

**BEFORE THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA**

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CORPORATION COMMISSION
OF OKLAHOMA

<u>APPLICANT:</u>	UNIT PETROLEUM COMPANY)	
)	
<u>RELIEF SOUGHT:</u>	POOLING)	CAUSE CD NO.
)	201501066-T
)	
<u>LEGAL DESCRIPTION:</u>	SECTION 17, TOWNSHIP 6)	
	NORTH, RANGE 7 WEST,)	
	GRADY COUNTY, OKLAHOMA)	

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Kathleen M. McKeown**, Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 6th day of May, 2015, at 8:30 a.m. in the Commission's Courtroom, Kerr Building, Tulsa, 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: **Ron M. Barnes**, and **Grayson Barnes**, attorneys, appeared on behalf of applicant, Unit Petroleum Company ("Unit"); **Charles B. Davis**, attorney, appeared on behalf of Richard L. Allen; Sandra Allen; Donald T Allen; Constance O. Allen; Eric Anthony Allen; Zachary Walton Allen; Richard Walton Resources, LLC; Larry Stanley Resources, LLC; and Canadian River Investment Limited Partnership ("Protestants"); **Karl Hirsch**, attorney, appeared on behalf of Canyon Exploration Company ("Canyon"); and **James L. Myles**, Deputy General Counsel for Deliberations, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed her Report of the Administrative Law Judge on the 28th day of May, 2015, 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 24th day of July, 2015. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

PROTESTANTS TAKE EXCEPTION to the recommendations of the ALJ that the pooling application should be granted; that Unit should be named operator of the well; that the parties timely electing to participate should receive a 60 day spud notice and then have 10 days to pay their share of the completed well costs; and if no well is commenced within 60 days, all monies will be refunded.

Unit seeks to pool the Cisco and Hoxbar common sources of supply as these zones underlie the subject unit. The Protestants object to the terms of payment for participating parties.

THE PROTESTANTS TAKE THE POSITION:

1) The Report of the ALJ is contrary to the law, contrary to the evidence, 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 applicable laws of the State of Oklahoma.

2) The ALJ's recommendation to grant the pooling application filed by Unit should be reversed for the following reasons:

a) The ALJ states that instances where other operators have agreed to use Joint Interest Billings for participating mineral owners, "those instances have always been pursuant to Private Agreement not pooling orders."

Pooling orders facilitate and accelerate the drilling of wells in duly constituted spacing units, but provide leverage in the form of the state's police power, for Unit to coerce the involvement of mineral owners in the unit in one of two ways, i.e. either participate or accept an option to relinquish the right to participate in drilling by acceptance of a cash bonus and royalty.

So called Private Agreement as referred to is not an arms-length transaction but a product of and resulting from the use of the police power to force the issue of development. Whether billing a participant as costs occur is pursuant to a Private Agreement is irrelevant.

b) The ALJ states that Joint Interest Billings "could result" in Unit being placed at risk by participants who stop paying costs requiring District Court action to collect costs owed. While a theoretical possibility, this reasoning is also irrelevant.

Testimony was presented that Protestants are sophisticated mineral owners and have a history of participation not only with other operators in Oklahoma

but have actually participated in a number of wells with Unit in which all payments were timely and properly made with no collection problems.

Moreover, receiving joint interest billings on a monthly basis provides participants with timely periodic information regarding the drilling activity as it occurs which will not be provided if all the cost is paid in a lump sum, prior to commencement of the well.

Periodic billing also would tend to avoid a final billing including cost overruns, if any. Those will have been paid as accrued during the complete drilling process.

c) The recommendation of the ALJ taken at face value still creates a situation where Unit may hold prepaid costs for up to 50 days without either returning the funds, applying them to costs of the well or paying interest on the funds provided by participant.

In addition, if the well is drilled but not completed because of economics, Unit will hold Protestants' funds for an indeterminate time with no obligation to account for the funds in whole or in part or to pay interest on the balance of the funds. Such a result was not contemplated when the pooling statute came into existence.

The Protestants respectfully request that the Report of the ALJ be modified to the extent necessary to authorize and require any order in this cause to provide Joint Interest Billings be sent to Protestants who participate and as modified be granted.

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 Unit be granted. Under any pooling order issuing from the cause the ALJ recommends that, if the Protestants timely elect to participate, they will receive a 60 day notice of spud with payment of their proportionate share of the completed well costs due within 10 days of the receipt of the notice of spud.

2) Under the statutory powers given to the Commission in 52 O.S. Section 87.1(e), parties may 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 in a bare-bones pooling order. 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 in an approved manner; these negotiations are part of business dealings among private companies and individuals. While the Protestants have had other operators agree to use joint interest billing for the Protestants' share of well costs, those instances have always been pursuant to private agreements, not pooling orders. Unit has not ever included joint interest billing provisions in pooling orders and, as an operator, is ultimately responsible for payment of all well costs. Joint interest billings could result in Unit being placed at risk by participants that stop paying costs requiring a district court filing by Unit to recover the well costs owed. The ALJ was not persuaded by the Protestants that this cause requires an order allowing for the incorporation of joint interest billing. While the concerns of the Protestants are legitimate, they do not outweigh the Commission's purpose in issuing orders that prevent waste and protect correlative rights.

3) Thus, in light of the aforementioned conclusions, it is the recommendation of the ALJ that the application in CD 201501066-T be granted. Any order issuing out of the cause should contain the recommendations provided herein.

POSITIONS OF THE PARTIES

PROTESTANTS

1) **Charles B. Davis**, attorney appearing on behalf of Protestants, argues that it is reasonable for Unit to be required to send Protestants a joint interest billing on a monthly basis.

2) Protestants agree that the requirements set out by the ALJ are the standard billing requirements, but that neither case law nor statute, 52 O.S. Section 87.1(e), deny the right to joint interest billing as a reasonable solution. The statute states that payment provisions should be "limited to actual expenditures, not in excess of what is reasonable." Protestants contend this statute allows for joint interest billing as a reasonable payment provision.

3) Protestants also contend that; 1) because the facts show other operators have allowed joint interest billing; 2) Protestants' payment history proves there has never been a problem with their payments; and 3) they are willing to provide financial security information to Unit, that joint interest

billing is a reasonable and definitive payment provision that the Corporation Commission can allow.

4) Also a joint interest billing allows Protestants to see what is going on with the operation. It allows for a flow of financial information to the investors. It shows where the money is going and Protestants argue they need to know what is going on with their investment.

5) Protestants also contend upfront payment is a form of custom and not a legal necessity. When the payment history between Protestants and Unit shows that there is no past problems of payment this upfront custom of payment can be changed.

6) Protestants argue that when the pooling application is filed Protestants do not have a choice if they want to participate, their participation is not voluntary. Protestants are putting in a lot of money according to their share and in the present economy if Unit chooses to drill the well and then not complete it for a period of time, they are holding completion costs that Protestants have put up and not paying any interest on those costs.

UNIT

1) **Grayson Barnes**, attorney appearing on behalf of Unit, contends that to their knowledge an order by the Commission has never offered a joint interest billing as a reasonable definitive payment provision.

2) The ALJ did abide by the statute, 52 O.S. Section 87.1(e), in choosing the standard payment requirement. This standard requirement is a custom followed by the Corporation Commission and by the ALJ choosing to follow the custom this further supports the reasonableness in the decision. There is no legal necessity for it to be another way.

3) Unit argues that the payment is not arbitrary or capricious. In other pooling cases money of the participants is held for a much longer period. The fifty days from receipt of notice of spud to commencement of operations is not an unreasonable amount of time for Unit to hold the Protestants' funds.

4) The concern that Protestants had with Unit commencing operations but not completing the well cannot be shown in the record or by looking at their history of operations. Just as Protestants want Unit to look to their history to discern whether or not a joint interest billing is appropriate,

Protestants can look to Unit's history to discern whether or not they will hold the funds and not complete the well.

5) Unit does offer joint interest billing to other operators that reciprocate that form of payment. This offers a checks and balance for Unit. If an operator that Unit has a joint interest billing with does not pay on their well, Unit can hold payment on that operators well. This type of guarantee through reciprocated joint interest billings allows for a form of checks and balances. Unit's major concern with the joint interest billing with Protestants is that they are interest owners only and there would not be a reciprocated joint interest billing therefore no form of guarantee or checks and balance.

6) Furthermore joint interest billings are made through private agreements and should not be forced through the Commission.

RESPONSE OF PROTESTANTS

1) Protestants reiterate that sending a joint interest billing is reasonable given Protestants' history of payment with Unit has never presented a problem.

2) The reason the financial history was not presented at the hearing is because the financial statement would have been dated at the time the well was commenced and it was not necessary at that time. However, if Unit would like a copy in order to justify a joint interest billing, one will be provided.

3) Finally, nothing has been found in case law or statutes that provides exactly how the payment provision is to be handled by the Commission. Therefore a joint interest billing could be reasonable, especially given that there are no guarantees that Unit will complete the well and will not hold Protestants' funds.

CONCLUSIONS

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

1) The Referee finds that the Report of the ALJ is supported by the weight of the evidence and free of reversible error. The ALJ had presented before her a prima facie case for a "standard" pooling order with "standard" elections, which she determined should be granted without the special provisions requested by

Protestants. Upon review, the Referee can find no reason to vary that determination.

2) 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 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 the 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 the owner's just and fair share of the oil and gas....

3) To protect the rights of all interest owners whose minerals may be drained by the unit well, the Commission is given power to enter the forced-pooling order. The pooling order covers all of the interest owners in the unit, willing or not, and the Commission seeks to protect their correlative rights in relation to one another through adjusting the equities of those owners, balancing the interests of the owners and being responsive to the evidence presented before it in the hearing process. "The pooling order should be responsive to the application and evidence." *C.F. Braun & Co., v. Corporation Commission*, 609 P.2d 1268 (Okl. 1980).

4) In fashioning the pooling orders, the Commission must always consider the purpose for which forced-pooling is provided. The Supreme Court in *Ranola Oil Co. v. Corporation Com'n of Oklahoma*, 752 P.2d 1116 (Okl. 1988) stated:

The purpose of forced 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 exploration...

- 5) The concept of forced pooling is further delineated by *Tenneco Oil Co. v. El Paso Natural Gas Co.*, 687 P.2d 1049 (Okl. 1984); where the Court stated:

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.** (Emphasis added)

* * *

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. (Emphasis added)

6) The Commission and the industry has contemplated that the "standard" pooling order will be "bare-bones" and not cover many of the problems that are satisfied through a joint operating agreement. Special provisions contained in a pooling order are not "a matter of right". Protestants seek to have special provisions placed into the pooling order mostly relying on standard joint operating agreements in the industry.

7) The Referee notes that the Supreme Court has addressed instants where special requests or provisions have been sought in *Ranola Oil Company v. Corporation Commission*, 460 P.2d 415 (Okl. 1969); and *Holmes v. Corporation Commission*, 466 P.2d 630 (Okl. 1970). As stated by the Supreme Court in *Ranola Oil Company v. Corporation Commission*:

Plaintiff in error further maintains that the decision of the Commission in denying him the "third alternative" in a "three way order" is not supported by the evidence. The three way order is a device whereby the party who has a mineral interest in an area to be pooled has the option within a certain time to elect whether he will be carried by the operator or producer of the well as to his proportionate interest for the costs of drilling the well on a percentage penalty basis, or whether he will participate in the costs of drilling the well, or whether he will accept a bonus as

compensation in lieu of participating in the working interest of the well.

The "third alternative" is merely a creature of the Corporation Commission, and is not given as a matter of right. The mandate of the statute, 52 O.S. § 87.1(d), only requires that the order of the Commission, "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. "

8) The ALJ in her Report on page 2, paragraph 2, states:

Under the statutory powers given to the Commission in 52 O.S. Section 87.1(e), parties may 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 in a bare-bones pooling order. 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 in an approved manner; these negotiations are part of business dealings among private companies and individuals. While the Allens have had other operators agree to use joint interest billing for the Allens share of well costs, those instances have always been pursuant to private agreements, not pooling orders. Unit has not ever included joint interest billing provisions in pooling orders and, as an operator, is ultimately responsible for payment of all well costs; joint interest billings could result in Unit being placed at risk by participants that stop paying costs requiring a district court filing by Unit to recover the well costs owed. The ALJ was not persuaded by the Allens that this cause requires an order allowing for the incorporation of joint interest billing. While the concerns of the Allens are legitimate, they do not outweigh the Commission's

purpose in issuing orders that prevent waste and protect correlative rights.

The evidence also reflected that Unit has agreed that if the Protestants timely elected to participate, they would receive a 60 day notice of spud with payment of the proportionate share of the completed well cost due within ten days of the receipt of the notice of spud. Unit has therefore agreed to not 180 days, but has agreed to a notice of spud to where the longest without commencing operations Unit would hold Protestants funds would be 60 days if they paid instantaneously upon receipt of the notice of spud. More likely, it would be 50 days that Unit would hold their payment. Fifty days is not an unreasonable amount of time for Unit to hold those funds. The evidence also reflected that if you get the payments upfront, an operator is able to plan accordingly to do operations as streamlined as possible and do not have setbacks of having to go to district court to make collections.

9) For the above stated reasons, the Referee would affirm the decision of the ALJ to deny Protestant's request for payment of well costs by joint interest billing. Unit has presented evidence supporting its request for the forced-pooling of Section 17 with the pooling order being "bare bones" as to the issue normally contained in a joint operating agreement concerning joint interest billing. The order, however, will include a provision that parties timely electing to participate shall receive a 60-day spud notice and then have ten days to pay their share of the completed well costs, and if no well is commenced within 60 days, all monies will be refunded.

RESPECTFULLY SUBMITTED THIS 22nd day of September, 2015.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Anthony
Commissioner Murphy
Commissioner Hiatt
James L. Myles
ALJ Kathleen M. McKeown
Ron M. Barnes
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