

STATEMENT OF THE CASE

APACHE TAKES EXCEPTION to the ALJ granting the pooling request of Newfield which requests that the Commission pool the interests and adjudicate the rights and equities of oil and gas owners in the Mississippian, Woodford and Hunton common sources of supply underlying the 640 acre horizontal drilling and spacing unit in Section 33, T2N, R3W, Garvin County, Oklahoma. The ALJ noted that the statutory pooling power given to the Commission does not empower it to require the offering of Joint Operating Agreement (JOA) by operators to parties owning a unit interest where voluntary agreements cannot be reached to develop the unit. The ALJ found that if Apache timely elects to participate under the pooling order, it should be allowed to defer payment of its proportionate share of the completed well costs until Newfield issues the 30 day notice of intent to spud the subject well. Apache protested the subject application for two reasons: 1) Apache was not given any opportunity by Newfield to sign a JOA prior to its receipt of a Newfield well proposal with an AFE giving Apache the right to participate, take a cash bonus with royalty or be pooled under those terms; and 2) Apache believes it should be allowed to elect under the pooling order and then be given a 30 day notice of intent to spud with the subsequent payment of its share of the dry hole costs of the well sufficient to meet the participation requirements under the order. Newfield is agreeable to the participation terms requested by Apache but, upon receipt of the 30 day notice, Newfield would request Apache pay its share of the completed well costs, not the dry hole costs.

APACHE TAKES THE POSITION:

1) Apache objects to the position espoused by the ALJ as regards efforts to negotiate an agreement concerning development of a drilling and spacing unit in advance of the filing of a pooling application. The provisions of 52 O.S. Section 87.1 (e) unambiguously assume that the filing of such an application must be preceded by good faith efforts to reach agreement on unit development.

2) The Newfield landman witness admitted there are only two methods available in Oklahoma to create a relationship between different working interest owners in a drilling and spacing unit, i.e. by a Joint Operating Agreement or by entry of a pooling order issued by the Commission.

3) Newfield does not offer a JOA to other working interest owners in a unit. In fact, the Newfield landman testified that he has never negotiated such an agreement while employed by that company. The pooling application is

employed by Newfield in all circumstances. Newfield will send out a "well proposal" in advance of filing the application. However, as illustrated by the facts of this case, such a proposal only offers to lease, or farm out, the working interest rights of other owners. Such offers are not efforts to reach an agreement on joint development. Those are offers to acquire the working interest rights of the recipient of such proposal.

4) The Commission has long resisted adding any significant development provisions typically found in operating agreements to its pooling orders. The standard response of the Commission to a request to "flesh out" the pooling order is that such an order is a "bare bones" document not intended to supplement an operating agreement. While that mantra may have been appropriate in the past (when JOA's were routinely offered), the inflexible position stated by Newfield should negate that stance.

5) Apache's position is that this application should be denied until, and unless, Newfield is willing to negotiate in good faith a private agreement for unit development, including provisions normally offered to working interest owners in private operating agreements. If such negotiations fail, then the power of the Commission to force a relationship can be activated.

6) Apache respectfully requests that the recommendation of the ALJ be reversed.

THE ALJ FOUND:

1) After taking into consideration all of the facts, circumstances, evidence and testimony presented in the cause, it is the recommendation of the ALJ that the subject application of Newfield be granted. Under any pooling order issuing from the cause the ALJ recommends that, if Apache timely elects to participate, it will receive a deferred payment of its proportionate share of the completed well costs which will be due in some form agreeable to Newfield 15 days after the receipt of a 30 day notice of intent to spud the subject well.

2) Newfield presented expert testimony as to its current practices regarding steps taken to pool multi-unit wells and the basis for these steps. Newfield does not use JOAs for multi-unit wells as a matter of course but does negotiate with respondents who may request delayed well cost payments, use of irrevocable letters of credit, etc. In this instance, Apache is requesting not only that it pay its share of the dry hole costs but, more specifically, be given the same terms as that given Continental which terms were not specifically made a part of the record. While Apache did not present any persuasive reason or evidence to support its proposal, Newfield did state that the ongoing agreement with Continental is due to the number of wells Newfield and Continental each operate in the subject area.

3) Under the statutory powers given to the Commission in 52 O.S. Section 87.1(e), parties are allowed to apply for forced pooling of units when owners cannot reach a voluntary agreement to develop reserves underlying said units. The purpose of the pooling hearing is to assure that the parties receive terms reflecting the fair market value for interests owned under a process that will prevent waste while protecting the correlative rights of the owners. While the Commission does not condone bad faith negotiating of leases or development of reserves, it is without the power to specifically set out steps necessary to be complied with prior to any pooling order being filed to assure that sufficient negotiation has occurred and in an approved manner. These negotiations are part of business dealings among private companies and individuals.

4) Prior to the subject pooling being filed, Newfield took numerous leases and, once the application was filed, parties interested in participating under the pooling order were told they would be given a deferred payment of completed well costs which payment could be satisfied through the use of an irrevocable letter of credit. While Apache has been offered the same deferred payment option as the other named parties in the pooling application if participation under the pooling order is selected, the fact that Apache has not been offered the same reciprocal agreement that Newfield has with Continental cannot be considered a reasonable protest resulting in further delay of the multi-unit well and pooling. Apache came into its very small percentage of ownership in the unit after the proposal and pooling application filing by Newfield; therefore it was not named as a respondent and it was not contacted prior to the pooling being filed. Due to the ownership and operation position of Newfield and the actions taken to successfully drill and pool the multi-unit well at hand, the ALJ finds the arguments of Apache fail to be persuasive and believes it would be in the best interests of preventing waste and protecting correlative rights to grant the Newfield application under the terms Newfield proposed at the hearing.

5) Thus, in light of the above, it is the recommendation of the ALJ that the application of Newfield be granted with any order issuing out of the cause to contain the recommendation of the ALJ as set forth in her Report of the Administrative Law Judge filed on November 26, 2013.

POSITIONS OF THE PARTIES

APACHE

1) **Richard A. Grimes**, attorney, appearing on behalf of Apache, stated that although Apache's interest in this unit is small, they own approximately

30,000 acres in the general area in the Woodford common source of supply and anticipate that this type of situation will be reoccurring.

2) The main issue is this: Are the provisions of our pooling statute, 52 O.S. Section 87.1(e), to be construed so as to find that there is no requirement at all, to be placed upon an applicant for pooling, to negotiate in advance of that filing in good faith with other working interest owners to validly pool their interests in a unit in accordance with what we believe the statute anticipates.

3) Apache's belief is the answer is NO. A party should not be allowed to proceed in a pooling application without making a valid effort to correctly pool the interests in a private way.

4) The specific language in the statute indicates that when two or more separately owned tracts are included within the drilling/spacing unit, those owners may pool their interests and develop the unit as a unit.

5) The second part of the statute which has significance for my argument notes that the pooling order MUST be issued upon terms and conditions which are just and reasonable.

6) Newfield does not offer or negotiate JOA's. Newfield simply offers a lease or forced pooling. That is not negotiations in good faith. Newfield indicates that this is their way of doing business, and Apache submits that this is not good faith negotiations which the pooling statute assumes has taken place. Apache's business process is to offer JOA's for wells to be drilled.

7) Pooling is similar to condemnation, but even condemnation requires good faith negotiations in advance of that condemnation. The Commission needs to take the same kind of approach to the pooling as that of a condemnation.

8) There are only two methods to establish a "relationship" between working interest owners in Oklahoma. Either through private negotiations or through forced pooling.

9) This is not about fair market value, but rather this is about establishing a working relationship with other interest owners in the unit. That is what the statute talks about.

10) JOA's in Oklahoma contain significantly different terms than a pooling order. The Commission has consistently stated that a pooling order is a bare bones agreement. A pooling order is not intended to be a JOA, it is not intended to supplement the terms of a JOA.

11) Historically JOA's have been offered and negotiated prior to a pooling order. Now pooling has become an offensive weapon. Companies are now

operating with the idea that interest owners either accept the offer or be forced pooled. That is an administrative threat.

12) The bare bones approach has evolved into a take-it or leave-it approach by operators. When two parties do not discuss alternate terms, there is no negotiation. That is not a good faith negotiation.

13) Pooling interests is the creation of the working interest relationship. You pool your resources and communize those efforts. Forced acquisition of interests is not pooling of interests because it does not require the working interest owners to negotiate a relationship.

14) Our alternate request would be to have the Commission relax the bare-bones approach to a pooling order to require an option which includes terms similar to those found in a JOA.

15) This application should be denied subject to a good-faith negotiation effort between Newfield and the other working interest owners in this unit, namely Apache.

NEWFIELD

1) **Ron M. Barnes**, attorney, appearing on behalf of applicant, Newfield, stated the issue here is whether or not an operator is required to offer a JOA to other working interest owners in a spacing unit.

2) The statutes, rules and case law do not require an operator to offer a JOA to the other working interest owners in the unit. There is nothing that supports the position that Apache takes. Newfield negotiated in good faith with all owners in the nine section area, taking nearly 3,500 acres and acquiring a 68% working interest in the unit.

3) Negotiations are part of regular business between private parties. However when an agreement cannot be reached, the pooling statute 52 O.S. Section 87.1 kicks in and requires the parties to agree to some terms in order to drill the unit and prevent waste. Newfield did attempt negotiations with the other interest owners in the unit, but an agreement could not be reached with Apache.

4) Apache acquired its interest in this unit after the pooling application had been filed. Different terms were negotiated with various interest owners in the unit, but Newfield and Apache could not reach an agreement on the interest that Apache acquired after the pooling application had been filed. It is

difficult to negotiate with an owner who did not own anything prior to the pooling application.

5) The *Tenneco Oil Company v. El Paso Natural Gas Company*, 687 P.2d 1049 (Okla. 1984) set out the idea that a pooling order is a bare bones agreement. The case does not suggest that a JOA is required to be offered during negotiations between private parties, this case only mentioned that in that particular pooling order a JOA was an option, not that a JOA is a required option.

6) 52 O.S. Section 87.1(e) however, does not require a JOA to be offered. In relevant part it says "Where, however, such owners have not agreed to pool their interests...the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application...and a hearing...require such owners to pool and develop their lands in the spaced unit as a unit."

7) The Commission rule OCC-OAC 165:5-7-7(a) says that: "Each pooling application shall include a statement by the applicant that the applicant exercised due diligence to locate each respondent and that a bone fide effort was made to reach an agreement with each respondent as to how the unit would be developed."

8) "Bona fide" means honest. Newfield did not mislead any of the interest owners nor did they hide anything from the interest owners. Newfield conducted good faith negotiations with the owners in the unit.

9) In 1982 at the Institute for Energy Development Seminars where Eugene Kuntz was the Editor of the book published concerning the "Statutes--Spacing, Force Pooling, & Related Proceedings Before the Oklahoma Corporation Commission", by Philip D. Hart which deals with what you do for a forced pooling and states at page 192:

II

FORCE POOLING

A. Items to Cover at Hearings to Obtain Pooling Order

...to propose a plan for the development of the unit(s), and as to those owners which applicant was able to locate and who have been named as respondents ("poolees"), herein applicant has been unable to agree with such owners a plan for the development of such unit(s). ("Plan for the development of the unit") is the

pooling statute terminology. The "plan" ordinarily consists simply of the applicant's proposal to drill the unit well."

There is nothing in this article at all about a joint operating agreement or what needs to be negotiated or not negotiated prior to the pooling case proceeding.

10) The landman testified that in the last 200 wells proposed to Apache where Apache has not been the operator and participating only, 15 included JOAs and 185 of the wells have been letter agreements as we have in the present case. The investment that Apache refers to it owning is nearly 100 miles from Newfield's unit in the present case. Apache does not own any significant interest in the nine section area and cannot show that it is normal practice in this area to offer JOA's to other working interest owners.

11) There was nothing in the Amended Pre-Hearing Conference Agreement dated September 18, 2013 to suggest that there was a lack of negotiation on the part of Newfield. The other 99.5% of the interest owners in this unit have all agreed to the drilling of this well. Only the .5% interest that Apache acquired after the pooling application was filed is at issue here.

12) Apache is not required to offer a JOA, and Apache does not wish to do so in this unit.

13) There is no statute, rule or case law to support the position that Apache takes and this pooling order should be issued to protect correlative rights and prevent waste.

RESPONSE OF APACHE

1) 52 O.S. Section 87.1(e) states that parties are allowed to apply for forced pooling when owners cannot reach a voluntary agreement. The phrase "parties are allowed" means that they can do it in advance of agreements. That is a condemnation.

2) The ALJ suggested that the purpose of the statute is to get fair market value for the interest owners. Apache thinks that the main purpose of pooling is about the relationship to be developed between the interest owners.

3) The ALJ in her Report on page 4, paragraph 3, states in the last sentence "[w]hile the Commission does not condone bad faith negotiating of leases or development of reserves, it is without the power to specifically set out steps necessary to be complied with prior to any pooling order being filed to assure that sufficient negotiation has occurred and in an approved manner;

these negotiations are part of business dealings among private companies and individuals." Newfield did not do any negotiation. Newfield gave a take-it or leave-it lease or be forced pooled. That is not good faith negotiation.

4) The *Tenneco* case, supra, is a 1984 case and illustrates my point about the evolution of pooling orders in Oklahoma. It used to be standard practice to negotiate and offer JOA's with other working interest owners in the unit. The *Tenneco* case speaks to the bare bones agreement of a pooling order only after the working interest owners fail to reach an agreement negotiated in good faith.

5) The *Tenneco* case reads "the practice within the industry (oil and gas) to refine, broaden, and specify duties between pooled interests in a spacing unit to provide specific rights and obligations between the parties...[w]ithout attempting to limit or list all such areas covered by operating agreement." This suggests that the standard practice is to negotiate terms, and the industry practice at the time was to negotiate JOA's.

6) The proposition of a well and a lease offered on a take-it or be forced pooled situation is not a good faith negotiation. This application should be denied subject to good faith negotiations between all working interest owners in the unit.

CONCLUSIONS

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

1) The Referee finds that the ALJ's recommendation to grant the application of Newfield should be affirmed, with any pooling order issuing from the cause providing that if Apache timely elects to participate it should be allowed to defer payment of its proportional share of the completed well costs which will be due, in some form agreeable to Newfield, 15 days after the receipt of a 30 day notice of intent to spud the subject well.

2) Newfield does not offer or negotiate JOAs for multi-unit wells but does negotiate with respondents who may request delayed well cost payments or use of irrevocable letters of credit, etc. Apache asserts that this is not negotiations in good faith as required by the Oklahoma Statute 52 O.S. 87.1(e). Apache submits that when two parties do not discuss alternate terms, there is no good faith negotiation. Apache's request would be to have the Commission relax the bare-bones approach to a pooling order to require an option which includes terms similar to those found in a JOA.

3) There was evidence presented by Newfield that while Newfield does not offer JOAs to respondents, Continental Resources Inc. ("Continental") and Newfield each operate a significant number of wells in the subject area and therefore the two companies have an ongoing reciprocal participation agreement. None of the respondents including Apache are in the same position as Newfield and Continental and therefore the reciprocal participation agreement was not offered to those parties. The nearest proposed Apache Woodford well is at least 100 miles away from Section 33. There was also testimony that Apache has reviewed more than 100 well proposals from various companies to Apache as a nonoperator and 15 of those proposals gave Apache the opportunity to sign a JOA. Newfield owns a 68% interest in Section 33 and has taken approximately 450 oil and gas leases covering just over 3,500 acres in the nine section area. Apache owns only .5% interest with 99.5% of the interest owners in the unit agreeing to the drilling of this well.

4) Newfield in the present case has agreed to include a deferred payment for parties electing to participate under the pooling order with each parties' proportionate share of completed well costs, which can be in the form of a irrevocable letter of credit, due within 15 days of receipt of a 30 day notice of intent to spud from Newfield. If no well is spud within the 30 days all participation monies will be returned and the process will begin again. Newfield seeks participation payment of completed well costs as horizontal wells are completed before decision is made as to whether production will occur.

5) 52 O.S. Section 87.1(e) provides in relevant part:

...When two or more separately owned tracts of land are embraced within an established spacing unit, or where there are undivided interests but separately owned, or both such separately owned tracts and undivided interests embraced within such established spacing unit, the owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owners have not agreed to pool their interests and where one such separate owner has drilled or proposes to drill a well on said unit to the common source of supply, the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application therefor and a hearing thereon, require such owners to pool and develop their lands in the spacing unit as a unit...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.

Thus, the pooling order covers all of the interest owners in the unit, willing or not, and the Commission attempts to protect their correlative rights in relation to one another by adjusting the equities of those owners, balancing the interest of the owners and being responsive to the evidence presented before them in the hearing process. "The pooling order should be responsive to the application and evidence." *C.F. Braun and Co. v. Corporation Commission*, 609 P.2d 1268 (Okl. 1980).

6) The Supreme Court in *Ranola Oil Company v. Corporation Commission of Oklahoma*, 752 P.2d 1116 (Okl. 1988) stated:

The purpose of force pooling is to equalize the risk of loss by forcing all of the oil and gas interest owners to choose in advance whether they will share in both the benefits and the risks of oil and gas production....

7) The Supreme Court of Oklahoma in *Tenneco Oil Company v. El Paso Natural Gas Company*, 687 P.2d 1049 (Okl. 1984) stated:

Restated the question posed is this: may the interested parties to a forced-pooling order contract as to interests created, duties defined, terms of participation, operations, etc?...We hold they may.

* * *

At the risk of oversimplification, we hold the enactments for the conservation of oil and gas are public in nature and that the spacing order, the pooling order, and the order fixing allowables, to name but a few of its functions, are within the realm of the public rights to be protected. Thus, the spacing order sets the stage for development and guards the public interest in developing an orderly and judicious drilling program. It is aimed at protecting the interest of all, by the prohibitions against waste. The forced-pooling order, among other things, represents the interest of consumers and mineral interests and disallows the "dog in the manger" attitude, which would deny economic development.

* * *

No amount of custom or usage can change the constitutional status and powers of the district courts or the constitutional and statutory powers of the Corporation Commission.

What has approached custom is the practice within the industry (oil and gas) to refine, broaden, and specify duties between pooled interests in a spacing unit to provide specific rights and obligations between the parties. Without attempting to limit or list all such areas covered by operating agreement, and by way of examples, we mention: procedures for payment, methods of accounting, liabilities of parties, regulations of expenditures, procedures for default, etc. Particularly within the realm of costs and payment, the operating agreement may substitute and approve a farm-out agreement as a method of division and may define the interests of such parties, giving one the working interest and the other royalty.

It is likewise common within the industry for the pooling agreement to be in existence and executed between some of the parties interested in the common source of supply and not executed by a "forced party." The forced-party's interest, of course, comes into existence after the forced pooling order is issued, and invariably at a later date than the voluntary agreement between parties. The forced-pooling order does not usually address such items as percentage of the interests owned by the parties, costs as to title examination or insurance, failure of title, successive operators by resignation, not to mention taxes, waiver or non-waiver of partition rights, etc.

In short, the forced-pooling order generally, and specifically in this case, is "bare bones"; many, many problems commonly encountered in the industry must be and were covered by an operating agreement.

8) The Supreme Court has addressed circumstances where special requests or provisions have been sought in a pooling order and determined that such special provisions depends on the evidence presented before the Commission at the time of the hearing on the merits and are not a "matter of right". See *Ranola Oil Company v. Corporation Commission*, 460 P.2d 415 (Okl. 1969) and *Holmes v. Corporation Commission*, 466 P.2d 630 (Okl. 1970).

9) The Supreme Court in *Marathon Oil Company v. Corporation Commission of State*, 651 P.2d 1051 (Okl. 1982) states:

Appellant Marathon additionally contends the Commission's order is fatally erroneous by virtue of the failure of the pooling application to include all owners of a right to drill in the units considered...

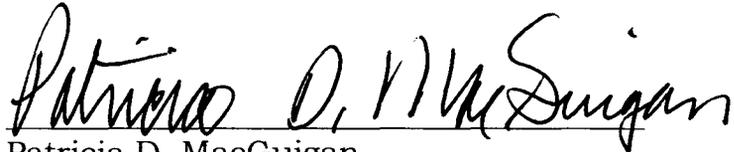
As the pooling statute now reads, it is clearly not contemplated that all owners of a right to drill must be joined in a pooling action. 52 O.S. Supp. 1979 Section 87.1(e) states the pooling action may be brought against those owners who have not agreed to develop as a unit...The authority to require pooling follows immediately upon language recognizing the validity of voluntary pooling agreements, and cannot be taken as a requirement that all owners must be pooled by order...The Appellant is required only to take up the burden of the cost of drilling the requested well coextensive with its ownership. Whether the applicant arranges a voluntary pooling agreement with the balance of the owners or pays all expenses other than Marathon's proportionate share of the cost of the well is immaterial from Marathon's point of view.

In the present case the ALJ in her Report of the Administrative Law Judge on page 4, paragraph 3, states:

Under the statutory powers given to the Commission in 52 O.S. Section 87.1(e), parties are allowed to apply for forced pooling of units when owners cannot reach a voluntary agreement to develop reserves underlying said units. The purpose of the pooling hearing is to assure that the parties receive terms reflecting the fair market value for interests owned under a process that will prevent waste while protecting the correlative rights of the owners. While the Commission does not condone bad faith negotiating of leases or development of reserves, it is without the power to specifically set out steps necessary to be complied with prior to any pooling order being filed to assure that sufficient negotiation has occurred and in an approved manner; these negotiations are part of business dealings among private companies and individuals.

10) Newfield has presented evidence supporting its request for the forced pooling of Section 33. The Referee agrees with the conclusions of the ALJ and for the above stated reasons and legal authority would acknowledge that a pooling order is "bare-bones" as to many of the issues contained within a joint operating agreement. The Referee would therefore recommend the ALJ's Report be affirmed.

RESPECTFULLY SUBMITTED THIS 21ST day of April, 2014.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

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