

FILED
AUG 31 2016

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

COURT CLERK'S OFFICE - OKC
CORPORATION COMMISSION
OF OKLAHOMA

<u>APPLICANT:</u>	CITIZEN ENERGY II, LLC)	
)	
<u>RELIEF SOUGHT:</u>	POOLING)	CAUSE CD NO.
)	201506281-T
)	
<u>LEGAL DESCRIPTION:</u>	SECTION 4, TOWNSHIP 9)	
	NORTH, RANGE 5 WEST,)	
	GRADY COUNTY, OKLAHOMA)	

REPORT OF THE OIL AND GAS APPELLATE REFEREE

This Cause came on for hearing before **Curtis M. Johnson**, Deputy Administrative Law Judge for the Corporation Commission of the State of Oklahoma, on the 2nd day of March, 2016, 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: **William H. Huffman**, attorney, appeared on behalf of applicant, Citizen Energy II, LLC ("Citizen"); **Roger A. Grove**, attorney, appeared on behalf of Mid-Continent II, LLC, Linn Operating, Inc. and Linn Energy Holdings, LLC (collectively "Linn"); and **James L. Myles**, Deputy General Counsel for Deliberations, filed notice of appearance.

The Administrative Law Judge ("ALJ") filed his Report of the Administrative Law Judge on the 6th day of June, 2016 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 15th day of July, 2016. After considering the arguments of counsel and the record contained within this Cause, the Referee finds as follows:

STATEMENT OF THE CASE

LINN TAKES EXCEPTION to the recommendation of the ALJ to grant the pooling application of Citizen and name Citizen as operator.

LINN TAKES THE POSITION:

- 1) The ALJ Report is contrary to the law, contrary to the evidence and is arbitrary, unreasonable and discriminatory and fails to effect the ends of the prevention of waste and the protection of correlative rights as is required by the applicable rules of the State of Oklahoma.
- 2) The ALJ has erred in recommending that Citizen be designated as unit operator under the pooling order to issue in the captioned cause. The evidence shows that Linn is the owner of the majority interest in the unit by a wide margin (approximately 66% to approximately 30%) and as such will have much more at stake in the drilling of the initial well and the unit development.
- 3) The ALJ gave undue weight to the fact that Citizen was the moving party by first filing the applications for spacing, a location exception and pooling of the subject unit. Just because one minority owner in the unit jumps out and files applications while the other majority owner is conducting seismic tests running in the millions of dollars to properly and thoroughly evaluate the unit and determine the best course of action by moving in a measured, deliberate manner to develop the subject common sources of supply, that majority owner should not be penalized by granting operations of the unit and common sources of supply to the minority owner.
- 4) The ALJ further gave undue weight to the fact that Citizen was the moving party by having drilled more horizontal Woodford wells in this particular area. The ALJ failed to take into account that Linn has drilled many, many more wells, and many more horizontal wells, than Citizen. Therefore, Linn actually has more experience in drilling horizontal wells than does Citizen, just not Woodford wells in this immediate area.
- 5) Linn respectfully requests that this Commission enter an order granting the pooling application but reversing the recommendation of the ALJ as to designation of operator and designate Linn Operating, Inc., as agent for Mid-Continent II, LLC, as unit operator of the unit and common sources of supply covered by the application filed in the captioned cause, and for such further relief to which it may be entitled in the premises.

THE ALJ FOUND:

- 1) After taking into consideration all of the facts, circumstances, evidence and testimony presented at the hearing, the ALJ finds that Citizen should be named as operator. In ruling, the ALJ relies heavily upon Mr. Charles Nesbitt's article on pooling orders and operations. Mr. Nesbitt emphasizes that with all things being equal, a party owning the majority interest in the unit and incurring the most financial risk should generally be named as operator. (See

OBJ Vol. 50, No. 13, Page 648 through 656) However, in this case, things are not equal. Even though Linn has the largest interest in the unit, both parties have similar interest in the area.

2) Citizen is the moving party to develop this unit. Citizen filed a spacing, pooling, rules exception and location exception. Citizen proposed the well first (see Exhibit 9). Linn's response was a reproposal (See Exhibit #11).

3) This is a Woodford play. Citizen has drilled 13 or 14 wells to develop the Woodford in the area. There was no testimony Linn has drilled any horizontal Woodford wells in the area. Citizen is the moving party. Citizen proposed the well. Citizen has been developing the Woodford. Citizen has the experience to drill this well. These factors override Linn's interest in the unit being superior. The pooling order should provide that as to a participating party, well information will be provided to the participants within 48 hours of receipt of the information by the operator.

POSITIONS OF THE PARTIES

LINN

1) **Roger A. Grove**, attorney, appearing on behalf of Linn, stated the appeal is about the designation of unit operator.

2) Linn's title opinion shows Linn controls approximately 66.5% (426.6 acres) to Citizen's 30% (194.6 acres). Linn is the only party that has run seismic in the area. Linn notes Citizen is a newly formed company with approximately 14 employees whereas Linn is based in Houston with approximately 600 employees to operate 13,000+ wells. Linn pointed out past issues regarding Citizen's handling of well data to participants, resolved only by filing of motions to obtain the required data. Linn notes the ALJ excluded these facts from his Report.

3) Linn notes that on the Sofia #1-31 well Citizen had flip-flopped the location of the well, not informed any working interest owners in the well, nor sought any approval for that, and thus denied participants to change their elections.

4) Linn points out on page 8 of the ALJ Conclusions, the ALJ mentions the Nesbitt pooling article which states "All other things being equal the owner of the largest share of the working interest has the best claim to operations." Linn disagrees with the ALJ's belief that in this cause things "are not equal".

Linn disagrees that its 66.5% ownership and Citizen's 30% ownership meet the definition of both parties having similar area interest.

5) Linn asserts the "similar interest in the area" should have no bearing on which party should be designated unit operator.

6) Linn notes the ALJ believes Citizen is the moving party here from viewing Exhibit 9. Linn notes this exhibit was not Citizen's proposal letter for the well herein, the TBD 54-9N-5W well. Linn states Exhibit 9 referenced the Sofia #1-31 well whereupon Citizen had flip-flopped the drill direction without giving notice to the participants.

7) Linn notes the real proposal letter for the well herein was never placed into the record. The transcript reflects on page 64 that Citizen's proposal letter was dated about a week before Linn's on December 7, 2015. How can a reproposal letter on a different well be considered in a reward of operations issue?

8) Linn notes while Citizen may have been the first to the courthouse, this alone does not define it as the moving party. It just means Citizen was the first party to file their application.

9) Linn's approach to development is a science-based approach. Linn has spent \$6 million on seismic data. Linn is currently evaluating the seismic. Linn feels it is being penalized for their efforts in acquiring science data prior to filing applications. Linn believes its seismic data begun 1.5 years ago are signs of being a moving party.

10) The Nesbitt article goes on to state "This is not a simple race to the courthouse with the earliest applicant getting the nod." Linn notes how many of the wells drilled by Citizen were Woodford is unknown.

11) Linn notes the ALJ states "This is a Woodford play and Citizen has drilled 13 or 14 wells to develop the Woodford in the area and there was no testimony Linn has drilled any horizontal Woodford wells in the area. Citizen is the moving party. They proposed this well. They've been developing the Woodford and they have the experience to drill this well. These factors override Linn's interest in the unit being superior."

12) Linn has drilled 402 horizontal wells which they currently operate versus Citizen's 13 to 14 wells. Linn asserts when determining operations, who first proposed the well or who filed the application should be given little, if any weight, as all things are not equal as noted with the ownership discrepancy of 66% to 30%.

13) Linn notes the ALJ ignored the issues had with Citizen on Citizen's operated wells in the past, where Linn claims that Citizen was essentially

"stacking the deck." Linn notes Citizen proposed additional wells and then withheld crucial well information from offset wells needed by participants in order to make proper elections, in order to gain a competitive advantage.

14) Linn notes the ALJ ignored the fact that for every dollar spent by Citizen on this \$5.9 million well, Linn would be paying \$.66 on the dollar, while Citizen would only be paying \$.30 on the dollar. Linn notes that historically the Commission sides with the largest owner as the operator, i.e. the one who has the most to lose. Linn believes the owner with the most to lose should be the one in charge of the decisions on the well.

15) Linn did adopt Citizen's Exhibit 3, the AFE of \$5.9 million.

16) Linn disagrees with the ALJ's decision to allow Citizen to have control over unit development. Linn believes when Linn is the largest owner of a unit, it is proper for Linn to be the designated unit operator.

17) Linn disagrees with the ALJ's belief that because a company has drilled the most wells in an area, this alone, is a reason to reward operations to Citizen. Linn disagrees that just because Citizen has a majority interest in an area, it should not automatically require Citizen to be the operator in every section out there.

18) Linn disagrees that Citizen's relative activity here in the area is enough to award Citizen operatorship. Linn believes that every section needs to be looked at individually. Linn believes the ALJ should be aware of Linn's dealings with Citizen in past wells prior to making any operator decision here.

19) Linn believes the ALJ's decision should be reversed, with Linn Operating, Inc. as agent for Mid-Continent II, LLC, being designated the unit operator in Section 4.

CITIZEN

1) **William H. Huffman**, attorney, appearing on behalf of Citizen, believes there was adequate evidence in the record to support the ALJ's decision to award operations to Citizen.

2) Citizen notes the ALJ looked at the Nesbitt article factors. Citizen proposed the development here. It was opposed by Linn. Citizen filed the spacing, the location exception, the pooling. Citizen even filed a consent to the spacing because Linn refused to consent to the horizontal spacing and Linn filed an exception to the rule because Linn protested. Citizen filed the

paperwork in December 2015 and nearly eight months later, Citizen is still trying to get this area developed.

3) Citizen notes in the Woodford play here that seismic will not add to the knowledge here. Citizen's geologist is confident in the geology alone to drill the well, hence, seismic is unneeded.

4) Citizen has drilled approximately 13 wells in the last seven months within a ten mile radius of this particular location. Citizen has operations in the immediate nine section area.

5) Citizen notes that Linn's landman was unable to state with certainty what well data Linn was still needing.

6) Citizen notes the Linn acreage here was legacy acreage, i.e. owned for many years yet never developed. Citizen decided to acquire acreage and moved forward to get development started in the Woodford.

7) Citizen notes the purpose of a forced pooling is a vehicle by which the smaller owners can get their acreage developed when bigger companies sit on it, thus, leaving a stranded investment.

8) Citizen asserts it is the moving party here, not Linn. Citizen believes the only reason Linn is now sending out proposal letters is due to Citizen's actions here. Citizen has been ready to move forward but has been continuously delayed by Linn's conduct.

9) Citizen notes Exhibit 3, United States Securities and Exchange Commission Form 12b-25, has a serious concern, not raised by Linn. Citizen notes Linn told the United States Securities and Exchange Commission, Form 10-K that "...Accordingly, the uncertainty associated with the Company's ability to meet its obligations as they become due raises substantial doubt about its ability to continue as a going concern." Citizen notes if Linn were to become the operator that Citizen could find themselves in a bankruptcy quagmire, and prevents Citizen from protecting their interest, but if Citizen pre-paid their money what happens to their pre-payments. Are the bills going to be paid by Linn to the contractors? What about the security of Citizen's interest and are we going to have liens due to unpaid bills by Linn.

10) Citizen notes the ALJ decided not to take those factors into consideration due to the ALJ's belief that Citizen should be the designated operator.

11) Citizen had taken the necessary steps to begin development, over Linn's protests. Citizen has the necessary experience to drill the wells here, as Linn has been a player in Citizen's drilled wells. Linn did not dispute this fact.

12) Citizen notes it plans to drill approximately 18 more wells prior to the end of 2016. Citizen has personnel to operate these wells and the ability to pay its bills.

13) Citizen wants to protect their interest here and not end up with a stranded investment, waiting for a shaky company to take over and try to operate the well. Citizen notes the moving party in an area is one of the biggest factors to look at in deciding operations. Citizen notes the ALJ weighed the evidence and decided in favor of Citizen. The ALJ should be upheld on appeal.

RESPONSE OF LINN

1) In the transcript the ALJ stated "I know there were issues that were pointed out regarding financial information of Linn and potential issues. I believe that could have been adequately addressed by the offer to place the drilling moneys in escrow, which would not have caused an issue if Linn would have had some problem where they would have to file bankruptcy."

2) Linn wonders how one can tell the ALJ one has not received all the well data when one has no specifics as to what data has not yet been received? Linn notes some of the missing data is of a technical nature yet Linn still has not received all the data requested from Citizen.

3) Linn notes the cause was filed in December 2015 and heard early March, 2016.

4) Linn notes someone with a small interest can come in, prepare an AFE, etc., and say we're the moving party. Linn responded back to Citizen with its own proposal letter with a title opinion and available rig and Linn was ready to drill the well.

5) Linn gets dumped on basically with operations given to a smaller owner, despite the wide percentages of ownership here.

6) Linn believes just because Citizen may have larger interest in nearby sections this does not require/imply that Citizen must be assigned operator of the entire field i.e. all of the sections near Citizen's current operating units.

7) Linn believes each section/unit operator must be looked at on a case-by-case basis, with one party on the ball or another party ready to go. Linn has shot seismic, which Citizen disagrees is needed here. Linn is ready to drill.

- 8) Linn disagrees with Citizen being granted operator, after having drilled no Woodford wells in the nine section area.
- 9) Linn believes it is wrong to grant operations to a smaller company when Linn has approximately 402 horizontal wells in their belt/experience.
- 10) Linn requests the ALJ's decision be reversed with Linn being named as unit operator.

CONCLUSIONS

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

- 1) After review of the March 2, 2015 transcript of the proceedings and the exhibits presented by the parties, the Referee finds the Report of the ALJ should be affirmed with the provisions as provided by the Report of the Administrative Law Judge. There is no dispute as to the terms of the pooling order, except for the designation of operations. Citizen is proposing to drill an approximate 14,900 foot measured depth horizontal well to the Woodford common source of supply.
- 2) The ALJ's Report is supported by the weight of the evidence, by law and free of reversible error. The ALJ is the initial finder of fact. It is the ALJ's duty as the finder of fact 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); *Palmer Oil Corporation v. Phillips Petroleum Company*, 231 P.2d 997 (Okl. 1951).
- 3) 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) sets forth a good review of the factors considered and the importance that the Commission attaches to those factors.
- 4) Mr. Nesbitt states:

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 notable 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.

5) As noted in said article, the ownership position of the parties and the actual bona fide exploration activity are factors that are given consideration by the ALJ. In the present case there are a number of factors presented for consideration. The ALJ acknowledged those considerations. In Section 4 Linn controls approximately 66.5% (426.6 acres) to Citizen's 30% (194.6 acres). Citizen was first to propose the drilling and development in this section. Citizen filed a spacing, a location exception and the present pooling. Linn would not consent to the horizontal spacing so Citizen filed an exception to the rule and it was protested by Linn. Citizen is in the process of drilling its 13th and 14th wells in the prospect area. Citizen has a position in the offsetting units in the Mississippian and Woodford formations of between 1,900 acres to 2,100 acres. The testimony reflected that Citizen has 7,190 acres in the prospect area and has spacing, pooling and location exception applications

filed. The testimony reflected that Citizen has settled surface damages for multiple wells and is the most active operator in the area. Citizen is drilling or has drilled six wells in the immediate area with three being multi-unit wells. While Citizen doesn't own or control the majority interest in this unit, it has a controlling interest in the area and is a very active operator with a significant investment in development of this area. The evidence reflected that Citizen has seven wells scheduled within the next 90 days, and a total of 13 to 16 additional wells to be drilled this year.

6) The Citizen testimony reflected that in the Woodford play seismic is not needed, as it will not add to the knowledge concerning the geology to drill the well in the Woodford.

7) The ALJ states in his Report of the ALJ on page 8 in the second paragraph of his Conclusions of Law:

The ALJ finds that Citizen Energy II, LLC should be named as operator. In ruling, the ALJ relies heavily upon Mr. Charles Nesbitt's article on pooling orders and operations. Mr. Nesbitt emphasizes that with all things being equal, a party owning the majority interest in the unit and incurring the most financial risk should generally be named as operator. (See The Oklahoma Bar Journal Vol. 50 No. 13 Page 648 through 656) However, in this case, things are not equal. Even though Linn has the largest interest in the unit, both parties have similar interest in the area. Citizen is the moving party to develop this unit. They filed a spacing, pooling, rules exception and location exception. Citizen proposed the well first (See Exhibit #9, Citizen Energy II, LLC Proposal Letter to Chaparral Energy, Inc. dated 7/7/15) Linn's response was a reproposal (See Exhibit #11 Osage Oil & Gas Proposal Letter to Silas Hughes dated 12/18/15). This is a Woodford play and Citizen has drilled 13 or 14 wells to develop the Woodford in the area, and there was no testimony Linn has drilled any horizontal Woodford wells in the area. Citizen is the moving party, they proposed the well, they have been developing the Woodford, and they have the experience to drill this well. These factors override Linn's interest in the unit being superior.

8) The ALJ had the opportunity to observe the demeanor of the expert witnesses while they were testifying. Generally, deference is given to a judge's opportunity to view the witnesses firsthand. In *Williams v. Volkswagenwerk*

Aktiengesellschaft, et al., 180 Cal.App. 3rd 1244, 226 Cal.Rpt. 306 (Cal.App.2nd District 1986) the court held:

Common sense dictates the rule. It is the trial judge who is at the best advantage point to surveil the grenades, the darts, the slings and arrows of outrageous forensic conduct, rather than the reviewer, who, with the delayed deliberate detachment of a coroner examines the cold body of the record only after the warm life of trial has expired and its rattlings have ceased.

9) When it comes to applying weight to an expert witness it is clear that the Commission must follow the procedures set forth in *Haymaker v. Oklahoma Corporation Commission*, 731 P.2d 1008 (Okl.Civ.App. 1986) where the Court stated:

Proper appraisal of the expert testimony requires observance of the following benchmark principle approved in *Downs v. Longfellow Corp.*, 351 P.2d 999 (Okl. 1960):

"The reasons given in support of the opinions [of an expert witness] rather than the abstract opinions are of importance, and the opinion is of no greater value than the reasons given in its support. If no rational basis for the opinion appears, or if the facts from which the opinion was derived do not justify it, the opinion is of no probative force, and it does not constitute evidence sufficient to...sustain a finding or verdict. "

10) The issue concerning the assignment of weight to expert testimony in direct conflict is addressed by the Supreme Court in *Palmer Oil Corporation v. Phillips Petroleum*, supra, at 1000, stating:

At the hearing herein the testimony adduced was chiefly that of petroleum engineers and geologists who testified on the basis of both personal surveys made and of an interpretation of the accumulated data in the hands of the Commission. The testimony of these experts was in direct conflict but that of each was positive upon the issue. Under the circumstances the objection is necessarily

addressed to only the weight of the evidence. Under the holding of this Court and that of courts generally, *Chicago, R.I. and P. Ry. Co. v. Pruitt*, 67 Okl. 219, 170 P. 1143; 22 C.J. 728, Section 823, 32 C.J.S., Evidence, Section 567, p. 378, the weight to be given opinion evidence is, within the bounds of reason, entirely for the determination of the jury or of the court, when trying an issue of fact, it taking into consideration the intelligence and experience of the witness and the degree of attention he gave to the matter. The rule should have peculiar force herein where by the terms of the Act the Commission is recognized as having peculiar power in weighing the evidence. Since the evidence before the Commission was competent and sufficient if believed, to sustain the order we must, and do, hold that the order is sustained by the evidence and that the contention is without merit. *Ft. Smith & W.Ry Co. v. State*, 25 Okl. 866, 108 P. 407; *Bromide Crushed Rock Co. v. Dolese Bros. Co.*, 121 Okl. 40, 247 P. 74.

- 11) The Supreme Court of Oklahoma in *Application of Choctaw Express Company*, 253 P.2d 822 (Okl. 1953) stated:

Other courts have said the principle which applies in determining whether the evidence will support a jury verdict, applies to findings of the Commission. We think that every order of the Commission must be sustained by competent and material evidence, and that an order is not justified without a basis in evidence having rational probative force. This case, therefore, calls for an answer to the question, whether there is substantial evidence to support the order of the Commission....In these cases we defined "substantial evidence" as something more than a "scintilla of evidence" and said it means evidence that possesses something of substance and of relevant consequence and such that carries with it fitness to induce conviction .

12) *Application of Continental Oil Company*, 376 P.2d 330 (Okl. 1962), the Supreme Court stated:

The Commission has a wide discretion in the performance of its statutory duties and this court may not substitute its judgment on disputed questions of fact for that of the Commission, unless the findings of the Commission are not supported by the law and substantial evidence.

See also *Vogel v. Corporation Commission*, 399 P.2d 474 (Okl. 1965).

13) In *Chenoweth v. Pan American Petroleum Corporation*, 382 P.2d 743 (Okl. 1963) the Supreme Court stated:

In *Producers Development Company v. Magna Oil Corporation*, Okl. 371 P.2d 702, we stated:

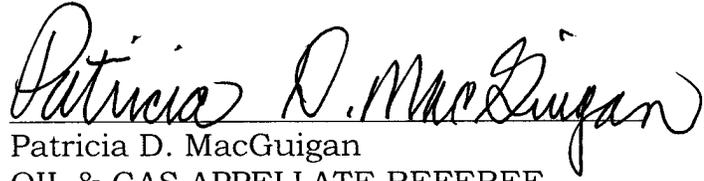
"The determination whether there is "substantial evidence" to support an order made by Corporation Commission does not require that the evidence be weighed, but only that the evidence tending to support the order be considered to determine whether it implies a quality of proof which induces the conviction that the order was proper or furnishes a substantial basis of facts from which the issue tendered could be reasonably resolved."

See also *Cameron v. Corporation Commission*, 414 P.2d 266 (Okl. 1966).

14) The ALJ, who is the initial finder of fact, found the Citizen experts to be more credible. The Referee finds there is substantial evidence to support the ALJ's recommendation. The ALJ chose to consider all of the factors as in a normal operator fight. From the substantial evidence before him the ALJ determined that Citizen is the primary mover in the unit and area; and, that Citizen, which has significant Mississippian and Woodford horizontal experience, should be named operator. The ALJ determined that the balance of factors support Citizen as operator. After reviewing the transcript and

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

RESPECTFULLY SUBMITTED THIS 31st day of August, 2016.


Patricia D. MacGuigan
OIL & GAS APPELLATE REFEREE

PM:ac

xc: Commissioner Anthony
Commissioner Murphy
Commissioner Hiatt
James L. Myles
ALJ Curtis M. Johnson
William H. Huffman
Roger A. Grove
Michael L. Decker, OAP Director
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