FILED
IN THE OFFICE OF THE
CLERK OF SUPREME COURT
NOVEMBER 19, 2012
STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Gadeco, LLC, Appellant, vs. Industrial Commission of the State of North Dakota and Slawson Exploration Company, Appellees.	)	Supreme Court No. 20120344

Appeal from the September 13, 2012 Judgment denying the appeal of Gadeco, LLC, and affirming the March 19, 2012 decision of the Industrial Commission of North Dakota
Case No. 31-10-C-00143
County of Mountrail, Northwest Judicial District
The Honorable Richard L. Hagar, Presiding

BRIEF OF APPELLEE SLAWSON EXPLORATION COMPANY, INC.

FREDRIKSON & BYRON, P.A.

Lawrence Bender, ND Bar #03908
Amy L. De Kok, ND Bar #06973
Michael D. Schoepf, ND Bar #07076
200 North 3rd Street, Suite 150
P. O. Box 1855
Bismarck, ND 58502-1855
Phone: (701) 221-4020
Attorneys for Appellee Slawson Exploration Company, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Paragraph

STATE CASES

STATE STATUTES AND ADMINISTRATIVE RULES

OTHER AUTHORITIES

STATEMENT OF THE ISSUE

[¶ 1] Whether the North Dakota Industrial Commission's ("Commission") decision to impose a risk penalty against Gadeco, LLC ("Gadeco") with respect to the Coyote 1-32H well (the "Coyote Well") is sustained by the law and by substantial and credible evidence.

STATEMENT OF THE CASE

[¶ 2] This appeal arises out of an application filed by Slawson Exploration Company, Inc. ("Slawson") with the Commission for an order pooling all interests in the spacing unit for the Coyote Well, and authorizing the recovery of a risk penalty from all nonparticipating interest owners, including Gadeco, pursuant to Section 38-08-08 of the North Dakota Century Code and Section 43-02-03-16.3 of the North Dakota Administrative Code. (Appendix of Appellant Gadeco, LLC ("Gadeco App.") 8–11.) The Commission held a hearing on Slawson's application on March 25, 2010, at which both Gadeco and Slawson appeared and presented evidence. (Supplemental Appendix of Appellee Slawson Exploration Company, Inc. ("Slawson App.") 33–101.) On or about April 22, 2010, the Commission issued Order No. 14238 granting Slawson's application, pooling all interests in the spacing unit for the Coyote Well, and imposing a two hundred percent (200%) risk penalty against Gadeco. (Gadeco App. 12–15.) The Commission found that Slawson had properly provided Gadeco with an opportunity to participate in the risk and cost of drilling the Coyote Well, and that Gadeco had failed to elect to participate in the well within the time period allowed by statute and the Commission's rules. (*Id.*)

[¶ 3] Gadeco appealed the Commission's decision to the Mountrail County District Court. (*See* Gadeco App. 16–21.) On appeal, Gadeco argued that the

Commission erred in imposing a risk penalty because Slawson changed the surface location of the well, certain itemized well costs, and the estimated spud date after inviting Gadeco to participate in the well. (*See id.*) Slawson and the Commission submitted briefs in opposition to the appeal, contending that Slawson's invitation to participate in the Coyote Well contained the information required by the applicable statute and rules, as well as such information necessary for Gadeco to decide whether to participate. (*See id.*) The District Court issued an Order dated February 28, 2011, overturning the Commission's decision. (*Id.*) In the Order, the District Court erroneously ruled, without explanation, that because the surface location, estimated spud date and itemization of estimated costs associated with the Coyote Well had changed following the first well proposal, Slawson was required to send a new well proposal and permit Gadeco an additional thirty days to respond. (*Id.*)

[¶ 4] Slawson and the Commission appealed the District Court's decision to this Court. (*See* Slawson App. 111–19.) Slawson and the Commission argued that the imposition of a risk penalty against Gadeco was authorized by the applicable statute and regulations, and that the District Court failed to give appropriate deference to the Commission's order. (*See id.*) Gadeco responded, contending that the regulations governing the information to be included in an invitation to participate should be strictly construed against well operators. (*See id.*) On February 17, 2012, this Court issued an opinion and order reversing the District Court's decision and remanding the case to the Commission for further proceedings. (*Id.*) The Court concluded that Order No. 14238 did not contain sufficient findings for the Court to understand the basis for the

Commission's decision, and directed the Commission to prepare supplemental findings of fact. (*Id.*)

[¶ 5] On March 19, 2012, without holding a hearing or requesting that the parties present additional evidence, the Commission issued Order No. 19700, again concluding that it was appropriate to impose a risk penalty against Gadeco in connection with the Coyote Well. (Gadeco App. 22–27.) Order No. 19700 contained additional findings explaining that Slawson's invitation to Gadeco to participate in the Coyote Well complied with the Commission's regulation governing risk penalties because it provided Gadeco with all the information necessary to evaluate whether to participate in the well. (*Id.*) Specifically, it contained the location of the completion zone of the Coyote Well, it identified the proposed depth of the well and the objective formation, it included an estimated itemization of costs, and it identified an approximate spud date. (*Id.*)

[¶ 6] Gadeco appealed the Commission's Order No. 19700 to the District Court, again arguing that it was error to impose a risk penalty because Slawson's invitation to participate in the Coyote Well did not contain all the information required by the applicable statute and rule and that the Commission failed to comply with this Court's direction to supplement its findings of fact. (*See* Gadeco App. 28–34.) Slawson and the Commission responded, contending that the invitation to participate complied with the applicable regulation and that the Commission's supplemental findings include sufficient information for a reviewing court to evaluate the decision. (*See id.*) On September 5, 2012, the District Court issued an order concluding that the Commission's decision to impose a risk penalty against Gadeco was "sustained by the law and by substantial and credible evidence," and affirmed Order No. 19700. (Gadeco App. 34.)

[¶ 7] On September 7, 2012, Gadeco filed a Notice of Appeal from the District Court's September 5, 2012 Order. (Gadeco App. 36–37.) On September 13, 2012, the Clerk entered a judgment denying Gadeco's appeal and affirming the Commission's decision to impose a risk penalty. (Gadeco App. 35.) On September 26, 2012, Gadeco filed an Amended Notice of Appeal from the Judgment. (Gadeco App. 38–39.) Because the Commission's Order No. 19700 and the District Court's Judgment are sustained by the law and by substantial and credible evidence, they must be affirmed.

STATEMENT OF THE FACTS

I. Slawson Makes Plans to Drill the Coyote Well and Invites Other Interest Owners to Participate.

[¶ 8] Slawson owns an interest in the oil and gas leasehold estate in and under real property located in Mountrail County, North Dakota described as Section 32, Township 152 North, Range 92 West ("Section 32"). (Slawson App. 120.) Gadeco also owns an interest in the oil and gas leasehold estate in and under Section 32. (Slawson App. 6, 40, 49, 65–66.) On August 19, 2009, Slawson spud the Coyote Well on a spacing unit comprised of Section 32 in the Big Bend-Bakken Pool, and completed it as a producing oil and gas well on September 18, 2009. (Gadeco App. 23–24.)

[¶ 9] On July 8, 2009, in accordance with Section 38-08-08 of the North Dakota Century Code and Section 43-02-03-16.3 of the North Dakota Administrative Code, Slawson sent each of the eleven working interest owners in the spacing unit for the Coyote Well, including Gadeco, an invitation to participate in the risk and cost of drilling and completing the well. (Slawson App. 6–7, 40.) Slawson's invitation indicated that the Coyote Well would test the Bakken formation from a surface location in the SW/4 of the SE/4 of Section 32 with a single lateral terminating in the N/2 of the NE/4 of Section 32

and a total vertical depth of not more than 10,500 feet. (*Id.*) An Authority for Expenditure ("AFE") attached to the invitation estimated the cost of completing the well as a dry hole at approximately $2.7 million and the cost of completing it as a producer at approximately $4.2 million, including approximately $120,000 to prepare the surface location for a producing well and $846,000 for the drilling contract. (Slawson App. 8.) Slawson estimated the spud date for the well to be August 25, 2009. (Slawson App. 6–7.) The invitation indicated that Slawson intended to impose a risk penalty against non-participating working interest owners, and that Slawson would impose a risk penalty against Gadeco if Gadeco's election to participate were not received by Slawson within thirty days of Gadeco's receipt of the invitation. (*Id.*) Gadeco received Slawson's written invitation to participate on July 10, 2009. (Slawson App. 6–7, 12).

[¶ 10] Following Slawson's invitation to participate, Slawson was made aware that constructing a well pad and other surface facilities in the SW/4 of the SE/4 of Section 32 would interfere with a center-pivot irrigation system operated by the surface owner in the SE/4 of Section 32. (Slawson App. 40.) Accordingly, to accommodate the surface owner, Slawson moved the surface location of the Coyote Well a short distance to the south across the section line into the NW/4 of the NE/4 of Section 5, Township 151 North, Range 92 West ("Section 5").[1] (*Id.*) The location of the lateral in the W/2 of the E/2 of Section 32, the 640-acre spacing unit for the well, the objective zone, the total vertical depth, and the bottom-hole location did not change. (Slawson App. 42–43.) The total estimated cost of the Coyote Well as described in the AFE also did not change.

[1] Gadeco contends that the new surface location was a quarter mile away. The record, however, does not disclose the precise distance between the initial location and the revised location.

(Slawson App. 56.) A modest increase in the cost of the drilling contract was offset by a similar decrease in the cost of constructing the surface location because Slawson was able to expand an existing well pad located in the NW/4 of the NE/4 of Section 5 rather than constructing a new pad. (Slawson App. 43, 56.)

[¶ 11] On July 15, 2009, Slawson sent a letter to all the working interest owners in Section 32, including Gadeco, to update them on the status of the Coyote Well. (Slawson App. 10.) The July 15, 2009 letter, which Gadeco received on July 17, 2009, explained that Slawson was moving the surface location of the well across the section line into the NW/4 of the NE/4 of Section 5, and that Slawson believed the spud date may be pushed back approximately 30 days. (*Id.*) The letter specifically stated that the bottom-hole location for the well would remain the same. (*Id*.)

[¶ 12] On August 18, 2009, Gene Webb, a representative of Gadeco, called Robert Todd Slawson, Slawson's chief operating officer, to discuss the invitation to participate. (Slawson App. 17–18, 47.) Webb acknowledged that Gadeco had missed the deadline to elect to participate, and explained that the invitation had "sat on a desk" while an employee was on vacation. (Slawson App. 47.) On August 19, 2009, forty-one days after receiving the invitation to participate from Slawson, thirty-three days after receiving the July 15, 2009 letter, and the same day that Slawson spud the Coyote Well,[2] Gadeco signed and returned the election to Slawson. (Gadeco App. 6–7, 23.) On August 20, 2009, Slawson notified Gadeco that it had received Gadeco's signed election, but that the

[2] The July 15, 2009 letter notified Gadeco and other working interest owners that the estimated spud date had change to September 27, 2009. (Slawson App. 10). However, the Coyote Well was actually spud on August 19, 2009, six days prior to the original estimated spud date of August 25, 2009 contained in the well proposal. (Slawson App. Gadeco App. 23–24.)

30-day election period had expired on August 10, 2009, eleven days earlier. (Slawson App. 12, 43.)

II. Slawson Receives an Order Pooling All Interests in the Spacing Unit For the Coyote Well And Imposing a Risk Penalty Against Nonparticipating Owners; Gadeco Appeals.

[¶ 13] On or about November 23, 2009, Slawson caused to be filed an application with the Commission requesting an order pooling all interests in a spacing unit for the Coyote Well and also authorizing the recovery of a risk penalty against Gadeco as a nonparticipating owner pursuant to N.D.C.C. § 38-08-08(3)(a). (Slawson App. 6–11.) A hearing on Slawson's application was held before the Commission on March 25, 2010. Gadeco appeared at the hearing in order to object to Slawson's request that a risk penalty be assessed against Gadeco. (Slawson App. 33–100.) The Commission received extensive testimony and exhibits from Slawson and Gadeco at the hearing. (*Id.*) On or about April 22, 2010, the Commission issued Order No. 14238 pooling all interests in Section 32 and authorizing Slawson to impose a two hundred percent (200%) risk penalty against Gadeco pursuant to N.D.C.C. § 38-08-08(3)(a). (Gadeco App. 12–15.)

[¶ 14] On or about August 5, 2010, Gadeco notified the parties of its intention to appeal the Commission's Order No. 14238 regarding the imposition of a risk penalty against Gadeco. (*See* Gadeco App. 1.) After considering the briefs filed by Slawson, Gadeco, and the Commission, the District Court issued an opinion and order on February 28, 2011, reversing the Commission's decision to impose a risk penalty against Gadeco. (Gadeco App. 16–21.) On April 29, 2011, the Commission filed a notice of its intention to appeal to the North Dakota Supreme Court. (*See* Slawson App. 111–19.) After considering the parties' briefs and oral arguments, on February 27, 2012, this Court filed

its opinion reversing the judgment of the District Court and remanding the case to the Commission for the entry of additional findings explaining the basis of its decision. (*Id.*) On or about March 19, 2012, the Commission issued Order No. 19700, imposing a two-hundred percent (200%) risk penalty against Gadeco and further explaining the basis of its decision. (Gadeco App. 22–27.)

III. The Commission Again Authorizes Slawson to Impose a Risk Penalty Against Gadeco.

[¶ 15] Upon remand, the Commission again determined that it was appropriate to impose a risk penalty against Gadeco under the applicable statute and administrative rules. (*Id.*) The Commission found that Gadeco received Slawson's invitation to participate on July 10, 2009, and that Slawson did not receive Gadeco's election until August 20, 2009—forty-one days later. (Gadeco App. 23–24.) The Commission further found that Slawson's invitation met all of the requirements imposed by the Commission's rules. (Gadeco App. 25.) With respect to the requirement that the invitation identify the location of the well, N.D.A.C. § 43-02-03-16.3(1)(a)(1), the Commission found that the "crucial" location is the completion location, which the invitation from Slawson accurately identified, and therefore the change in the surface location of the Coyote Well did not invalidate the invitation. (*Id.*) With respect to the itemization of estimated costs, N.D.A.C. § 43-02-03-16.3(1)(a)(2), the Commission found that the AFE submitted by Slawson accurately estimated the total costs of the Coyote Well, and that the offsetting cost increases and decreases associated with the change in the well's surface location did not require a new AFE. (*Id.*) The Commission emphasized that Slawson completed the Coyote Well for $3.4 million, substantially less than the AFE's total estimate of $4.2 million. (Gadeco App. 24.) The Commission also found that the invitation appropriately

estimated the well's spud date, N.D.A.C. § 43-02-03-16.3(1)(a)(3). (Gadeco App. 25–26.) Slawson initially estimated that it would spud the well on August 25, 2009, and later revised the date to September 27, 2009. (*Id.*) The Coyote Well was actually spud on August 19, 2009. (Gadeco App. 23.) The Commission noted that all three dates are well within the ninety-day window provided by the statute, and that the information Slawson provided to Gadeco was sufficient to inform Gadeco of the "approximate" spud date. (Gadeco App. 25–26.) Finally, the Commission found that because of the nature of the oil and gas industry, flexibility in the thirty-day deadline for responding to an invitation to participate should not be allowed, N.D.A.C. § 43-02-03-16.3(1)(b). (Gadeco App. 26.) Therefore, because Gadeco's election to participate was not received during the thirty-day window, it was invalid and Slawson is entitled to a risk penalty against Gadeco's interest. (*Id.*)

LAW AND ARGUMENT

I. Statement of the Standard of Review.

[¶ 16] When a decision of an administrative agency is appealed from the district court to the North Dakota Supreme Court, the Court reviews the decision of the agency and looks to the record compiled before the agency. *Consolidated Telephone Cooperative v. Western Wireless Corp.*, 2001 ND 209, ¶ 6, 637 N.W.2d 699; *Steen v. N.D. Dep't of Human Services*, 1997 ND 52, ¶ 7, 562 N.W.2d 83; *Amoco Production Co. v. N.D. Industrial Comm'n*, 307 N.W.2d 839 (N.D. 1981). The Court does not substitute its judgment for that of the agency or make independent findings. *Huff v. N.D. State Bd. of Medical Examiners*, 2004 ND 225, ¶ 8, 690 N.W.2d 221; *see also Bank of Hamilton v. State Banking Bd.*, 236 N.W.2d 921, 925 (N.D. 1975). Thus, the Court's review of administrative agency decisions is limited. *Id.*

[¶ 17] The standard of review in reviewing orders of the Commission is set out in Section 38-08-14(3) of the North Dakota Century Code. The statute provides a specific standard of review for decisions of the Commission, recognizing that the Commission's findings of fact are entitled to greater deference than findings of other administrative agencies because of the Commission's technical expertise in the regulated industries. *See Hanson v. Indus. Comm'n of N.D.*, 466 N.W.2d 587, 590 (N.D. 1991). Specifically, the statute provides that the Court shall sustain orders of the Commission if it "has regularly pursued its authority and its findings and conclusions are sustained by the law and by substantial and credible evidence." N.D.C.C. § 38-08-14(3). The North Dakota Supreme Court in *Citizens State Bank of Neche v. Bank of Hamilton*, 238 N.W.2d 655, 660 (N.D. 1976), defined this as:

> such relevant evidence as a reasonable mind might accept as adequate to support a conclusion . . . . It must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury. . . . This is something less than the weight of the evidence, and the possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency's findings from being supported by substantial evidence.

[¶ 18] In *Hanson*, 466 N.W.2d 587, the court further observed that the substantial evidence test standard of review is not preponderance of the evidence as used with other agencies under the state Administrative Procedures Act. *See* N.D.C.C. § 28-32-46. Under this test, the court said it was "required to accord greater deference to Industrial Commission findings of fact than we ordinarily accord to other administrative agencies' findings of fact." *Hanson*, 466 N.W.2d at 590. The *Hanson* court also ruled that "[d]etermining the credibility of witnesses is a function of the administrative agency."

Id. at 594. The Commission is free to accept evidence it deems credible and reject evidence it deems incredible. *Amoco*, 307 N.W.2d at 848.

II. The Commission and the District Court Properly Authorized the Imposition of a Risk Penalty Against Gadeco.

[¶ 19] In this instance, for the reasons set forth below, the Commission's decision to impose a risk penalty against Gadeco, as affirmed by the District Court, is sustained by the law and by substantial and credible evidence and, therefore, must be affirmed. First, when a well operator complies with the applicable regulation and provides the non-operating interest owner with all of the information necessary to evaluate whether to participate in the well, as the Commission found Slawson did here, and the non-operator interest owner nevertheless fails to elect to participate within the thirty-day time period, the operator must be permitted to collect a risk penalty. Risk penalties are a critical component of North Dakota's statutory framework for encouraging reasonable development of the State's oil and gas resources while also protecting the rights of all interest owners, and as a result, the Court should not dilute the Commission's authority to impose them. In addition, Gadeco's purported election to participate in the Coyote Well was submitted at least eleven days after the deadline and on the day that the Coyote Well was spud. As the Commission noted in its decision, because drilling an oil and gas well is an enormously expensive and risky undertaking, the operator needs to understand who is participating in the well and how much money it needs to assemble in advance, not eleven days after the deadline.

A. The Invitation to Participate Received by Gadeco on July 10, 2009 Meets all of the Requirements Set Forth in N.D.A.C. § 43-02-03-16.3, but Gadeco Failed Return the Required Election within the Statutory Time Period.

[¶ 20] Slawson complied with the Commission's rules and issued a valid well proposal to participate in the risk and cost of drilling the Coyote Well. Gadeco, on the other hand, failed to comply with the Commission's rules for timely and properly electing to participate in the well. Thus, Slawson is entitled to recover a risk penalty against Gadeco.

[¶ 21] Section 43-02-03-16.3 of the North Dakota Administrative Code governs the recovery of the risk penalty provided under section 38-08-08(3) of the North Dakota Century Code. By promulgating section 43-02-03-16.3, the Commission has adopted clear requirements for recovery of a risk penalty. The two broad requirements for imposing the risk penalty are: (1) a valid invitation to participate; and (2) failure to elect within thirty days after receiving a valid invitation. In this case, Slawson sent a valid well proposal offering all working interest owners an opportunity to participate, but Gadeco failed to properly and timely elect.

[¶ 22] Pursuant to Section 43-02-03-16.3(1)(a),[3] a valid invitation to participate in a well must contain:

> (1) The location of the proposed or existing well and its proposed depth and objective zone.
>
> (2) An itemization of the estimated costs of drilling and completion.
>
> (3) The approximate date upon which the well was or will be spudded or reentered.

[3] The provision has since been amended. All citations in this brief are to the provision in effect in August 2009.

(4) A statement indicating the invitation must be accepted within thirty days of receiving it.

(5) Notice that the participating owners plan to impose a risk penalty and that the nonparticipating owner may object to the risk penalty by either responding in opposition to the petition for a risk penalty, or if no such petition has been filed, by filing an application or request for hearing with the commission.

N.D.C.C. § 43-02-03-16.3(1)(a). Here, it is undisputed that on July 10, 2009, Gadeco received an invitation to participate in the risk and cost of drilling and completing the Coyote Well that contained all of the information required by the regulation, including the location of the well, an itemization of the estimated costs, the estimated spud date, a statement that Gadeco would need to accept the invitation within 30 days, and notice the Slawson planned to impose a risk penalty if Gadeco failed to timely elect to participate in the well. (Slawson App. 6–7.)

[¶ 23] Following receipt of the invitation to participate, the owner *must* elect to participate in writing and such written election *must* be received by the operator giving the invitation within 30 days of the participating party's receipt of the invitation. N.D.A.C. § 43-02-03-16.3(1)(b) (emphasis added). In this instance, Gadeco admits that it failed to return to Slawson its election to participate in the drilling and completion of the Coyote Well within thirty days of receiving the invitation. Indeed, Gadeco admits that it missed the deadline for election because the responsible employee was on vacation and the election form "sat on a desk." (Slawson App. 47, 89.)

[¶ 24] Gadeco nevertheless contends that Slawson is not entitled to a risk penalty because Slawson sent all of the working interest owners a letter dated July 15, 2009, updating certain information contained in the invitation. (*See* Slawson App. 10.)

According to Gadeco, the information changes noted in the July 15, 2009 letter somehow required Slawson to provide a new invitation and restart the thirty-day election clock.

[¶ 25] First, Gadeco contends that because Slawson changed the *surface* location of the Coyote Well a new invitation was required. Gadeco argues that the location that is required to be identified by Section 43-02-03-16.3(1)(a) is the proposed surface location of the well. While that may have been true before the advent of horizontal drilling, in today's world the surface location provides no geological or other useful information upon which an informed decision to participate can be made. With the advent of horizontal drilling, it is the location from which the well will produce and not the surface location that provides the prospective participant with the geological information necessary to make an informed decision to participate in the well. The Commission recognized that the surface location was of little or no importance when they ruled that it is the location from which the well will produce that must be identified in the invitation. (Gadeco App. 25.) As the Commission explained in its Order No. 19700, Section 43-02-03-16.3(1)(a)(1) does not specifically require identification of the *surface* location; rather, it requires the operator to identify the "location of the . . . well and its proposed depth and objective zone." (*Id.*). According to the Commission, that means that the "crucial" location that must be identified in an invitation is not the surface location of the well, but the completion location. (*Id.*). That is, the location from which the well will produce. The initial invitation indicated that the Coyote Well would target the Bakken formation with a single lateral located in the E/2 of Section 32. (Slawson App. 6–7). Because that completion location never changed, the Commission determined that a change in the surface location did not require issuance of a new invitation. (Gadeco App. 25.) The

Commission's interpretation of its own regulation is reasonable, and therefore must be upheld. *See St. Benedict's Health Ctr. v. N.D. Dep't of Human Servs.*, 2004 ND 63, ¶ 9, 677 N.W.2d 202 (directing reviewing courts to "give deference to an administrative agency's reasonable interpretation of its own regulations").

[¶ 26] Despite the Commission's explanation for its interpretation of the regulation, Gadeco contends that when Section 43-02-03-16.3(1)(a)(1) refers to "location" it must mean "[surface] location" because otherwise the regulations references to "depth" and "objective zone" would be redundant. Contrary to Gadeco's assertion, the depth of a proposed well would be meaningless to an interest owner considering whether to participate in it unless the interest owner knows where (*i.e.* the "location") that the well will reach that depth. Similarly, the "objective zone" does not refer to the location where the proposed well will be completed, but to the stratigraphic interval (*e.g.* the Bakken or Three Forks formations) that the well will target. *See* 8 *Williams & Myers Oil and Gas Law* 1166 (Patrick H. Martin, et al. eds., 2011) (defining "zone"); *see also Hystad v. Indus. Comm'n of N.D.*, 389 N.W.2d 590, 592–94 (N.D. 1986) (concluding that the use of the word "zone" means something other than stratigraphic interval for the limited purpose, and in the exclusive context, of N.D.C.C. § 38-08-07(1)). Thus, the "objective zone" of the well is also meaningless to the interest owners evaluating the well unless they know where the well will target that "zone."

[¶ 27] Gadeco further contends that unless the reference to "location" in Section 43-02-03-16.3(1)(a)(1) is interpreted to mean "[surface] location" then the Administrative Code's reference to a well's location in a neighboring provision would "lose all meaning." Specifically, Gadeco contends that N.D.A.C. § 43-02-03-16 requires

applicants for well permits to include a certified plat showing the "location of the proposed well" and therefore "location," as used in the Code, cannot refer to the completion location but must refer to the surface location because "surveyors do not crawl deep into the earth to the 'completion location.'" However, Gadeco does not identify any evidence in the record suggesting that surveyors cannot identify the location of the bottom hole of a well on a plat just as easily as they identify the surface location without "crawl[ing] deep into the earth," nor is there any evidence as to whether permit applications for horizontal wells routinely identify the surface location and the completion location. Indeed, although not a certified plat, the only maps in the record that identify the location of the Coyote Well identify both its surface location and the horizontal lateral. (Slawson App. 3-4.)

[¶ 28] The fact that the Commission amended Section 43-02-03-16.3 following the issuance of Order No. 14823 to "eliminate ambiguity" and clarify that the operator need only provide the well's "approximate location" also does not demonstrate that the regulation's reference to "location" means "[surface] location." The completion location may also be "approximate" at the time a well is proposed. Similarly, there is no reason that approximating the completion location of a well necessarily violates spacing rules. Depending upon the field rules, an operator can, and often does, drill more than one horizontal well in a single spacing unit, and there may be post-invitation modifications in the completion location of one of those wells. The Coyote Well, for example, is located in a 640-acre spacing unit, but the entire lateral (*i.e.* the completion location) is located within a defined 160-acre parcel within the 640-acre spacing unit. Thus, defining the spacing of a well does not necessarily define the completion location.

[¶ 29] Gadeco also contends that because moving the surface location of the Coyote Well resulted in slight changes to the cost of the well, a new invitation with a new AFE was required. *See* N.D.A.C. § 42-02-03-16.3(1)(a)(2) (requiring an invitation to include an itemization of "estimated costs"). The Commission, however, determined that the initial AFE provided an appropriate *estimate* of the cost of drilling and completing the well, and that the modest increase in the cost of drilling the well was offset by the decrease in cost that resulted from the use of an existing well pad. (Gadeco App. 25.) The Commission also noted that the overall actual cost of the well, about $3.4 million, was still substantially less that the AFE's estimate of $4.2 million. (Gadeco App. 24) The Commission reasonably concluded that a $50,000 offsetting change in two line items within the AFE did not require the issuance of a new AFE for a well that was estimated to cost $4.2 million and was completed $800,000 under budget.

[¶ 30] Gadeco challenges the Commission's conclusion that the AFE provided a reasonable estimate of the itemized costs of drilling the well by suggesting that the Commission lacked evidentiary support for its suggestion that minor errors in cost estimates are commonplace. Gadeco's argument ignores the fact that the regulation specifically requires the operator to *estimate* the cost of drilling the well, recognizing that there may be uncertainty as to what the *actual* cost of the well may be. N.D.A.C. § 42-02-03-16.3(1)(a)(2). Cost estimates are inherently uncertain, and use of the word estimate demonstrates that the Commission anticipated some variance between the estimated costs and actual costs. Because the Commission's finding that the AFE provided a reasonable estimate of the cost of drilling and completing the Coyote Well is a

reasonable interpretation of its own regulation, it must be upheld. N.D.C.C. § 38-08-14(3).

[¶ 31] Finally, Gadeco contends that because Slawson updated the estimated spud date of the Coyote Well in the July 15, 2009 letter, Slawson was required to provide a new invitation. Again, the Commission emphasized that Section 43-02-03-16.3(1)(a)(3) requires the operator to provide an *approximate* spud date, not the exact spud date. (Gadeco App. 25.) The Commission also noted that any invitation to participate is binding only for ninety days. *See* N.D.A.C. § 43-02-03-16.3(1)(d). The Commission found that because both the estimated spud dates provided by Slawson—as well as the date the well was actually spud—were within the ninety-day window, the date provided in the initial invitation was a satisfactory approximation of the spud date of the Coyote Well. (Gadeco App. 25–26.) Notably, the Coyote Well was spud six days before the spud date estimated in the initial invitation, and well within the ninety-day window. (Gadeco App. 23.) As Gadeco recognizes, plans can change quickly in the drilling industry, and as a result, the Commission rightly concluded that minor variations in the spud date do not require new invitations and a new thirty-day election period.

[¶ 32]Based on the foregoing, it is clear from the substantial and credible evidence in the record that the Commission reasonably concluded that Slawson adhered to all of the express requirements of section 43-02-03-16.3 relating to the recovery of a risk penalty provided under section 38-08-08 of the North Dakota Century Code.

B. The Imposition of Risk Penalties Against Non-Participating Working Interest Owners Pursuant to the Commission's Regulations Promotes Reasonable Development of North Dakota's Oil and Gas Resources While Protecting the Rights of Interest Owners.

[¶ 33] Because Slawson complied with the Commission's regulations and provided Gadeco with all the information necessary to evaluate whether to participate in the Coyote Well, but Gadeco failed to submit a timely election, the Commission's decision to impose a risk penalty conforms to the underlying purpose of the statute. As a general matter, statutes authorizing risk penalties, including N.D.C.C. § 38-08-08(3), were adopted to encourage reasonable development, prevent waste, and to protect the rights of mineral owners. *See* 1 Bruce M. Kramer & Patrick H. Martin, *The Law of Pooling and Unitization* § 12.02 (LexisNexis Matthew Bender 2011); *see also Gadeco, LLC v. Indus. Comm'n of N.D.*, 2012 ND 33, ¶¶ 3–7, 812 N.W.2d 405 (summarizing the history and purpose of North Dakota's pooling statute, including the risk penalty provisions). In the absence of risk penalties, when the ownership of the oil and gas in and under a particular spacing unit is divided among more than one party, unless all the owners agree to share in the risk and cost up front, the incentive for any one owner to drill a well is significantly reduced. This is so because if the well is completed as a dry hole, all "nonparticipating owner[s] los[t] nothing and owe[d] nothing," but if, on the other hand, the well is completed as a producer, the nonparticipating owners are entitled to their share of the production without incurring the corresponding risk of loss. *Gadeco, LLC*, 2012 ND 33, ¶ 5, 812 N.W.2d 405 (quoting *In re SAM Oil, Inc.*, 817 P.2d 299, 302 (Utah 1991) (second and third alterations in original)). Thus, in situations where the ownership of the oil and gas in a spacing unit is divided, like Section 32 in this case, each working interest owner has an incentive to wait and hope another owner will drill a well

because all owners share equally if the well is successful but the drilling party alone incurs the risk of a dry hole. *Id.* ("Success has a thousand fathers; a dry hole is an orphan.") (citation and quotation marks omitted). Accordingly, the North Dakota legislature authorized the Commission to impose risk penalties against nonparticipating owners to encourage development, and compensate the operator for incurring additional risk. N.D.C.C. § 38-08-08(3).

[¶ 34] When an operator proposing to drill a well provides the nonoperating interest owners in the spacing unit with all the information required by the applicable regulation and necessary to evaluate whether to participate in the well, as Slawson did here, *see* Section II.A., *supra*, the nonoperators must either elect to participate in the well or face the imposition of a risk penalty. Permitting Gadeco to participate in the well based on a late election would create uncertainty and set a dangerous precedent for operators. If the Court adopts a rule that allows non-operating owners to opt-in after drilling has begun and outside of the thirty-day window set by the rules, it would make it impossible for operators to determine who is in and who is out of a well and discourage development.

C. There Is No "Immaterial Tardiness" Exception to the Thirty-Day Deadline for Returning an Invitation to Participate.

[¶ 35] Gadeco admits that it returned its election to participate in the Coyote Well at least ten days late because it sat on an employee's desk while the employee was on vacation. (Slawson App. 90.) Gadeco contends, however, that its "tardiness" in returning the election to participate should be excused because it is "immaterial." Contrary to Gadeco's assertion, there is no "immaterial tardiness" exception to the rule that an election to participate must be received by the operator within thirty days of the

non-operator's receipt of the invitation to participate. Accordingly, the Commission's conclusion that the election to participate was not returned on time must be upheld.

[¶ 36] As the Commission specifically found, the timely return of the election is critical to the efficient drilling and completion of the well and "flexibility in the thirty-day deadline should not be allowed." (Gadeco App. 25.) Horizontal wells, like the Coyote Well, are expensive to drill and complete—a single drilling rig costs approximately $50,000 per day to operate. (Slawson App. 54–55.) Because of the high cost, it is important for the operator who is proposing the well to know up front whether the other working interest owners will participate in the costs of drilling the well. (Gadeco App. 25.) If the Court adopts Gadeco's suggestion that "immaterial" delays in returning the election should not bar a non-operating owner from participating, it would further increase uncertainty in an industry that is already burdened by the shortage of rigs and experienced drillers. Operators who are already laboring under tight deadlines to begin wells would be further burdened by uncertainty concerning financing and allocation of risk.

[¶ 37] Indeed, the circumstances surrounding the drilling of the Coyote Well illustrate the importance of a firm deadline for electing to participate. Slawson had already spud the Coyote Well when it received Gadeco's election. (Gadeco App. 23.) Thus, Slawson arranged financing, contracted with a drilling company, moved the rig to the well site, and began drilling the well under the assumption that Gadeco would not participate. Permitting late elections would force operators to delay wells until the uncertain "immaterial tardiness" period expires or risk a late election altering their drilling plans after the wells are begun.

[¶ 38] Nevertheless, Gadeco contends that because it mailed its check for expenses on the day the well was spud Slawson could not have been prejudiced by the late election. Gadeco's argument ignores the challenges facing operators in the oil and gas industry that the Commission recognized. Planning to drill a well, including evaluating the geology and financials, obtaining permits, completing dirt work, and obtaining a rig and crew, is conducted in advance of the spud date. Forwarding a check on the spud date and after the expiration of the thirty-day election period necessarily changes the operator's plans and alters its projections regarding the financial performance of the well and the risk associated with drilling it. For those reasons, the Commission recognized the importance of a firm deadline for identifying who is in and who is out to the proper functioning of its own rule governing risk penalties. *See St. Benedict's Health Ctr.*, 2004 ND 63, ¶ 9, 677 N.W.2d 202.

[¶ 39] As this Court has emphasized, "[a]dministrative rule-making power is predicated on the theory that in certain subjects of governmental regulation public interest is better served by delegating a part of detailed lawmaking to expert administrators who are especially familiar with the subject the legislature has directed them to regulate. *Gofor Oil, Inc. v. State of N.D.*, 427 N.W.2d 104, 107 (N.D. 1988). While an administrative agency is bound by its own duly issued regulations, an agency nevertheless has a reasonable range of informed discretion in the interpretation and application of its own rules. *See Quarles v. McKenzie Pub. Sch. Dist. No. 34*, 325 N.W.2d 662, 670 (N.D. 1982); *Fercho v. Montpelier Pub. Sch. Dist. No. 14*, 312 N.W.2d 337, 341 (N.D. 1981); 2 Am. Jur. 2d *Administrative Law* § 349 (1962). Thus, the courts generally defer to an agency's reasonable interpretation when the subject matter is so

technical that only a specialized agency has the experience and expertise to understand it or when the language is ambiguous. *In re Application for Permits to Drain Related to Stone Creek Channel Improv. etc.*, 424 N.W.2d 894, 900 (N.D. 1988) (citing *Resident v. Noot*, 305 N.W.2d 311, 312 (Minn. 1981)).

[¶ 40] The North Dakota Legislature expressly granted the Commission the authority and duty to effectuate the public interest to encourage and promote the development of oil and gas in the State of North Dakota. *See* N.D.C.C. §§ 38-08-01 and 38-08-04. This includes the ability to promulgate and adopt rules to regulate the oil and gas industry. *Id.* The Commission promulgated and adopted N.D.A.C. § 43-02-03-16.3 to govern the recovery of a risk penalty pursuant to N.D.C.C. § 38-08-08 and is entitled to a reasonable range of informed discretion in the interpretation and application of the same. *See Quarles*, 325 N.W.2d at 370. With those principles in mind, it was well within the Commission's authority to require strict compliance with the 30-day deadline, while also permitting operators some flexibility to minor changes in their drilling plans.

CONCLUSION

[¶ 41] For the reasons set forth above, it is clear that the Commission's findings and conclusions as set forth in its Order No. 19700 are sustained by the law and by substantial and credible evidence in the record. Accordingly, the District Court's judgment should be affirmed.

DATED this 19th day of November, 2012.

FREDRIKSON & BYRON, P.A.

By *__/s/ Lawrence Bender__*
LAWRENCE BENDER, ND Bar #03908
AMY L. DE KOK, ND Bar #06973
MICHAEL D. SCHOEPF, ND Bar #07076
Attorneys for Appellee
Slawson Exploration Company, Inc.
200 North 3rd Street, Suite 150
P. O. Box 1855
Bismarck, ND 58502-1855
Phone: (701) 221-4020

ADDENDUM

N.D.C.C. 38-08-01. Declaration of policy.

It is hereby declared to be in the public interest to foster, to encourage, and to promote the development, production, and utilization of natural resources of oil and gas in the state in such a manner as will prevent waste; to authorize and to provide for the operation and development of oil and gas properties in such a manner that a greater ultimate recovery of oil and gas be had and that the correlative rights of all owners be fully protected; and to encourage and to authorize cycling, recycling, pressure maintenance, and secondary recovery operations in order that the greatest possible economic recovery of oil and gas be obtained within the state to the end that the landowners, the royalty owners, the producers, and the general public realize and enjoy the greatest possible good from these vital natural resources.

N.D.C.C. 38-08-04. Jurisdiction of commission.

The commission has continuing jurisdiction and authority over all persons and property, public and private, necessary to enforce effectively the provisions of this chapter. The commission has authority, and it is its duty, to make such investigations as it deems proper to determine whether waste exists or is imminent or whether other facts exist which justify action by the commission. The commission has the authority:

1. To require:

   a. Identification of ownership of oil or gas wells, producing leases, tanks, plants, structures, and facilities for the transportation or refining of oil and gas.

   b. The making and filing with the industrial commission of all resistivity, radioactivity, and mechanical well logs and the filing of directional surveys, if taken, and the filing of reports on well location, drilling, and production.

   c. The drilling, casing, operation, and plugging of wells in such manner as to prevent the escape of oil or gas out of one stratum into another, the intrusion of water into oil or gas strata, the pollution of freshwater supplies by oil, gas, or saltwater, and to prevent blowouts, cavings, seepages, and fires.

   d. The furnishing of a reasonable bond with good and sufficient surety, conditioned upon the full compliance with this chapter, and the rules and orders of the industrial commission, except that if the commission requires a bond to be furnished, the person required to furnish the bond may elect to deposit under such terms and conditions as the industrial commission may prescribe a collateral bond, self-bond, cash, or any alternative form of security approved by the commission, or combination thereof, by which an operator assures faithful performance of all requirements of this chapter and the rules and orders of the industrial commission.

   e. That the production from wells be separated into gaseous and liquid hydrocarbons, and that each be accurately measured by such means and upon such standards as may be prescribed by the commission.

   f. The operation of wells with efficient gas-oil and water-oil ratios, and to fix these ratios.

   g. Certificates of clearance in connection with the transportation or delivery of oil, gas, or any product.

   h. Metering or other measuring of oil, gas, or product related to production in pipelines, gathering systems, storage tanks, barge terminals, loading racks,

refineries, or other places, by meters or other measuring devices approved by the commission.

i. Every person who produces, sells, purchases, acquires, stores, transports, refines, disposes of, or processes oil, gas, saltwater, or other related oilfield fluids in this state to keep and maintain within this state complete and accurate records of the quantities thereof, which records must be available for examination by the commission or its agents at all reasonable times, and to file with the commission reports as the commission may prescribe with respect to oil or gas or the products thereof. An oil and gas production report need not be notarized but must be signed by the person submitting the report.

j. The payment of fees for services performed. The amount of the fee shall be set by the commission based on the anticipated actual cost of the service rendered. Unless otherwise provided by statute, all fees collected by the commission must be deposited in the general fund of this state, according to procedures established by the state treasurer.

k. The filing free of charge of samples and core chips and of complete cores when requested in the office of the state geologist within six months after the completion or abandonment of the well.

l. The placing of wells in abandoned-well status which have not produced oil or natural gas in paying quantities for one year. A well in abandoned-well status must be promptly returned to production in paying quantities, approved by the commission for temporarily abandoned status, or plugged and reclaimed within six months. If none of the three preceding conditions are met, the industrial commission may require the well to be placed immediately on a single-well bond in an amount equal to the cost of plugging the well and reclaiming the well site. In setting the bond amount, the commission shall use information from recent plugging and reclamation operations. After a well has been in abandoned-well status for one year, the well's equipment, all well-related equipment at the well site, and salable oil at the well site are subject to forfeiture by the commission. If the commission exercises this authority, section 38-08-04.9 applies. After a well has been in abandoned-well status for one year, the single-well bond referred to above, or any other bond covering the well if the single-well bond has not been obtained, is subject to forfeiture by the commission.

2. To regulate:

a. The drilling, producing, and plugging of wells, the restoration of drilling and production sites, and all other operations for the production of oil or gas.

b. The shooting and chemical treatment of wells.

c. The spacing of wells.

d. Operations to increase ultimate recovery such as cycling of gas, the maintenance of pressure, and the introduction of gas, water, or other substances into producing formations.

e. Disposal of saltwater and oilfield wastes.

f. The underground storage of oil or gas.

3. To limit and to allocate the production of oil and gas from any field, pool, or area and to establish and define as separate marketing districts those contiguous areas

within the state which supply oil and gas to different markets, and to limit and allocate the production of oil and gas for each separate marketing district.

4. To classify wells as oil or gas wells for purposes material to the interpretation or enforcement of this chapter, to classify and determine the status and depth of wells that are stripper well property as defined in subsection 8 of section 57-51.1-01, to certify to the tax commissioner which wells are stripper wells and the depth of those wells, and to certify to the tax commissioner which wells involve secondary or tertiary recovery operations under section 57-51.1-01, and the date of qualification for the reduced rate of oil extraction tax for secondary and tertiary recovery operations.
5. To adopt and to enforce rules and orders to effectuate the purposes and the intent of this chapter and the commission's responsibilities under chapter 57-51.1.
6. To provide for the confidentiality of well data reported to the commission if requested in writing by those reporting the data for a period not to exceed six months.

N.D.C.C. 38-08-07. Commission shall set spacing units.

The commission shall set spacing units as follows:

1. When necessary to prevent waste, to avoid the drilling of unnecessary wells, or to protect correlative rights, the commission shall establish spacing units for a pool. Spacing units when established must be of uniform size and shape for the entire pool, except that when found to be necessary for any of the purposes above mentioned, the commission is authorized to divide any pool into zones and establish spacing units for each zone, which units may differ in size and shape from those established in any other zone.
2. The size and shape of spacing units are to be such as will result in the efficient and economical development of the pool as a whole.
3. An order establishing spacing units for a pool must specify the size and shape of each unit and the location of the permitted well thereon in accordance with a reasonably uniform spacing plan. Upon application, if the commission finds that a well drilled at the prescribed location would not produce in paying quantities, that surface conditions would substantially add to the burden or hazard of drilling such well, or that the drilling of such well at a location other than the prescribed location is otherwise necessary either to protect correlative rights, to prevent waste, or to effect greater ultimate recovery of oil and gas, the commission is authorized to enter an order permitting the well to be drilled at a location other than that prescribed by such spacing order; however, the commission shall include in the order suitable provisions to prevent the production from the spacing unit of more than its just and equitable share of the oil and gas in the pool.
4. An order establishing units for a pool must cover all lands determined or believed to be underlaid by such pool, and may be modified by the commission from time to time to include additional areas determined to be underlaid by such pool. When found necessary for the prevention of waste, or to avoid the drilling of unnecessary wells, or to protect correlative rights, an order establishing spacing units in a pool may be modified by the commission to increase or decrease the size of spacing units in the pool or any zone thereof, or to permit the drilling of

additional wells on a reasonably uniform plan in the pool, or any zone thereof, or an additional well on any spacing unit thereof.

N.D.C.C. 38-08-08. Integration of fractional tracts.

1. When two or more separately owned tracts are embraced within a spacing unit, or when there are separately owned interests in all or a part of the spacing unit, then the owners and royalty owners thereof may pool their interests for the development and operation of the spacing unit. In the absence of voluntary pooling, the commission upon the application of any interested person shall enter an order pooling all interests in the spacing unit for the development and operations thereof. Each such pooling order must be made after notice and hearing, and must be upon terms and conditions that are just and reasonable, and that afford to the owner of each tract or interest in the spacing unit the opportunity to recover or receive, without unnecessary expense, that owner's just and equitable share. Operations incident to the drilling of a well upon any portion of a spacing unit covered by a pooling order must be deemed, for all purposes, the conduct of such operations upon each separately owned tract in the drilling unit by the several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by a pooling order must, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon. For the purposes of this section and section 38-08-10, any unleased mineral interest pooled by virtue of this section before August 1, 2009, is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit, but in no event may the royalty interest of an unleased tract be less than a one-eighth interest. An unleased mineral interest pooled after July 31, 2009, is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit or, at the operator's election, a cost-free royalty interest of sixteen percent. The remainder of the unleased interest must be treated as a lessee or cost-bearing interest.
2. Each such pooling order must make provision for the drilling and operation of a well on the spacing unit, and for the payment of the reasonable actual cost thereof by the owners of interests in the spacing unit, plus a reasonable charge for supervision. In the event of any dispute as to such costs, the commission shall determine the proper costs. If one or more of the owners shall drill and operate, or pay the expenses of drilling and operating the well for the benefit of others, then, the owner or owners so drilling or operating shall, upon complying with the terms of section 38-08-10, have a lien on the share of production from the spacing unit accruing to the interest of each of the other owners for the payment of the owner's or owners' proportionate share of such expenses. All the oil and gas subject to the lien must be marketed and sold and the proceeds applied in payment of the expenses secured by such lien as provided for in section 38-08-10.
3. In addition to any costs and charges recoverable under subsections 1 and 2, if the owner of an interest in a spacing unit elects not to participate in the risk and cost of drilling a well thereon, the owner paying for the nonparticipating owner's share of the drilling and operation of a well may recover from the nonparticipating

owner a risk penalty for the risk involved in drilling the well. The recovery of a risk penalty is as follows:

a. If the nonparticipating owner's interest in the spacing unit is derived from a lease or other contract for development, the risk penalty is two hundred percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of, and only out of, production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty or overriding royalty.

b. If the nonparticipating owner's interest in the spacing unit is not subject to a lease or other contract for development, the risk penalty is fifty percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty provided for in subsection 1.

c. The owner paying for the nonparticipating owner's share of the drilling and operation of a well may recover from the nonparticipating owner a risk penalty for the risk involved in drilling and completing the well only if the paying owner has made an unsuccessful, good-faith attempt to have the unleased nonparticipating owner execute a lease or to have the leased nonparticipating owner join in and participate in the risk and cost of drilling the well. Before a risk penalty may be imposed, the paying owner must notify the nonparticipating owner with proof of service that the paying owner intends to impose a risk penalty and that the nonparticipating owner may object to the risk penalty by either responding in opposition to the petition for a risk penalty or if no such petition has been filed, by filing an application or request for hearing with the industrial commission.

N.D.C.C. 38-08-14. Party adversely affected may appeal to district court.

1. Any party adversely affected by an order entered by the commission may appeal, pursuant to chapter 28-32, from the order to the district court for the county in which the oil or gas well or the affected property is located. However, if the oil or gas well or the property affected by the order is located in or underlies more than one county, any appeal may be taken to the district court for any county in or under which any part of the affected property is located.
2. At the time of filing of the notice of appeal, if an application for the suspension of the order is filed, the commission may enter an order suspending the order complained of and fixing the amount of a supersedeas bond. Within ten days after the entry of an order by the commission which suspends the order complained of and fixes the amount of the bond, the appellant shall file with the commission a supersedeas bond in the required amount and with proper surety. Upon approval of the bond, the order of the commission suspending the order complained of is effective until its final disposition upon appeal. The bond must run in favor of the commission for the use and benefit of any person who may suffer damage by reason of the suspension of the order in the event the same is affirmed by the district court. If the order of the commission is not superseded, it must continue in

force and effect as if no appeal was pending, unless a stay is ordered by the court to which the appeal is taken under section 28-32-48.

3. Orders of the commission must be sustained by the district court if the commission has regularly pursued its authority and its findings and conclusions are sustained by the law and by substantial and credible evidence.

N.D.C.C. 28-32-46. Scope of and procedure on appeal from determination of administrative agency.

A judge of the district court must review an appeal from the determination of an administrative agency based only on the record filed with the court. After a hearing, the filing of briefs, or other disposition of the matter as the judge may reasonably require, the court must affirm the order of the agency unless it finds that any of the following are present:

1. The order is not in accordance with the law.
2. The order is in violation of the constitutional rights of the appellant.
3. The provisions of this chapter have not been complied with in the proceedings before the agency.
4. The rules or procedure of the agency have not afforded the appellant a fair hearing.
5. The findings of fact made by the agency are not supported by a preponderance of the evidence.
6. The conclusions of law and order of the agency are not supported by its findings of fact.
7. The findings of fact made by the agency do not sufficiently address the evidence presented to the agency by the appellant.
8. The conclusions of law and order of the agency do not sufficiently explain the agency's rationale for not adopting any contrary recommendations by a hearing officer or an administrative law judge.

If the order of the agency is not affirmed by the court, it must be modified or reversed, and the case shall be remanded to the agency for disposition in accordance with the order of the court.

43-02-03-16. Application for permit to drill and recomplete.

Before any person shall begin any well-site preparation for the drilling of any well other than surveying and staking, such person shall file an application for permit to drill (form 1) with the director, together with a permit fee of one hundred dollars. Verbal approval may be given for site preparation by the director in extenuating circumstances. No drilling activity shall commence until such application is approved and a permit to drill is issued by the director. The application must be accompanied by the bond pursuant to section 43-02-03-15 or the applicant must have previously filed such bond with the commission, otherwise the application is incomplete. An incomplete application received by the commission has no standing and will not be deemed filed until it is completed.

The application for permit to drill shall be accompanied by an accurate plat certified by a registered surveyor showing the location of the proposed well with reference to true north and the nearest lines of a governmental section. The plat shall also

include latitude and longitude of the proposed well location to the nearest tenth of a second. Information to be included in such application shall be the proposed depth to which the well will be drilled, estimated depth to the top of important markers, estimated depth to the top of objective horizons, the proposed mud program, the proposed casing program, including size and weight thereof, the depth at which each casing string is to be set, the proposed pad layout, including cut and fill diagrams, and the proposed amount of cement to be used, including the estimated top of cement.

Prior to the commencement of recompletion operations or drilling horizontally in the existing pool, an application for permit shall be filed with the director. Included in such application shall be the notice of intention (form 4) to reenter a well by drilling horizontally, deepening, or plugging back to any source of supply other than the producing horizon in an existing well. Such notice shall include the name and file number and exact location of the well, the approximate date operations will begin, the proposed procedure, the estimated completed total depth, the anticipated hydrogen sulfide content in produced gas from the proposed source of supply, the weight and grade of all casing currently installed in the well unless waived by the director, the casing program to be followed, and the original total depth with a permit fee of fifty dollars. The director may deny any application if it is determined, in accordance with the latest version of ANSI/NACE MR0175/ISO 15156, that the casing currently installed in the well would be subject to sulfide stress cracking.

The applicant shall provide all information, in addition to that specifically required by this section, if requested by the director. The director may impose such terms and conditions on the permits issued under this section as the director deems necessary.

The director shall deny an application for a permit under this section if the proposal would cause, or tend to cause, waste or violate correlative rights. The director of oil and gas shall state in writing to the applicant the reason for the denial of the permit. The applicant may appeal the decision of the director to the commission.

A permit to drill automatically expires one year after the date it was issued, unless the well is drilling or has been drilled below surface casing. A permit to recomplete or to drill horizontally automatically expires one year after the date it was issued, unless such project has commenced.

N.D.A.C. 43-02-03-16.3. Recovery of a risk penalty. The following govern the recovery of the risk penalty pursuant to subsection 3 of North Dakota Century Code section 38-08-08 and subsection 3 of North Dakota Century Code section 38-08-09.4:

1. An owner may recover the risk penalty under the provisions of subsection 3 of North Dakota Century Code section 38-08-08, provided the owner gives, to the owner from whom the penalty is sought, a written invitation to participate in the risk and cost of drilling a well, including reentering a plugged and abandoned well, or the risk and cost of reentering an existing well to drill deeper or a horizontal lateral. If the nonparticipating owner's interest is not subject to a lease

or other contract for development, an owner seeking to recover a risk penalty must also make a good-faith attempt to have the unleased owner execute a lease.

a. The invitation to participate in drilling must contain the following:
   (1) The location of the proposed or existing well and its proposed depth and objective zone.
   (2) An itemization of the estimated costs of drilling and completion.
   (3) The approximate date upon which the well was or will be spudded or reentered.
   (4) A statement indicating the invitation must be accepted within thirty days of receiving it.
   (5) Notice that the participating owners plan to impose a risk penalty and that the nonparticipating owner may object to the risk penalty by either responding in opposition to the petition for a risk penalty, or if no such petition has been filed, by filing an application or request for hearing with the commission.

b. An election to participate must be in writing and must be received by the owner giving the invitation within thirty days of the participating party's receipt of the invitation.

c. An invitation to participate and an election to participate must be served personally, by mail requiring a signed receipt, or by overnight courier or delivery service requiring a signed receipt. Failure to accept mail requiring a signed receipt constitutes service.

d. An election to participate is only binding upon an owner electing to participate if the well is spudded or reentry operations are commenced on or before ninety days after the date the owner extending the invitation to participate sets as the date upon which a response to the invitation is to be received. It also expires if the permit to drill or reenter expires without having been exercised. If an election to participate lapses, a risk penalty can only be collected if the owner seeking it again complies with the provisions of this section.

2. An owner may recover the risk penalty under the provisions of subsection 3 of North Dakota Century Code section 38-08-09.4, provided the owner gives, to the owner from whom the penalty is sought, a written invitation to participate in the unit expense. If the nonparticipating owner's interest is not subject to a lease or other contract for development, an owner seeking to recover a risk penalty must also make a good-faith attempt to have the unleased owner execute a lease.

   a. The invitation to participate in the unit expense must contain the following:
      (1) A description of the proposed unit expense, including the location, objectives, and plan of operation.
      (2) An itemization of the estimated costs.
      (3) The approximate date upon which the proposal was or will be commenced.
      (4) A statement indicating the invitation must be accepted within thirty days of receiving it.
      (5) Notice that the participating owners plan to impose a risk penalty and that the nonparticipating owner may object to the risk penalty by either responding in opposition to the petition for a risk penalty, or if no such

petition has been filed, by filing an application or request for hearing with the commission.

b. An election to participate must be in writing and must be received by the owner giving the invitation within thirty days of the participating party's receipt of the invitation.

c. An invitation to participate and an election to participate must be served personally, by mail requiring a signed receipt, or by overnight courier or delivery service requiring a signed receipt. Failure to accept mail requiring a signed receipt constitutes service.

d. An election to participate is only binding upon an owner electing to participate if the unit expense is commenced within ninety days after the date the owner extending the invitation request to participate sets as the date upon which a response to the request invitation is to be received. If an election to participate lapses, a risk penalty can only be collected if the owner seeking it again complies with the provisions of this section.

e. An invitation to participate in a unit expense covering monthly operating expenses shall be effective for all such monthly operating expenses for a period of five years if the unit expense identified in the invitation to participate is first commenced within ninety days after the date set in the invitation to participate as the date upon which a response to the invitation to participate must be received. An election to participate in a unit expense covering monthly operating expenses is effective for five years after operations are first commenced. If an election to participate in a unit expense comprised of monthly operating expenses expires or lapses after five years, a risk penalty may only be assessed and collected if the owner seeking the penalty once again complies with this section.

3. Upon its own motion or the request of a party, the commission may include in a pooling order requirements relating to the invitation and election to participate, in which case the pooling order will control to the extent it is inconsistent with this section.

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

Gadeco, LLC, Appellant, vs. Industrial Commission of the State of North Dakota and Slawson Exploration Company, Appellees.	)	Supreme Court No. 20120344

STATE OF NORTH DAKOTA)
) ss.
COUNTY OF BURLEIGH)

I hereby certify that on November 19, 2012, I electronically filed the foregoing with the Clerk of the North Dakota Supreme Court and served the same electronically as follows:

Mr. Ariston Edward Johnson	ari@dakotalawdogs.com
Mr. Dennis Edward Johnson	dennis@dakotalawdogs.com
Ms. Hope L. Hogan	hhogan@nd.gov

Dated: November 19, 2012

/s/ Lawrence Bender
LAWRENCE BENDER

5269446_3.DOC