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THE STATE CORPORATION COMMISSION
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Kansas Corporation Commission
J. & Patricia Petersen/11/11

In the Matter of an Order to Show Cause on the)
Commission's won Motion issued TSCH, LLC,) Docket No. 11-CONS-253-CSHO
Gary and Kayla Bridwell dba Black Rain Energy,)
and John M. Denman Oil Co., Inc., with regard to) CONSERVATION DIVISION
responsibility under K.S.A. 55-179 for plugging)
the M. A. Alexander lease in the East Half of the) License No. 34407
Northwest Quarter and the West Half of the North-) License No. 30916
east Quarter of Section 31, Township 34 South,) License No. 5729
Range 12 East, Chautauqua County, Kansas.)
_____)

MEMORANDUM OF RESPONDENT
JOHN M DENMAN OIL CO., INC.

COMES NOW, respondent John M. Denman Oil Co., Inc. ("Denman"), and submits to the State Corporation Commission of the State of Kansas ("KCC" or "the Commission") its memorandum on the issue presented for determination, evidence adduced at the hearing on September 15, 2011, and legal arguments with proposed conclusions of law to be reached by the Commission in this docket.

INTRODUCTION

On June 3, 2011, the Commission issued its Order to Show Cause in this docket to determine the party or parties legally responsible for plugging 44 wells located on the M. A. Alexander Lease in the East Half of the Northwest Quarter (E/2 NW/4) and the West Half of the Northeast Quarter (W/2 NE/4) of Section 31, Township 34 South, Range 12 East, Chautauqua County, Kansas. Named in this Order as potentially responsible parties, based upon current or prior ownership of leases covering the affected acreage, were TSCH, LLC ("TSCH"), Gary Bridwell and Kayla Bridwell ("Bridwells"), doing business as Black Rain Energy, and Denman. The sole issue for determination

in this proceeding is whether one or more of the respondents is legally responsible for plugging open and abandoned wells on the Alexander Lease.

SUMMARY OF TESTIMONY AND EVIDENCE

At the hearing, the Commission Staff presented the testimony of Ryan Duling and Duane Sims, each a Petroleum Industry Regulatory Technician II at the Commission's Chanute District 3 office, and John Almond, Compliance Officer and Petroleum Industry Regulatory Technician II at the Commission's Chanute District 3 office. Together, these witnesses testified that this matter began with a complaint from the owners of the surface rights associated with the Alexander Lease in August 2007 concerning abandoned wells, spills and oil field debris on the property. Duling Prefiled Testimony, p. 2, lines 24 through 30; Almond Prefiled Testimony, p. 3, lines 7 through 12. Investigation of public records showed Denman to be the current owner of the lease, and a GPS survey of the lease by Mr. Duling on April 30, 2008 revealed the existence of 32 unplugged wells. Duling Prefiled Testimony, p. 3, lines 10 through 17; p. 3, line 31 through p. 4, line 2. After being apprised of compliance issues by the Commission in October 2007, Denman indicated that its interest in the lease was to be conveyed to the Bridwells, and initiated a meeting between Mr. Duling, Wayne Bright on behalf of Denman, and Gary Bridwell on June 27, 2008 to discuss the Commission's requirement that the abandoned wells be restored to production or plugged within an acceptable period of time. During this meeting, Mr. Bridwell assured Mr. Duling and Mr. Bright that he would begin work on the Alexander Lease immediately, and agreed to accept full responsibility for all unplugged wells on the lease. Duling Prefiled Testimony, p. 4, lines 8 through 21; Sims Prefiled Testimony, p. 3, lines 4 through 23; Transcript, p. 31, lines 5 through 13.

Denman assigned its rights to the Alexander Lease to the Bridwells in July 2008. Duling Prefiled Testimony, p. 3, lines 14 through 17; Duling Exhibit 2. Progress was not made to the Commission's satisfaction, however, and on December 30, 2008, John Almond, the District 3 Compliance Officer, submitted a Notice of Violation letter to Mr. Bridwell requiring that a specific number of wells either be restored to production or plugged. Duling Prefiled Testimony, p. 4, line 29 through p. 5, line 25; Duling Exhibit 7; Almond Prefiled Testimony, p. 5, lines 12 through 20; Almond Exhibit 6. Additionally, Gary Bridwell signed an agreement with the Commission in January 2009 that required the Bridwells to produce or plug at least two wells per month, so that all of the abandoned wells would be producing or plugged within a two year period. Sims Prefiled Testimony, p. 3, line 30 through p. 4, line 2; Sims Exhibit 2; Almond Prefiled Testimony, p. 4, lines 24 through 30; p. 5, line 27 through p. 6, line 6; Almond Exhibit 4. The Bridwells equipped three wells and produced them for a short time, but did not plug any wells or otherwise comply with the agreement.

The Bridwells assigned their rights to the Alexander Lease to TSCH in March 2010, and Commission records show TSCH to be the current operator of the Alexander Lease. Almond Prefiled Testimony, p. 4, lines 10 through 12. TSCH has not produced or plugged any wells, but ran pipe in two wells, moved two pump jacks without setting them on wells, and applied for and received authorization for salt water injection into the Alexander Well No. 16, KCC Docket No. E-30,693. Sims Prefiled Testimony, p. 4, lines 18 through 29; Almond Prefiled Testimony, p. 4, line 31 through p. 5, line 8. TSCH was made aware of the pending compliance issues by the Commission before it acquired rights to the Alexander Lease from the Bridwells, and agreed to produce wells on the Alexander Lease. Almond Prefiled Testimony, p. 7, lines 7 through 25; Almond Exhibit 9. TSCH filed an application for a ten year temporary abandonment exception for the wells on the lease

which was denied by the Commission. Almond Prefiled Testimony, p. 8, lines 3 through 5; Almond Exhibit 11.

Duane Sims confirmed that the GPS survey conducted by Ryan Duling had located 32 abandoned wells on the Alexander Lease, but further testified that “[t]he lease had thick native grass three feet tall and the rocky, brushy terrain proved to be very challenging and in some cases impossible to locate wells at the surface of the ground.” Sims Prefiled Testimony, p. 5, lines 14 through 16. Inspection later by Mr. Sims and John Almond in November 2010 identified 12 additional abandoned wells. Sims Prefiled Testimony, p. 5, lines 16 through 24; Almond Prefiled Testimony, p. 3, lines 12 through 14. Change of Operator forms (Form T-1) filed with the Commission by Gary Bridwell showed 32 wells transferred by Denman to the Bridwells, and the same 32 wells transferred by the Bridwells to TSCH. Sims Prefiled Testimony, p. 5, line 25 through p. 6, line 5; Sims Exhibits 1 and 3; Almond Prefiled Testimony, p. 8, line 27 through p. 9, line 8.

Gary Bridwell testified for the Bridwells. He confirmed that the Bridwells had obtained full rights to the Alexander Lease by assignment from Denman effective July 1, 2008, and that they assumed full responsibility for all wells on the lease.. Bridwell Prefiled Testimony, p. 1, lines 17 through 22; Exhibit GB-1; Transcript, p. 87, line 18 through p. 88, line 7. He also acknowledged that they had equipped and reinstated production from three wells on the lease, but that operations were discontinued and the lease was assigned to TSCH on April 1, 2010. Bridwell Prefiled Testimony, p. 2, lines 1 through 19; Exhibit GB-2; Transcript, p. 89, line 4 through p. 90, line 6. The operator of record is currently TSCH. Bridwell Prefiled Testimony, p. 3, lines 11 through 16; Exhibit GB-4. Mr. Bridwell admitted the existence of an agreement between the Bridwells and the Commission for producing or plugging wells on the Alexander Lease, and that the compliance obligations set forth in that agreement were never fulfilled, but alleged that the agreement was

superceded by a later agreement between TSCH and the Commission with the same objectives. Bridwell Prefiled Testimony, p. 3, line 22 through p. 5, line 2; Exhibit GB-5. According to Mr. Bridwell, the Bridwells currently have no right to operate or control the Alexander Lease, or any of the wells located thereon. Bridwell Prefiled Testimony, p. 5, lines 5 through 11.

Mr. Bridwell further testified that, despite the absence of production from the Alexander Lease, the lease still has proven production potential, and that plugging existing wells without allowing them to be reworked for production would constitute economic and physical waste. Bridwell Prefiled Testimony, p. 5, line 12 through p. 7, line 7; p. 8, line 3 through p. 9, line 14. Production potential is evidenced by swab tests of six wells on the lease by TSCH, which identified three wells that are economically productive. TSCH ran pipe in these wells and installed electric and flow lines. Bridwell Prefiled Testimony, p. 7, lines 8 through 16. Mr. Bridwell also testified to the possibility of sale of the Alexander Lease by TSCH to Cimarron Resources, Inc. for development of its production potential, but indicated that this transaction has been frustrated by the Commission's requirement that existing wells be plugged. Bridwell Prefiled Testimony, p. 10, line 7 through p. 11, line 5; Exhibit GB-6. Finally, the witness noted a provision of the assignment of the Alexander Lease from the Bridwells to TSCH requiring that the assignee assume all responsibility for plugging all wells located on the lease and indemnify the Bridwells against any liability with respect to the same. Bridwell Prefiled Testimony, p. 16, lines 4 through 12; Exhibit GB-2.

Denman presented the testimony of its consultant, Wayne Bright, who acknowledged Denman's prior ownership of the Alexander Lease and its assignment to the Bridwells effective July 1, 2008. Bright Prefiled Testimony, p. 1, lines 15 through 21; Bright Exhibit 1. Mr. Bright confirmed that he and Ryan Duling met with Gary Bridwell at the Commission's District 3 office

on June 27, 2008 at his request to apprise Mr. Bridwell of the Commission's requirements with respect to abandoned wells on the lease, and that Mr. Bridwell assured them that he intended to restore all wells to production or plug them. Although the Bridwells entered into a formal written agreement for producing or plugging the wells in question, Denman did not have such an agreement with the Commission, nor did Denman receive a notice of violation or show cause order from the Commission in connection with those wells. Bright Prefiled Testimony, p. 2, line 6 through p. 3, line 1. Denman was aware of only 32 abandoned wells on the Alexander Lease at the time of its assignment to the Bridwells, and did not learn of the existence of 12 additional abandoned wells until advised of the same later by counsel for the Commission. See, Bright Exhibit 4.

Despite its lack of knowledge of the additional wells, Denman does not consider that they were withheld from its assignment to the Bridwells, or that Denman retained any interest in, or responsibility for, unplugged wells on the lease. Bright Prefiled Testimony, p. 3, lines 2 through 16. Assignment of the Alexander Lease by Denman to the Bridwells contemplated conveyance of all wells and property on the lease, including wells discovered by the Commission. Transcript, p. 139, lines 13 through 23. Mr. Bright also noted that the Bridwells obtained new oil and gas leases of the land covered by the Alexander Lease in 2009, which effectively extinguished all rights under the Alexander Lease assigned by Denman to the Bridwells, and that the new leases were assigned to TSCH effective April 1, 2010 without warranty, and on condition that TSCH indemnify the Bridwells against liability for plugging any and all wells located on the lease premises. Bright Prefiled Testimony, p. 3, line 17 through p. 4, line 6; Bright Exhibits 2 and 3. Mr. Bright concluded by stating that Denman was not legally responsible for plugging abandoned wells on the Alexander Lease due to its assignment of all rights to those wells to the Bridwells in 2008, termination of the lease which Denman at one time owned, and assumption of responsibility for all wells on the lease

by the Bridwells and TSCH later. Bright Prefiled Testimony, p. 4, lines 7 through 20.

TSCH did not respond to the Order to Show Cause, present witnesses or exhibits, file prefiled testimony, or appear at the hearing.

ISSUE PRESENTED

The sole issue presented to the Commission is determination of the person legally responsible for plugging and abandonment of wells subject to this proceeding.

ARGUMENTS AND PROPOSED CONCLUSIONS OF LAW

The evidence admitted at the hearing on this matter absolves Denman of any responsibility for the wells in question. In support of its position, Denman submits the following arguments and suggested conclusions of law:

K.S.A. 179(b) establishes the parameters for determining the person legally responsible for the proper care and control of abandoned wells. Such persons include, but are not limited to, the operator of a waterflood or other pressure maintenance program, the current or last operator of the lease upon which the abandoned well is located, the original operator who plugged or abandoned such well, and any person who, without authorization, tampers with or removes surface equipment or downhole equipment from an abandoned well. K.S.A. 179(c) gives the Commission authority to determine the person legally responsible for an abandoned well which is causing, or likely to cause, pollution of any usable water strata or supply or loss of usable water via a show cause proceeding, and to enter any of the orders prescribed by K.S.A. 55-162, including an order requiring the person responsible to take necessary remedial action, or in this case, plug the abandoned wells.

Although Denman, or its predecessors, operated the Alexander Lease in the past, Denman does not meet the criteria for a person legally responsible for the wells on the Alexander Lease under K.S.A. 179(b), and thus is not is not liable for their plugging.

The lease has not been subjected to waterflooding or pressure maintenance, so Denman cannot be responsible as the operator of such a program. The current operator of the lease, as shown by Commission records, is TSCH. The previous operators were the Bridwells. Denman relinquished all control of the Alexander Lease and the right to operate the wells thereon to the Bridwells effective July 1, 2008, nearly three years prior to issuance of the Order to Show Cause. Moreover, the lease Denman operated was replaced by new oil and gas leases from the current mineral owners to the Bridwells in 2009. Denman is thus neither the current nor last operator of the lease upon which the abandoned wells are located. Finally, the abandoned wells in this docket have not been plugged, and Denman therefore is not the original operator who plugged the wells. Following Denman's operation of the Alexander Lease, ownership and control of all wells on the lease was transferred to and assumed by, first, the Bridwells, and then TSCH. Denman could not have abandoned the wells on the Alexander Lease because it did not have the right to do so.

In its Order on Show Cause Hearing in the Quest Cherokee, LLC abandoned well case, Docket No. 07-CONS-155-CSHO, the Commission invoked the definition of "operator" in K.S.A. 55-150(e) to hold that an operator responsible for abandoned wells under K.S.A. 55-179(b) must exercise physical operation and control of the wells. Evidence of physical operation includes drilling or operating a well, and evidence of control includes signing a Request for Change of Operator form or taking a lease assignment or new lease that provides for assumption of plugging responsibility for the abandoned wells. The Commission also interpreted "lease" upon which such well is "located", as those terms are used in K.S.A. 55-179(b), to refer to the particular oil and gas lease which grants

the lessee or operator exclusive right to produce oil and gas, and to the drilling, operating or plugging of a well under the terms of that lease. These principles absolve Denman of responsibility for the abandoned wells in the present case.

There is abundant evidence of physical operation and assumption of full control of all wells subject to these proceedings by the Bridwells, and later by TSCH. The Alexander Lease, pursuant to which the wells at issue here were presumably drilled, was assigned by Denman to the Bridwells, and accepted by the Bridwells, without reservation or exception of any kind, other than reservation of a small nonoperating overriding royalty interest by Denman, effective July 1, 2008. The Bridwells entered into an agreement with the Commission to produce or plug all known wells on the lease, and equipped and produced several wells before assigning their lease rights to TSCH effective April 1, 2010.

The assignment from the Bridwells to TSCH covered new leases obtained by the Bridwells that did not except or exclude any of the existing wells, and expressly provided that TSCH is responsible for plugging all abandoned wells on the premises. The new leases acquired by the Bridwells superceded and effectively terminated the oil and gas lease acquired by the Bridwells from Denman. Denman could not release the oil and gas lease assigned to the Bridwells, and their acquisition of new leases operated as a tacit admission that the prior lease had terminated, making release of the prior lease by the Bridwells unnecessary

TSCH, in turn, asserted its custody and control of the lease and all abandoned wells thereon by testing and completing several wells for production, applying for and receiving approval to complete and operate a well for salt water disposal, applying to extend temporary abandonment of the wells on the lease, and confirming in writing its obligation to produce or plug all wells. Change of Operator forms filed with the Commission in connection with transfer of operating rights from

Denman to the Bridwells, and from the Bridwells to TSCH, further substantiate current ownership and control of all abandoned wells by TSCH, and ultimate responsibility of TSCH for their plugging.

The Change of Operator forms (Form T-1) filed in connection with the various transfers of well and lease operating rights, while indicative of assumption of those rights by the transferee, are for Commission use and information only, did not transfer legal title to the wells and lease in question, and do not limit the number of wells actually affected by each transfer. Those forms cannot be construed to manifest an intent by Denman to retain rights to wells not listed thereon. The Change of Operator form listed the same 32 wells on the Alexander Lease in each case because, by all accounts, these were the only wells known to the Commission and the respondents at the time notice of transfer was given. The additional 12 wells that the Commission Staff identified as abandoned in these proceedings were not known to Denman at the time of its conveyance to the Bridwells, or by the Bridwells at the time of their conveyance to TSCH. Nor was the Commission aware of the existence of the additional wells until November 2010, approximately seven months after rights to those wells were assigned to TSCH.

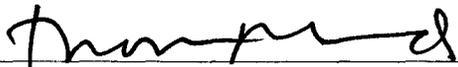
Based on this sequence of events, it is logical to conclude that Denman intended to transfer its rights to all wells on the Alexander Lease to the Bridwells, despite omission of some of those wells from its Form T-1 inventory. This is the only conclusion consistent with the absence of any reservation or exception from the assignment made by Denman to the Bridwells, and by the Bridwells to TSCH. Consequently, TSCH is the sole party responsible for plugging of all abandoned wells on the Alexander Lease, notwithstanding the absence of some wells from the inventory filed with the Commission in connection with its acquisition.

In accordance with the foregoing, Denman requests that the Commission enter its order herein finding and concluding that Denman is not responsible for the plugging of any of the

abandoned wells subject to this proceeding, and that Denman be granted such other and further relief as the Commission deems just and proper.

Respectfully submitted,

GLAVES, IRBY AND RHOADS

By:  _____

Thomas M. Rhoads (S.C. 10005)

1050 Market Centre

155 North Market

Wichita, Kansas 67202-1829

Telephone: (316) 262-5181

Facsimile: (316) 264-6860

Email: tmrhoads@sbcglobal.net

Attorneys for Respondent,
John Denman Oil Co., Inc.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that, on this 18 day of October, 2011, he filed the original and seven (7) copies of the above and foregoing Memorandum of Respondent John M. Denman Oil Co., Inc. with the State Corporation Commission, Conservation Division at Wichita, Kansas, and caused a true and correct copies of the same to be served via hand delivery upon the following:

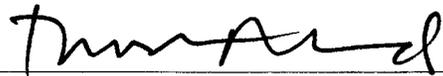
Ryan A. Hoffman, Litigation Counsel
Kansas Corporation Commission,
Conservation Division
State Office Building, Room 2078
130 South Market
Wichita, Kansas 67202

and by depositing the same in the United States mail, postage prepaid, addressed to the following persons:

Charles L. Hoffman, Jr.
TSCH, LLC
480 Mars Way
Juno Beach, Florida 33408

James G. Flaherty
Keith A. Brock
Anderson & Byrd, LLP
216 S. Hickory, P. O. Box 17
Ottawa, Kansas 66067

Attorneys for Gary and Kayla Bridwell,
dba Black Rain Energy



Thomas M. Rhoads