalent will occur with Chesapeake as operator by virtue of the well having an 11 year shorter economic life. With Fairway as operator, the well will produce 11 years longer and recover 60 MBOE during such time. Fairway will prevent waste of 60 MBOE.

g. Obviously, working interest owners, mineral owners, and the State of Oklahoma will all enjoy substantially more oil and gas and substantially more value of their ownership with Fairway as operator. Regardless of the difference in ownership between Fairway and Chesapeake, if one operator demonstrates that it can dramatically reduce waste and increase the value of everyone's interest, our pooling statute mandates this Commission implement a Plan of Development to achieve those results. Here such Plan of Development mandates designating Fairway as operator.

2) The ALJ erred in failing to designate Fairway, the single largest risk taker as operator.

a. Here it is undisputed that Fairway will be the single largest risk taker in drilling and completing a horizontal well with a cost bearing interest of 49.22%. Based upon Fairway's AFE, Exhibit 6, estimated drilling and completion costs are $3,286,300. Here is how those costs will be born: Fairway $1,617,517; Chesapeake $808,101; Tiptop $808,101; and Mr. William Hadwiger $52,252. While the Chesapeake Group, which includes its Chinese Partner, Tiptop, and Mr. Hadwiger, will incur approximately $51,000 more in drilling and completion costs than Fairway, the Commission should recognize and give more weight to the party that is bearing the single largest risk in drilling and completion of the well, especially when such party is bearing close to 50% of the total costs.

b. Further, the $51,000 of additional risk capital being born by the Chesapeake Group pales in comparison to the savings of $250,000 to $350,000 of drilling and completion costs expected with Fairway as operator; pales in comparison to the approximately $11,000 per month savings in operating expenses to be enjoyed with Fairway as operator; and pales in comparison with the substantially higher oil and gas prices that will be enjoyed with Fairway as operator. Certainly, where working interest owners can expect to obtain an additional $6,970,000 net income over the life of the well; where the royalty owners will obtain in excess of $1 million extra revenue over the life of the well; and where the State of Oklahoma will obtain an extra $471,000 over the life of the well, this Commission should balance the scales in favor of prevention of economic waste by designating Fairway, the single largest risk taker, as operator.

3) The ALJ erred in failing to designate Fairway as operator because it is the only party guaranteed to be in a position to commence operations before the first expiration of Chesapeake's leases on February 18, 2014.

a. Fairway testified that it is ready, willing and able to commence operations for a horizontal Mississippi well in Section 19 and can guarantee that operations will commence prior to February 18, 2014, the date that Chesapeake claimed that they would have their first lease expiring. Fairway is the only company that has a valid location exception; the only company that has a drilling permit; and Fairway also has a rig under contract that is available to drill this well. Fairway has had Meridian Rig 6 drilling wells in this area for the last 1.5 year and with Meridian Rig 6, Fairway has drilled and completed its last four wells, the LaWilda #2-10, Fellers #2-1, Goeken #2-20, and O'Neil Farms #1-29, at an average cost of $3,110,000 per well. Fairway also has a title opinion and has already been in negotiations to settle surface damages. Fairway also has a SWD system in the area capable of handling and producing saltwater from the well. If Chesapeake is concerned about saving its leases, Fairway should be named operator.

4) The ALJ erred and misconstrued the significance of Pike's carried working interest.

a. In rendering his decision, the ALJ thought it was significant that Fairway was paying for Pike's share of the drilling and completion costs. The ALJ failed to understand that this is a common industry transaction for an operator to sell interest to another operator in exchange for a carried working interest, in addition to either cash or an override.

b. It was the undisputed testimony of Fairway that they acquired the leasehold interest of Pike and are paying the cost of 49.22% to drill and complete a well. Only after that drilling and completion cost is paid will Pike come in and pay approximately 5% of the operating costs and receive approximately 5% of the working interest revenue in the unit. Based upon Fairway's AFE, Fairway is at risk for $1,617,757 wherein Chesapeake is only at risk for $808,101. Pike wants to make more money and Pike stands to gain approximately $350,000 over the life of the well with Fairway as operator versus Chesapeake (5% of $6,970,000). The ALJ should not have discounted the support of Pike for Fairway as operator.

5) The ALJ erred in giving special weight to Mr. Hadwiger's support of Chesapeake with his 10 acres.

a. While Mr. Hadwiger is a lawyer and has participated in prior wells with Chesapeake, Mr. Hadwiger acknowledged that his lease agreement with Chesapeake, wherein he reserved 10 acres with which to participate, required him to support Chesapeake. He further admitted that he had not been in any wells with Fairway and did not know anything about their operations. Mr. Hadwiger also admitted he knew nothing about the difference in the costs of Fairway's operations versus Chesapeake's operations. Mr. Hadwiger admitted he did not know the difference between Chesapeake's prices for oil and gas versus the prices obtained by Fairway. The ALJ erred in giving special weight to the support of Mr. Hadwiger of Chesapeake with his 10 acres because Mr. Hadwiger had no objective information to know the actual facts as to the cost savings and product pricing surpluses to be gained with Fairway as operator versus Chesapeake as operator.

b. Mr. Hadwiger did admit upon questioning by the ALJ that he "wanted to get more money versus less money." With Fairway as operator, Mr. Hadwiger will enjoy more money from his oil and gas in Section 19 from both his working interest ($130,000) and his royalty interest (about 1/2 of $1,052,000 or $526,000) versus with Chesapeake as operator.

6) The Commission should reverse the ruling of the ALJ and designate Fairway as operator. This well is substantially more important to Fairway than to Chesapeake. This is one of approximately 25 horizontal Mississippi wells that would be owned and operated by Fairway versus hundreds if not thousands of Mississippi wells owned and operated by Chesapeake. Fairway will drill and complete the well for substantially less money than Chesapeake; will operate the well for substantially less money than Chesapeake; will obtain more money for the oil and gas than Chesapeake; and will ultimately produce approximately 60,000 BO equivalent more than Chesapeake, with its longer economic life of 31.3 years versus 20.3 years. Fairway is the only party that is ready to immediately commence its operations for the well prior to February 18, 2014. To comply with its mandate to prevent waste and to obtain the greatest value of an owner's interest under a pooling order, this Commission should designate Fairway as operate of the subject unit.

THE ALJ FOUND:

1) Both parties have done an excellent job demonstrating the difficulty of comparing drilling programs and product sales as a basis for settling operational issues. The AFEs contain different information concerning completion cost, drilling cost, frac design, and mud programs. Company geologists argue as to which wells are comparable wells. There are also issues concerning electrical infrastructure, types of lift systems, and differing gas sales agreements, some proprietary, which add to comparative complexity. The ALJ found it an inefficient and confusing exercise to try to compare wells apples-to-apples. In addition, should a meaningful comparison be possible, then the change in knowledge curve make understanding short lived. There is insufficient evidence to analyze all of these factors and, most probably, there could never be sufficient evidence submitted for an apples-to-apples comparison.

2) The ALJ is convinced that both operators conduct operations in a competitive manner and either would do a fine job operating the proposed project. Concerning the number of employees; the number of employees on this project; the number of assets devoted to the project; the number of wells drilled; the number of wells completed; etc. Chesapeake will always prove triumphant because they are the larger company. However, many smaller oil and gas companies have made lucrative careers from operating wells that larger companies could no longer operate efficiently.

3) Because experience counts and the number of Mississippian horizontal projects drilled increases that experience and increases the efficiency and profitability of these projects, even should the above analysis be possible, it is an ever-changing analysis that could change with each well. To paraphrase Mr. J.P. Dick, most of these factors even out in the end. If they did not even out, then one company would no longer be in business.

4) Deciding factors in breaking this statistical stalemate are the facts that Chesapeake, with supporting working interest, is the majority owner in this short section; that Fairway is paying Pike's cost to drill and complete this well; and the testimony of Mr. Hadwiger. These factors trump Fairway proposing the first well and first filing Commission paperwork.

5) It is undisputed that Chesapeake has the support of the majority of the working interest owners, although by a small margin. It is reasonable to assign operations to the majority of the working interest, as they are paying the majority of the cost.

6) A second, clearly objective factor is that Chesapeake is not paying any other working interest owner's cost and Fairway is paying other working interest owner's cost. This raises the implication that an entity whose costs are being paid by an operations company would, in all likelihood, be more likely to support that operating company's applications.

7) Mr. Hadwiger is a geologist and an attorney, and has mineral interests in this and other areas of our state. He represents he is familiar with oil and gas operations and this was undisputed. He also represents that he would rather make more money than less money. He has participated in several Chesapeake wells and supports Chesapeake. He heard all the testimony up to and through his own testimony and, after consideration, continued to support Chesapeake for operations. Chesapeake is not paying Mr. Hadwiger's costs to drill and complete this well. In fact, Chesapeake has laid off Mr. Hadwiger's son from employment with Chesapeake and this has not clouded Mr. Hadwiger's apparently objective judgment as to the best way to increase his profitability and prevent waste. The ALJ recommends operations be given to

Chesapeake. The ALJ also recommends the highest and best bonus values of $1,600 and 1/5th or no cash and a quarter.

POSITIONS OF THE PARTIES

FAIRWAY

1) **Gregory L. Mahaffey**, attorney, appearing on behalf of Fairway, stated that bigger is not always better and bigger is not always more efficient. Fairway is more efficient and economical as an operator than Chesapeake, as has been shown by Fairway.

2) Fairway filed for a pooling/spacing order as well as a well location exception and a hearing was held in July 2013 for those applications. Proper notice was given to all parties interested, including Chesapeake. Chesapeake failed to make an appearance; the orders were recommended and Fairway was named operator for this well.

3) Chesapeake successfully filed a motion to re-open and protested the pooling.

4) Fairway is the single largest working interest owner in this unit with 49.22% working interest. Chesapeake has approximately 24.59% as does Tip Top which is a partner with Chesapeake. Together along with their other supporter, they have 50.78% working interest, but not as a single owner.

5) Mr. Hadwiger owns 320 acres in this 630 acre unit. He leased 310 acres to Chesapeake and Tip Top retaining 10 acres for himself. As part of his consideration in this lease, he is required to support Chesapeake as operator. He has never participated in a well with Fairway and is not familiar with any of Fairways operational methods.

6) There is unrefuted evidence that Fairway will produce approximately 60,000 BO equivalents more than Chesapeake over the life of the well.

7) Case law and the Commission rules support the prevention of waste of hydrocarbons as well as economic waste. Fairway as the operator will accomplish both by producing more at a lower cost and for higher prices.

8) Chesapeake has produced no hard data on their actual costs for drilling and completing a well. Fairway produced evidence about its actual costs, not estimates, for the drilling and completing of wells in this area and this formation.

9) Fairway's actual costs are, on average, only 1.9% over their estimated costs which are sent out in proposal letters to interested parties. The average cost of wells drilled by Fairway is approximately $250,000 less per well than the cost per well that Chesapeake testified to, but, again Chesapeake has provided no actual costs data to support their claims. Historically Chesapeake's costs have been substantially higher than the estimates that were included in their proposal letters.

10) Fairway obtains a substantially higher price per MCFG as well as a higher price per barrel of oil than Chesapeake.

11) Testimony by Chesapeake indicates that the long term contract they operate with will provide higher revenue, but not until the price per MCF rises above $5.73. During low prices, as we have now, Fairway obtains much better revenue under its contracts for gas. In both cases, Fairway obtains approximately $3.00 per barrel more for oil than Chesapeake.

12) The economic benefit to all parties involved is greater when Fairway is named operator. Fairway will produce more oil and gas, obtain a higher price for those hydrocarbons, and do it at a lower cost. These factors will prevent both waste of hydrocarbons and economic waste.

13) In a typical operator fight, all other factors being equal as we have here, the Commission will side with the party that has the greatest risk. We submit that the Chesapeake group has 50.78% interest, but that as a single operator, Fairway with 49.22% has the greatest single risk of all working interest owners. The Chesapeake group is comprised of Chesapeake, its Chinese partner Tip Top, and its lessor Mr. Hadwiger who retained 10 acres but is required to support Chesapeake as operator.

CHESAPEAKE

1) **Richard K. Books**, attorney, appearing on behalf of Chesapeake, stated this case was reopened to correct testimony that had been given by Fairway concerning fair market values in the area, which Fairway was not concerned about fixing.

2) During trial we could not get apples to apples comparison of costs between Fairway and Chesapeake. Fairway would use old wells versus new wells and shallow wells versus deep wells, none of which will have the same expenses.

3) The Chesapeake group owns the majority of this unit and the group includes the largest mineral owner in the unit. This mineral owner, Mr. Hadwiger, owns 320 of the 630 acres, and he supports Chesapeake as operator.

4) The claim that Fairway can drill, complete, and operate wells for less money than Chesapeake is simply not true. Exhibit 6, which Fairway made the centerpiece of their case, is not the most recent AFE prepared by them, rather Exhibit 39, which is $400,000 higher in cost estimate, is the most recent. This moving target makes it difficult to compare apples to apples on costs.

5) The other AFE's presented by Fairway are more in line with the numbers reflected in Exhibit 39 rather than Exhibit 6, which again is the exhibit that Fairway would have this Court focus on.

6) The oil and gas prices that Fairway complained of are contract prices, and simply do not apply here. They can take their hydrocarbons in-kind and sell to their own buyers.

7) Fairway admitted that the main difference between the AFE's of Chesapeake and Fairway is the number of days for drilling operations. Fairway's Exhibit 6 says 23 days, but Exhibit 39 says 31 days and their proposal letter says 28 days. The Chesapeake drilling engineer testified that the Chesapeake AFE says 18 days and that the last 10 wells drilled by Chesapeake in this area were drilled in 15-17 days, well within the 18 day proposal.

8) The last 25 wells drilled by Chesapeake, including the good and the bad wells, averaged a cost of $3.348 million which is significantly lower than the Fairway AFE presented in Exhibit 39, as well as the costs presented by Fairway in Exhibits 10 through 13. Since Fairway would have us look at the last four wells they have drilled for a comparison, Chesapeake's last four wells were drilled at an average cost of $3,117,570. Again, that is well below the AFE's that Fairway is having this Court focus on.

9) The Chesapeake completion engineer testified about the importance of getting production as soon as possible from a well. Chesapeake averages approximately 52 days while the five wells in which Fairway operates, and Chesapeake is participating, the average time to production was 135 days.

10) The Chesapeake Billing Accountant talked about the on-going operation costs of a well. Chesapeake charges $165,000 on the AFE for electrical grid work to be completed to operate the pumps. Fairway uses generators at a cost of $58,000 per month until a grid is locatable in the area. One well alone used a generator for 6 months totaling over $400,000 which would have paid for the Chesapeake costs three times over.

11) Fairway's operating costs are not less than Chesapeake, so this argument that they will be able to operate the well for a longer period of time, which will prevent waste, is simply not true. Fairway's monthly operations are $77,195 per month and Chesapeake is $42,611 per month. Fairway will not prevent economic waste, they will create it.

12) The pricing contracts which Fairway discussed are within 3% of Fairway' pricing when the contracts are fully analyzed and pricing on all hydrocarbons are input. Fairway will receive higher revenues while gas prices are low, but as prices rise, Chesapeake will far surpass the revenues that Fairway will be able to generate.

13) The traditional reasons for appointing an operator of a unit are: ownership of the unit and the cost's associated with drilling, completing and operating the well. The Chesapeake group owns a majority of the unit, including having the largest mineral owner in the unit supporting Chesapeake as the operator. Chesapeake can drill, complete, and operate a well for less than Fairway, depending on which moving target provided by Fairway that you use as a comparison.

14) Fairway only wins on being the first to propose a well and the first to pool the unit. These alone are not enough to name a company operator. The ALJ heard testimony by expert witnesses on both sides and concluded that Chesapeake be named the operator. We ask that you affirm his decision.

RESPONSE OF FAIRWAY

1) The ALJ should be overturned because the law says to give each owner an opportunity to get their share of production without unnecessary costs. You should overturn his decision to prevent economic waste. That is the main issue of this case.

2) The closest we can get to an apple to apple comparison are the AFE's provided by both companies for this well. Exhibit 37 is the AFE provided by Chesapeake for this well and it includes a 5% contingency. Exhibit 6 is the AFE provided by Fairway for this same well and it includes a 10% contingency. If you place the contingencies at the same 5%, then Fairway is at a cost of $3.1 million while Chesapeake is at a cost of $3.457 million. However the best evidence regarding cost is not the AFE's, but what was actually spent to drill a well. The nearest well drilled to this location by Chesapeake was at a cost of $3.58 million, while the nearest Fairway well was drilled at a cost of $3.32 million.

3) Chesapeake has not provided any actual costs to drill a well. These numbers are from the wells that Fairway participated in with Chesapeake, which is the only way to get their numbers. Chesapeake provided no evidence to support their actual drilling costs.

4) Regarding the testimony provided in the pooling hearing. The broker that testified was mistaken about the size of this unit. He believed it was a traditional 640 acre unit when in fact it is an irregular 630 acre unit. He also testified about the fair market values which he could determine in the area at the time of that hearing. The increased value that was discussed in trial was not found until after the initial hearing, primarily because Chesapeake is the company that contracted at those values, and they would not disclose those values to the Fairway broker when he called to gather information regarding the surrounding area values. However, the bonus amount is a moot point in this unit since all three owners are going to participate in the well.

5) Hydrocarbon pricing comparisons are best when compared to a benchmark like the NYMEX. Over a six month period Fairway was within 2.3% of the oil price on NYMEX while Chesapeake was 5.6% below NYMEX. It gets worse with the gas pricing; Fairway was within 6.6% of NYMEX while Chesapeake was 53.8% below NYMEX. That is a large difference and constitutes economic waste.

6) Chesapeake claims that they have a new gas price contract which will no longer reflect these low prices, but they have provided no evidence to support that argument.

7) For hard operating costs, with the variable charges removed, Fairway operates a well for $11,460 per month while Chesapeake operates a well for $21,830 per month. Again, this is a large difference and constitutes economic waste. The lower costs of Fairway will allow the life of this well to be prolonged and prevent waste. The evidence shows that Fairway's operational costs are less.

8) Mr. Hadwiger testified that he had not had an opportunity to compare drilling and completion costs or operating costs between Fairway and Chesapeake. In addition, the other operators that Mr. Hadwiger has participated with are not drilling in the Mississippi in this area. The only operator that participates with Mr. Hadwiger in this area is Chesapeake.

9) The facts of this case show that Chesapeake will create a considerable amount of economic waste. That amount is so high that it should outweigh the slight ownership majority that the Chesapeake group enjoys over Fairway.

10) The role of the Commission is to protect correlative rights and prevent waste. For this purpose the ALJ's ruling should be overturned and Fairway should be named operator.

CONCLUSIONS

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

1) The Referee finds the ALJ's recommendation to appoint Chesapeake as operator under the combined pooling orders to issue in the present case is supported by the weight of the evidence and free of reversible error. The ALJ is the initial finder of fact. It is the ALJ's duty 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); *Application of Choctaw Express Company*, 253 P.2d 822 (Okl. 1953); *Palmer Oil Corporation v. Phillips Petroleum Company*, 231 P.2d 997 (Okl. 1951).

2) The Commission has always focused on a number of different factors in the award of operations. Charles Nesbitt in his Oklahoma Bar Journal article, entitled "A Primer On Forced Pooling of Oil and Gas Interests in Oklahoma," 50 Okl.B.J. 648 (1979) set forth a good review of the factors considered and the importance that the Commission attaches to them.

DESIGNATION OF OPERATOR

> A deceptively important provision of the pooling order is the designation of the operator of the proposed well. In most cases the applicant already owns the majority interest in the spacing unit, and is routinely named operator. However, there are noteable exceptions where a spirited battle occurs between lessees over operations. The working interest ownership of non-participating pooled owners inures to the operator, at least in absence of a claim by other participants to share therein. A lessee who is promoting the proposed well for a carried interest, or similar remuneration, has a significant financial stake in being designated operator.
>
> Several factors are considered in the selection of the operator, the most important being working interest ownership. All other things being equal, the

> owner of the largest share of the working interest has the best claim to operations. However, this is not always true, and other factors can outweigh majority ownership.
>
> Second in importance is actual bona fide exploration activity. This is not a simple race to the courthouse, with the earliest applicant getting the nod, but involves such matters as when a well was first proposed and by whom, whether the proposed well is part of a multi-well exploration program, whether a rig has been contracted for, and so on.
>
> Other factors having a bearing on the final selection include the number of wells operated in the vicinity, the extent of developed and undeveloped lease ownership, the availability of operating personnel and facilities, a comparison of proposed costs of drilling and operating the well, and, rarely, the relative experience and competence of the contenders for operating rights.

3) As noted in Nesbitt's article, the ownership position of the parties and the actual bona fide exploration activity are the two factors of most importance. The ALJ focused on those factors in his award of operations. Chesapeake has the largest working interest position, with Chesapeake having 155 acres, Tip Top 155 acres and Hadwiger 10 acres, which equals a 320 acre mineral interest. This is a 630.26 acre irregular unit. Fairway is the single largest working interest owner, However, Chesapeake, with support, becomes the largest working interest owner. Chesapeake has 50.77% of the unit. Chesapeake operates 91 Mississippian horizontal wells that were drilled in 2013. Fairway has drilled 21 Mississippian horizontal wells in Oklahoma.

4) Fairway however is the moving party having proposed the well, obtained a drilling permit and was the first to file the pooling application and spacing application as well as a location exception. Chesapeake also has an area field office with full-time employees and has seismic information.

5) The claim that Fairway can drill, complete and operate wells for less money than Chesapeake is refuted by Chesapeake. Exhibit 6 which Fairway made as the primary exhibit in their case for the proposition that Fairway can drill, complete and operate wells for less money than Chesapeake is not the most recent AFE prepared by Fairway. Exhibit 39 a later AFE prepared by Fairway reflects the dry hole costs are $400,000 higher than Exhibit 6 which Fairway wanted to use as a center piece of their case. Exhibit 37, Chesapeake AFE dry hole costs of $1,933,250 were less than the dry hole costs on the

Exhibit 39 Fairway AFE. Using the same Exhibit 37 AFE, Chesapeake had completed well costs of $3,457,650 which is more than the Exhibit 6 Fairway AFE ($3,286,300) and less than the Exhibit 39 Fairway AFE ($3,655,600). The last Chesapeake 25 completed well costs including the good wells and the bad wells were $3.348 million. That is significantly less than Exhibit 39, Fairway's most recent exhibit. It also is less than Fairway's Exhibits 10 through 13, the wells they placed into evidence concerning costs. The last four wells that Chesapeake has drilled, their costs were $3,117,971. That is well below any of the AFEs that Fairway presented.

6) The evidence also presented by Chesapeake stated that the last ten Chesapeake wells averaged 52 days from spud date to first sale. For the last five Fairway wells, in which Chesapeake had an interest, the average was 130 days.

7) The evidence presented by Chesapeake also reflected that Chesapeake operating costs were $42,611 a month with Fairway's operating cost being $77,193 a month for a difference every single month of almost $40,000 higher for Fairway. However Fairway presented testimony that conflicted with Chesapeake's operating costs.

8) The ALJ in his Report of the Administrative Law Judge in H. Conclusions of Law, paragraph 1, states:

> Both parties have done an excellent job demonstrating the difficulty of comparing drilling programs and product sales as a basis for settling operational issues. The AFEs contain different information concerning completion cost or drilling cost, frac design, and mud programs, and company geologists argue as to which wells are comparable wells. There are also issues concerning electrical infrastructure, types of lift systems, and differing gas sales agreements, some proprietary, which add to comparative complexity. I find it an inefficient and confusing exercise to try to compare wells apples-to-apples. In addition, should a meaningful comparison be possible, then the change in knowledge curve make understanding short lived. There is insufficient evidence to analyze all of these factors and, most probably, there could never be sufficient evidence submitted for an apples-to-apples comparison.

9) The ALJ did recognize that Chesapeake prevails in regard to Nesbitt's factor concerning the number of wells operated in the vicinity, the extent of developed and undeveloped lease ownership, the availability of operating

personnel and facilities. Chesapeake also prevailed on the first "most important being working interest ownership" factor. Chesapeake also prevailed in the second most important factor by Nesbitt being actual bona fide exploration activity.

10) Considering these factors to determine a proper operator of a well within a drilling and spacing unit, the Referee believes that the ALJ has made a determination that should be affirmed.

RESPECTFULLY SUBMITTED THIS 10th day of April, 2014.

Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Anthony
Commissioner Douglas
Commissioner Murphy
Jim Hamilton
ALJ Paul E. Porter
Gregory L. Mahaffey
Richard K. Books
William A. Hadwiger
Office of General Counsel
Michael L. Decker, OAP Director
Oil Law Records
Court Clerks – 1
Commission Files