

DH 11/24

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICANT: NEWFIELD EXPLORATION )  
MID-CONTINENT INC. )

) CAUSE CD NO. 201500223-T

RELIEF SOUGHT: POOLING (PART OF A )  
MULTI-UNIT HORIZONTAL WELL )

LEGAL DESCRIPTION: SECTION 2, )  
TOWNSHIP 16 NORTH, RANGE 9 WEST, )  
KINGFISHER COUNTY, OKLAHOMA )

**FILED**  
NOV 0'6 2015

COURT CLERK'S OFFICE - OKC  
CORPORATION COMMISSION  
OF OKLAHOMA

REPORT OF THE OIL AND GAS APPELLATE REFEREE

On October 19, 2015, Oil and Gas Appellate Referee Ben Jackson heard exceptions to the report of Deputy Administrative Law Judge Curtis M. Johnson from the full evidentiary hearing. Before the Referee, Eric R. King appeared for American Energy – NonOp, LLC (“AENO”), and Ron M. Barnes appeared for Newfield Exploration Mid-Continent, Inc. (“Newfield”). Being fully advised of the premises, the Referee finds:

STATEMENT OF THE CASE

1. AENO excepts to portions of the ALJ’s report recommending granting of a second pooling order for the Mississippian and Woodford common sources of supply underlying Section 2-16N-9W.

2. Order No. 631057 established 640-acre horizontal oil units for the Mississippian and Woodford common sources of supply underlying Sections 2 and 11.

3. Order No. 636153 pooled the Mississippian and Woodford common sources of supply underlying Section 2.

4. Under Order No. 636153, Newfield drilled a multi-unit oil well described as the Willms 1H-2X, which is a single zone completion for the Mississippian. The surface location is in Section 11, and the terminus is in Section 2.

5. The application in the above-captioned cause seeks a “cleanup pooling” to add seven respondents to the prior pooling order and additional multi-unit wells for the Mississippian and Woodford. Newfield proposes to develop the two Sections with four to six multi-unit wells.

6. The ALJ recommended the application as proposed by Newfield. Only AENO opposes the ALJ’s recommendation. The dispute centers on the treatment of Mississippian and Woodford as a single unit and the terms and conditions for the payment of costs.

ALJ’s RECOMMENDATION

1. The ALJ recommended granting the pooling application with Newfield as the designated operator.

2. The ALJ recommended royalty provisions consistent with the prior pooling order. However, after the prior pooling order, AENO acquired an overburdened interest and currently asks for the right to elect one-quarter royalty with no cash. The ALJ denied AENO's request for one-quarter royalty, because this term was paid after the well was proposed.

3. The ALJ recommended deferral of the completed for production costs. Any participant in drilling would pay upfront its share of dry hole costs but would only pay completion costs when Newfield decides to complete a well. The ALJ based this recommendation on an agreement by the parties.

4. The ALJ denied AENO's request for joint interest billing. The ALJ found that joint interest billing could place a burden on Newfield and that joint interest is not normally provided in pooling orders.

5. The ALJ recommended that all participants in the first well be allowed to participate in subsequent wells and that any participant should have the right to propose a subsequent well.

6. The ALJ recommended that any participant should be allowed to share in pooled acreage for any future wells but not under the prior pooling order.

7. The ALJ recommended that Newfield be allowed to propose more than two wells at one time, because proposing additional wells would reduce well costs.

8. The ALJ recommended that AENO have the right to audit well costs.

9. The ALJ denied AENO's request for separate elections for Mississippian and Woodford. The ALJ found that fracture treatment of the Meramec portion of the Mississippian extended fractures, which drain reserves from the Woodford Shale.

#### AENO

AENO timely filed extensive exceptions to the ALJ's report. AENO excepted to each of its requests that Judge Johnson rejected. AENO contends that Newfield unreasonably rejected AENO's proposed letter agreement which incorporates terms and conditions accepted by Newfield for other wells. AENO contends that the terms for the proposed pooling order are not just and reasonable as required by 52 O.S. 2011, Section 87.1(e).

#### NEWFIELD

Newfield contends that the parties have a long course of dealings. Newfield proposes to fully develop Sections 2 and 11 in a prudent manner. Newfield's application is consistent with the prior pooling order and treats all owners in a just and reasonable manner.

### REFEREE'S FINDINGS

1. The application seeks to add seven respondents to a forced pooling involving one horizontal drilling and spacing unit of a two Section multi-unit project. The project will consist of four to six horizontal wells including the Willms well. Newfield is the designated operator under the prior pooling order and will remain the designated operator under the proposed order. In Section 2, Newfield owns 144 acres, while AENO owns 198.7 acres.

2. As a precondition to forced pooling, OAC 165:5-7-7(a) required Newfield to make a bona fide effort to reach an agreement with each respondent as to how the unit should be developed. AENO contends that Newfield failed to make a bona fide effort to reach an agreement. AENO contends that Newfield refused to accept terms of AENO's proposed letter agreement containing terms accepted by Newfield for other wells elsewhere in this field. I agree with the ALJ that the course of dealings met the minimum requirements of the rule, even though the parties failed to reach an agreement. Transcript page 47 shows that Newfield's lease broker sent AENO a pre-pooling proposal letter offering the right to participate or receive royalty and cash consistent with the prior pooling order.

3. The ALJ denied AENO's request for no cash and one-quarter royalty. The ALJ concluded that he had to reject the request, because the interest was acquired after the well was proposed. The ALJ's approach is consistent with the terms of the prior pooling order. However, the underlying issue is not the timing of a transaction but fair market value for the right to drill. AENO acquired a small interest with only a seventy-five percent net revenue interest, when fair market value required at least an eighty-percent net revenue interest. The transaction for a seventy-five percent net revenue interest was an isolated transaction which failed to represent fair market value, and Newfield should only have to pay nominal consideration for the overburdened interest.

4. The ALJ found that any of the seven respondents who elect to participate should share in pooled acreage in future wells but not under the prior pooling. I disagree with the ALJ concerning rights under the prior pooling. The new respondents get elections for the Willms well and are entitled to the same elections offered other owners. The prior pooling order provided for sharing of pooled acreage. See Transcript pages 167 and 168. Page 168 of the Transcript states that AENO can elect to share in pooled acreage under the prior pooling order. Sharing in pooled acreage is an equitable right of the participants in the unit. See *Woolley v. Corp. Comm.*, 2011 OK CIV App 90 ¶12, 261 P.3d 1181, 1184. Consequently, the better view is that any person electing to participate under the new pooling order should have a right to share in pooled acreage under the prior pooling order.

5. The ALJ denied AENO's request for separate elections for the Mississippian and Woodford. The ALJ found that fracture treatment of the Meramec extended fractures into the Woodford Shale and drained reserves from the Woodford Shale. The ALJ based his conclusion on Newfield's engineering testimony on the micro-seismic surveys, which are not in the record. The Newfield's testimony appears at pages 119 and 120 of the Transcript. I disagree with the

ALJ about whether that testimony resolves the separate elections question. The testimony failed to identify and quantify any type of Woodford production, and the testimony does not state that a fracture treatment for the Meramec will prudently develop the Woodford Shale. Consequently, the evidence did not resolve the issue of whether drilling new wells or adding laterals to existing wells is needed to prudently develop the Woodford. As a result, I do not think that it is fair and reasonable to require a Woodford election based on an AFE for a Meramec completion. Therefore, I recommend separate elections for the Mississippian and the Woodford.

6. A major issue in this cause is the ALJ's requirement that AENO must pay approximately \$7.8 million dollars to participate in four multi-unit wells. The ALJ gave AENO some relief by only requiring dry hole costs to be paid upfront. Nevertheless, AENO made several proposals to further stagger the payments. One approach was to allow an election for two wells as opposed to all four wells. I agree with the ALJ that the two well election is inappropriate. Newfield showed potential savings of three-hundred thousand dollars per well on drill pad and rig mobilization costs and that maximizing ultimate recovery requires simultaneously fracture treating multiple wells within the same plane.

7. The ALJ denied AENO's request for joint interest billing ("JIB") or escrow account. Newfield insisted on lump sum payments based on an alleged problem where AENO wired a payment on a well allegedly without proper instructions. See Transcript page 66. However, on Transcript page 146, AENO showed that the payment was timely made and for the correct amount. Be that as it may, the issue on JIB is really not about AENO's ability to pay or its payment history. The Commission generally offers JIB for drilling and completion operations only with consent of the designated operator. In a pooling, the designated operator must have sufficient money to pay actual expenses, including his supervision fee, up to the point of distribution of proceeds from production through permanent production equipment. The challenge in preparing the AFE is to have enough money to address any unforeseen emergency. As a result, the traditional approach is to recognize that the AFE is just a ballpark estimate and that the designated operator needs a reasonable amount of money upfront. The ALJ appropriately required participants in unit wells to pay dry hole costs upfront and to pay completion costs later before wells are completed.

8. The ALJ found that he had never seen escrow account required by a pooling order. The legal theory for an escrow account arises from *Superior Oil Co. v. Corp. Comm.*, 1952 OK 123, 242 P.2d 454. Under *Superior*, the threshold question is whether the Commission needs to protect the payments from well participants because of the potential insolvency of the unit operator. That problem does not apply here. Therefore, the ALJ correctly denied the request for an escrow account.

RECOMMENDATION

Based on the foregoing findings, I recommend that the Commission affirm in part and reverse in part.

Respectfully submitted,

  
\_\_\_\_\_  
Ben Jackson  
Oil and Gas Appellate Referee  
  
11/6/2015  
\_\_\_\_\_  
Date

Xc:  
Commissioner Anthony  
Commissioner Murphy  
Commissioner Hiatt  
Joseph Briley  
Teryl Williams  
Nicole King  
Eric R. King  
Ron M. Barnes  
Curtis M. Johnson  
Michael Decker  
Court Clerk  
Commission records