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Hayes' energy history

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Changes and challenges have been a part of J. Kevin Hayes' story since he started practicing energy law 38 years ago.

It was in 1975 that Hayes, who had just graduated from the University of Tulsa College of Law, joined the Hall Estill Law Firm.

He previously worked with the firm as a law clerk.

Now a partner with the firm, Hayes has found himself representing producers and clients on a variety of issues.

Hayes recalled the shortage of natural gas experienced in the U.S. because the federal government kept rates down and there wasn't a lot of incentive to drill wells.

Then came the Natural Gas Policy Act in 1978 and a change in gas pricing which encouraged producers to drill deep high cost wells and the call came for price deregulation.

Higher natural gas prices for new and stripper wells encouraged production even though natural gas produced from old wells were kept at relatively low prices.

The increased drilling led to a significant increase of natural gas supplies and suddenly there was a surplus. That surplus caused havoc among producers and set the scene for a variety of legal cases.

At the outset, the producers who spent millions of dollars drilling deep wells and were receiving between $7 and $9 per MCF suddenly found the interstate purchasers didn't have a market for their expensive product.

"The purchasers couldn't take the natural gas to customers and customers started to rebel," Hayes continued. "The federal government got into the act and that resulted in the take or pay litigation."

Those cases would span a decade or more before all were settled.

Producers entered into contracts with interstate pipeline companies where the pipeline companies were required to take a certain percentage of the deliverability of the gas. If they didn't take the gas, they still were required to make payments and could take gas in the future without paying additional money for the product.

"Interstate pipeline companies found they were unable to take all the gas they were required to purchase," Hayes said.

At about the same time the Federal Energy Regulatory Commission (FERC) basically opened up interstate pipelines to a different role.

"Prior to that time, the pipeline companies would buy the natural gas at the wellhead and then sell it," he said. "Customers didn't like the prices that pipeline companies were charging and started making purchases from the distribution companies and then wanted the pipeline companies to transport the gas to them."

It was in the mid-1980s that interstate pipeline companies went from being transporters and merchants to just being natural gas transporters at regulated rates.

This change resulted in significant litigation between producers and pipelines and big industrial end users and royalty owners.

"What happened is interstate pipeline companies became transporters," he said. "Producers sold their gas to independent gas gatherers and formed marketing companies or departments that moved the gas downstream.

"When I first started practicing law, virtually all producer-clients entered into a gas purchase contract with the purchaser calling for gas to be delivered at the wellhead. All interstate gas was subject to price regulations."

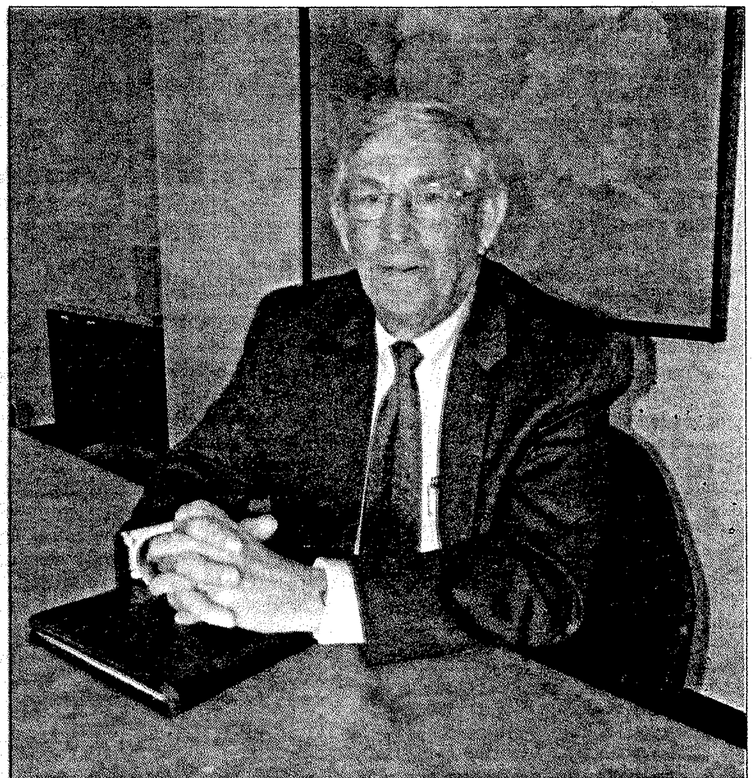
Royalty owners, at that time, were paid on the basis of the price the working interest owner — the producer — received at the wellhead. When the changes went into effect, producers sold their gas at the wellhead, but not at regulatory prices.

Prices were established and end users would agree to pay a certain price at points along the pipelines utilizing an index that had been designed as a price guide.

A number of royalty owner attorneys filed class action lawsuits claiming royalty payments were not properly paid based on the working interest of the well. Suits maintained royalty owners shouldn't have to bear the costs associated with transporting gas through a gathering line, pay costs associated with the processing plan and to the ultimate sale, even though the producer was receiving just the wellhead price.

"Royalty owner attorneys working in the class action suits received more than $320 million in fees over a 10-year period and those figures are a bit outdated," Hayes said. "With that amount of money potentially available it is easy to see why those cases have proliferated."

It was during law school classes that Hayes was taught that a producer's duty was to drill for, produce gas and equip the well and market the product.



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J. Kevin Hayes, partner for Hall Estill Law Firm

"I think that everybody at that time believed the producer's obligation ended after the oil and been produced," he said. "These royalty owner cases changed that concept to include transportation and processing of gas until it reaches the interstate pipeline."

Oklahoma's Supreme Court stepped into the foray and ruled that producers may deduct costs, gathering transportation, and compression once the gas is marketable — as long as costs are reasonable and the royalty owner gets his share.

The question then becomes "what is marketable?" he asked. The law in Oklahoma is unclear.

"Most royalty class action cases are filed in rural Oklahoma counties," Hayes said. "Costs are astronomical because of a required 12 percent compounded interest requirement."

Cases have been filed in federal court and some judges have ruled the class action relief sought did not meet previous guidelines that had been established in the Dukes vs Wal-Mart case.

"Technology and new drilling techniques have changed the industry through the use of vertical and horizontal drillings and fracking," he said. "This has made it possible to go into older vertical wells and drill in various horizons."

"As a result, there has been a resurgence in oil and gas drilling activity in the state," Hayes said. "But this state is not truly business friendly and without legislative assistance, energy companies were getting hammered by lawsuits."

Exploration companies had a choice of spending the dollar in Oklahoma or going to Texas or North Dakota where there is a more favorable business climate.

"Oklahoma lawmakers have made changes in the law and there are attempts by the governor's office to make this a more business-friendly state," he said.

Hayes didn't think Iraq would have been invaded to protect the flow of oil into the U.S. had local supplies been developed, but that also is his personal opinion.

"Oil and gas law is ever changing," he said. "It is challenging to keep up with the different that is ever changing."«