

AUG 26 2015

TIM RHODES
COURT CLERK

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IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

OKLAHOMA DEPARTMENT OF)
SECURITIES, *ex rel.* IRVING L. FAUGHT,)
ADMINISTRATOR,)
))
Plaintiff,)
))
vs.))
))
JASMINE, INC., an Oklahoma corporation;)
OKLAHOMA ENERGY EXCHANGE, LLC,)
Oklahoma limited liability company;)
HARRISBURG PROSPECT LEASE FUND,)
LLC, an Oklahoma limited liability company;)
GATES OIL & GAS, LTD., an Oklahoma)
Corporation; HARRISBURG 2 PROSPECT)
LEASE FUND, LLC, an Oklahoma limited)
Liability company; JIMMY W. GRAY, an)
Individual; GREG L. GRAY, an individual;)
MICHAEL K. GRAY, an individual, and)
LANCE P. BOWMAN, an individual,)
))
Defendants.)

Case No. CJ-2013-5023

**RECEIVER’S APPLICATION FOR APPROVAL TO SUBMIT
AN AUTHORIZATION FOR EXPENDITURE TO WORKING
INTEREST OWNERS IN MACKENZIE WELL**

The Receiver for the Estate of Gates Oil & Gas, Ltd. (“Receiver”), submits the following Application for Approval to Submit an Authorization for Expenditure to the various working interest owners in the Mackenzie Well. In support of this Application, the Receiver states and alleges as follows:

1. By Order dated September 30, 2013, this Court appointed Receiver as the Receiver of all the assets and business affairs of Gates Oil & Gas, Ltd. (“Gates”).
2. Shortly before the Receivership was created, Gates had completed the Mackenzie No. 1 Well, API #35049249430000, located in the NW/4 SE/4 of Section 21-3N-1W, Garvin County, Oklahoma (the “Mackenzie Well”).

2. The Mackenzie Well was completed as an oil and gas well capable of producing approximately 15 to 20 barrels of oil per day from the Second Bromide formation. As is typical with oil production from the Second Bromide formation in this area of Garvin County, the oil is produced in conjunction with substantial amounts of saltwater. Of the total volume of fluid produced from the well, oil accounts for approximately 2% of the recovered fluid. The remaining volume of fluid consists of saltwater.

3. The Receiver approved, and has contracted Magnum Energy, Inc. ("Magnum") as the designated operator for the Mackenzie Well.

Working Interest Owners

4. According to the Receiver's records, there are 62 individuals or entities that invested money with Gates for the purpose of participating in the drilling of the Mackenzie Well and that have verified the interest owned with the Receiver. While neither Gates nor the Receiver have assigned such Owners a leasehold interest of record, such owners collectively own approximately a 45.02% working interest.

5. According to the Receiver's records and calculations, there are an additional 42 investors who may have contributed money to Gates for the drilling of the Mackenzie Well that have been requested to verify their investment with the Receiver but have failed to provide any documentation for such investment. The Receiver's records also indicate that these potential investors received the Receiver's request for information either via certified mail or via personal contact. Assuming all such owners made an investment in the Mackenzie Well, they would collectively own approximately a 16.9983% working interest.

6. According to the Receiver's records, there are 4 parties claiming a working interest in the Mackenzie Well that have not provided complete confirmation of payment for said interest to the Receiver. These claimants make up approximately 4.5% of the working interest.

7. According to the Receiver's records, there are 2 parties claiming a working interest in the Mackenzie Well at a discounted rate.¹ These claimants make up 2.5% of the working interest.

8. According to the Receiver's records, there are 9 parties claiming a working interest in the Mackenzie Well without having actually paid any funds for the claimed interest.² These claimants make up 4.5% of the working interest.

9. According to the Receiver's records, Gates owns at least an approximate 12.415% working interest in the Mackenzie.³

10.

11. Accordingly, the Receiver has determined that.

Operation of the Mackenzie Well

12. In conjunction with the Mackenzie Well, 1500 to 2000 barrels of water must be disposed of each day, either hauled off or pumped into an Oklahoma Corporation Commission approved salt water disposal well..

¹ With respect to the parties claiming an interest at a discounted rate, the Receiver is simultaneously filing his Application for Judicial Determination of Interests in the Mackenzie PPM and the Mackenzie Well ("Application for Judicial Determination") with the Court to credit their claimed interest commensurate with the amounts invested in the Mackenzie PPM/Well. The Application for Judicial Determination is set to be heard at the same time as the present Application—September 17, 2015 at 11:15 a.m.

² With respect to the parties claiming an interest that was not paid for, the Receiver is simultaneously filing his Application for Judicial Determination of Interests in the Mackenzie PPM and the Mackenzie Well ("Application for Judicial Determination") with the Court to deny their claimed interest in the Mackenzie PPM/Well. The Application for Judicial Determination is set to be heard at the same time as the present Application—September 17, 2015 at 11:15 a.m.

³ There are 7 parties that appear on the Mackenzie Division Order Title Opinion ("DOTO") as working interest owners that are not investors with Gates and are thus not dealt with in the present Application. The DOTO lists their aggregate working interest total at approximately 14.0625%.

13. On the oil and gas lease where the Mackenzie Well was drilled, Gates also owned a depleted oil well that has been converted into a saltwater disposal well, identified as the Jamie #1 Saltwater Disposal Well, API #35049246020001, also located in the NE/4 SW/4 of Section 21-3N-1W, Garvin County. The disposal well, less than 300 feet from the Mackenzie Well, is under the Receiver's control and is also operated by Magnum.

14. At the commencement of the Receivership, the Jamie Well was red tagged by the Oklahoma Corporation Commission as a result of spills and leaks from the well during injection operations by Gates. Through the expenditure of revenues derived from oil and gas production from the Mackenzie Well, Magnum remediated the well site and restored the Jamie Well to operational integrity. Unfortunately, the geologic zone into which the saltwater is injected in the Jamie Well is too tight and too thin to accept the daily quantities of saltwater that must be disposed of in order to profitably produce the Mackenzie Well. Despite Magnum's repeated efforts to clean out the zone and the perforations shot into the zone to facilitate injection, as well as changes to the disposal pump to decrease the rate of injection, the Jamie Well immediately pressures up to injection pressures in excess of 1800 psi, exceeding the safe pressure maximum permitted by the Oklahoma Corporation Commission for the Jaime Well. As a result, the Mackenzie Well must be shut down daily to permit the pressure to bleed off the disposal well.

15. In order to return the Mackenzie to continuous production, the Receiver must have an economical method for disposal of the 1500 to 2000 barrels of saltwater the Mackenzie produces daily. The alternatives are: (i) attempt to drill out the Jamie Well into a deeper geologic zone that may have a sufficient disposal capacity to handle all the produced water; (ii) haul the water to a commercial disposal well; (iii) purchase another depleted well in the area for

purposes of converting to a disposal well; or (iv) drill a new well for disposal purposes. The Receiver and Magnum have evaluated the options and reached the following conclusions:

- Option (ii) – hauling the saltwater is not economical. Costs to haul the saltwater from the Mackenzie Well to a commercial disposal well, together with the disposal fees would, at a minimum, cost the Receiver \$1.50 per barrel. As discussed, *supra*, the Mackenzie Well produces approximately 1500 to 2000 barrels of saltwater per day in conjunction with about 15 to 20 barrels of oil, hauling and disposal costs would exceed the daily value of all oil production until the price of oil exceeds \$200/barrel..
- In respect to Option (iii), purchasing an alternative well for disposal purposes, the wells operator of the marginal wells located within the vicinity of the Mackenzie Well have not been willing to sell their wells for purposes of converting same to disposal. Further, the Receiver and Magnum estimate the cost of purchasing a marginal well in the area to exceed \$150,000. Of course, there is no assurance that even if a well was purchased, it could be successfully recompleted as a disposal well capable of handling the quantities of water the Mackenzie Well produces.
- In respect to Option (iv), cost to drill a new well for disposal purposes, even if completed using salvageable equipment off the Jamie Well, is estimated at \$625,000. Again, there is no assurance a new well would have any better disposal capacity than the Jamie Well.
- The Receiver and Magnum believe the only economical solution is option (i), attempting to drill out the bottom of the well bore into a more porous and permeable geologic zone that will accept the quantities of water the Mackenzie produces. Magnum has an Authority for Expenditure for the necessary work, estimating the recompletion of the Jaime Well at \$57,420.00.

16. Magnum has advised the Receiver that, given his prior experience in reworking other Gates and Jasmine, Inc. drilled and operated wells, there is no assurance the reported condition of the Jamie well bore, including completion intervals, size and length of casing, amount of cement in the hole, etc., have been accurately reported to the OCC or in the well records. Further, Magnum makes absolutely no assurance that the recompletion will be successful given the inherent risk of problems associated with drilling in an old well bore and the unknown characteristics of the geologic formations in which disposal may be permitted by the OCC. Nevertheless, given the expense and identical risks associated with the other options, the Receiver believes recompleting the Jamie SWD is the best option for the Mackenzie owners.

The Recommended Authorization for Expenditure

17. The Authorization for Expenditure ("AFE") to rework the Jaime SWD is attached hereto as Exhibit A. The total estimated cost is \$57,420.00.

18. None of the working interest owners in the Mackenzie Well have executed an Operating Agreement (or other contract) pertaining to payment of rework or operating costs. Gates, and prior to that, OEE and Jasmine, represented to each investor that they would be assigned working interest ownership in the well and would be required to sign an industry standard Operating Agreement.

19. Thus, the AFE must be paid for via money received from both Gates as well as the other working interest owners in the Mackenzie based on their working interest shares – e.g. Gates, as a ~12.415% working interest owner would need to pay ~\$7,129.06.

20. Magnum and the Receiver both believe that this is the only way the Mackenzie will be able to produce at capacity and provide some form of return to the Mackenzie working interest owners; otherwise the well will need to be shut in.

21. Accordingly, the Receiver requests that this Court approve the issuance and sending of the AFE proposal to the working interest owners in the Mackenzie on the following terms and with the following elections available to each:

- a. Option 1: Participate. Each working interest owner electing to participate would be required to pay all receivables accumulated to date associated with the Mackenzie/Jamie SWD as well as the prorated amount of the AFE costs attributable to his/her/it's working interest within fifteen (15) days of the election period commencing.

For example: Joe Smith has a working interest of 0.005 (0.5%) and has a current outstanding amount owed of \$50.00. Mr. Smith wants to participate. Accordingly, he must submit a check for \$337.10⁴ within the fifteen (15) day window.

- b. Option 2: Non-Consent Option 1. Each working interest owner would have the option to elect "non-consent" on all costs associated with the AFE and keep his/her/it's full working interest only after a 400% recovery of all costs (including receivables).

For Example: Using the same hypothetical investor situation, Mr. Smith instead elects this Option with respect to the AFE. He does not send in any funds and retains his working interest in a "carried" status. Under this Option, Mr. Smith would not receive any funds associated with his working interest

⁴ .005 x \$57,420.00 = \$287.10 (pro rata share of AFE). \$287.10 + \$50.00 = \$337.10 (total of receivables outstanding and pro rata share of AFE)

until \$1,348.40⁵ attributable to his working interest had been recovered by the operator from the Mackenzie production.

- c. Option 3: Abandon Interest. Consideration for this Option being forgiveness of all receivables owed to date and release from plugging and restoration cost liability.

Furthermore, failure to elect or failure to pay within time period if Option 1 is selected is deemed to have elected Option 3.

22. Magnum has informed the Receiver that it will provide any necessary capital to "carry" any non-consent working interest owners as delineated above as well as the parties that have not proven their working interest ownership, should the Receiver decide it is unfeasible to provide the necessary funds.

WHEREFORE, the Receiver requests that this Court enter its Order approving this Application, the attached AFE, and the election options for the working interest owners as delineated in Paragraph 19.a.-c., *supra*.

WHEREFORE the Receiver also requests that this Court direct him to:

1. Pay Gates' proportionate share of the AFE out of its operating account (~12.415%, or ~\$7,129.06), or make an election based on his best judgment.
2. Submit the attached AFE to all 62 identified, verified, and approved Mackenzie working interest owners (~45.19%, or ~\$25,850.48 total) and include with the submitted AFE:
 - a. An explanation of why the AFE is necessary;
 - b. An explanation of the three (3) election options;
 - c. A deadline to submit proportionate payment by fifteen (15) days from the date of the mailing; and

⁵ $\$337.10 \times 4 = \$1,348.40$ – total of 400% of Mr. Smith's pro rata AFE cost and receivables owed.

d. A copy of this Court's Order approving the AFE.

3. Submit the attached AFE to all 42 identified possible investors in the Mackenzie Well that have not submitted any information to the Receiver at their last known address (~16.9983%, or ~\$9,760.42), and include with the submitted AFE:

- a. A cover letter explaining that the Receiver must receive the necessary documentation⁶ to verify the party's interest in the Mackenzie, if any;
- b. An explanation of why the AFE is necessary;
- c. An explanation of the three (3) election options;
- d. A deadline to submit investment verification along with proportionate payment by fifteen (15) days from the date of the mailing; and
- e. A copy of this Court's Order approving the AFE.

4. Submit the attached AFE to all 4 identified possible investors in the Mackenzie Well that have not submitted payment confirmation to the Receiver (~4.5%, or ~\$2,583.90) and include with the submitted AFE:

- a. A cover letter explaining that the Receiver must receive the necessary documentation to verify the party's payment for their claimed interest in the Mackenzie;
- b. An explanation of why the AFE is necessary;
- c. An explanation of the three (3) election options;
- d. A deadline to submit investment verification along with proportionate payment by fifteen (15) days from the date of the mailing; and
- e. A copy of this Court's Order approving the AFE.

⁶ A copy of the Subscription Agreement as well as a proof of payment confirmation.

5. Take action commensurate with this Court's decision at the hearing on the Receiver's Application with respect to the 2 investors that were given working interest in the Mackenzie at a discounted rate (claimed at 2.5%, or ~\$1,435.50)

6. Take action commensurate with this Court's decision at the hearing on the Receiver's Application with respect to the 9 parties claiming an interest in the Mackenzie (claimed at 4.5%, or \$2,583.90) that did not actually pay any funds for the claimed interest.

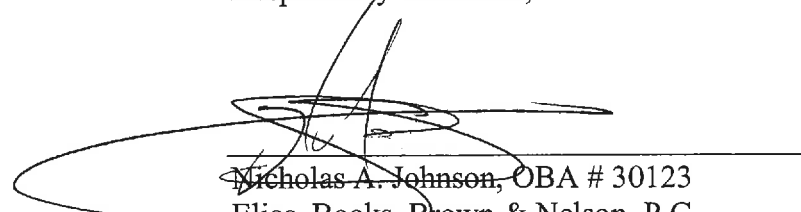
7. Post the AFE and requirements associated therewith along with this Court's Order on this Application to the "Recent Developments" tab on www.gatesoil.com; and

8. Allow the Receiver (through Gates' operating account), or Magnum—via approval from the Receiver—to "carry" any non-consent working interest owners as well as any parties that have not proven their working interest ownership.

9. Issue a Notice of Hearing on this Application to all 119 Mackenzie PPM/Well investors discussed above at their last known addresses and to all 24 creditors that have filed claims with the Receiver.

DATED this 26th day of August, 2015.

Respectfully submitted,



Nicholas A. Johnson, OBA # 30123
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Attorney for the Receiver

VERIFICATION

STATE OF OKLAHOMA)
) ss.
COUNTY OF OKLAHOMA)

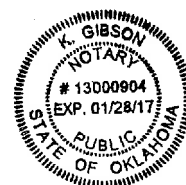
I, L. Vance Brown, the court-appointed Receiver in the above captioned matter, being first duly sworn upon oath, state:

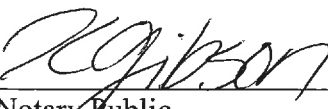
That I have reviewed the books and accounts of Gates Oil & Gas, Inc., and, upon the basis of the information set forth in such accounts and my examination thereof, verifies that the statements contained herein are true and correct to my best knowledge and belief.



L. Vance Brown

Subscribed and sworn before me 26 day August, 2015.





Notary Public

My commission expires:

CERTIFICATE OF SERVICE

I certify that on the 27 day of August, 2015, a true and correct copy of the above and foregoing was mailed via U.S. Mail, postage prepaid, to the following counsel of record:

Irving L. Faught, Esq.
David Lawson, Esq.
Robert Fagnant, Esq.
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*Attorneys for Defendants Jimmy W. Gray,
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I further certify that on the 27 day of August, 2015, a true and correct copy of the above and foregoing was mailed via U.S. Mail, postage prepaid, to the following individuals identified as possible Mackenzie PPM Investors and/or Mackenzie Well working interest owners:

Orlando Alaniz
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Colleyville, TX 76034

Randall A. Davis
1022 N County Rd 30 East
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Cedar Rapids, IA 52402

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Kerrville, TX 78028

Mason Carl Radke
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Morro Bay, CA 93442

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Canal Fulton, OH 44614

Raymond W. Ruegg
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Massillon, OH 44646-7412

Sidney Schmidt
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Garfield, MN 56332

Phillip Schwob
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South San Francisco, CA 94080

Siegmar Seida
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Edmonton, AB T6T1G6

Gyan Shanker
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Plainfield, IL 60585

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San Pierre, IN 46374

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Walnut Creek, CA 94598

Herbert & Pamela Smith
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Burgess, VA 22432-2112

Darryl & Erlinda Stone
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Diamond Bar, CA 91765

Edward and John Edward Strohmaier
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Chestertown, MD 21620

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Lubbock, TX 79413

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c/o Karen Thurman
8380 Ken-Love Court
Brighton, MI 48116

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Westerville, OH 43081

Rebecca N. Warburton
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Victoria, BC V85 4X2
Canada

Timothy Weber
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Clarkston, WA 99403

Timothy Wiggins
8763 Olentangy River Rd.
Delaware, OH 43015

Hoy or Irene Wiley
195 CR 4415
Poplar Bluff, MO 63901

Blaine Allen Wright
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Austin, TX 78756

Charles & Naomi Yett
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Monument, CO 80132

Bryan Frederick Zilkey
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Simcoe, ON N3Y 5L8
Canada

I further certify that on the 27 day of August, 2015, a true and correct copy of the above and foregoing was mailed via U.S. Mail, postage prepaid, to the following creditors that have filed claims in the Receivership proceedings:

Jenkins Oilfield Supply, LLC
P.O. Box 536
Velma, OK 73491

High Tech Office Systems
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Lawton, OK 73507

Dunn Swan & Cunningham
4832 Richmond Square, Ste. 200
Oklahoma City, OK 73118

C & H Bit Company
P.O. Box 481
Ada, OK 74820

Sooner Completions, Inc.
P.O. Box 37
Shawnee, OK 74802

Henderson Supply LLC
P.O. Box 906
Duncan, OK 73534

McDonald Surveying & Mapping, P.C.
P.O. Box 1642
Duncan, OK 73534

S & W Power Systems
& Engine Service, Inc.
P.O. Box 94638
Oklahoma City, OK 73143-4638

A & A Tank Truck Co.
P.O. Box 722588
Norman, OK 73070

Nelco
P.O. Box 1157
Grand Rapids, MI 49501-1157

Stephen Turner
d/b/a John Turner Roustabout Service
RR 2 Box 308
Duncan, OK 73534

Keystone Production Company
1730 W. Camelback Road
Duncan, OK 73533-9117

Bunch Trucking, LLC
P.O. Box 127
Lindsay, OK 73052

Cox's Cash & Dash, LLC
c/o Jay Watkins, Leach & Sullivan,
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Duncan, OK 73534-0160

REC - Rural Electric Cooperative, Inc.
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Lindsay, OK 73052-0609

United Land Company, LLC
6801 Broadway, Ste. 105
Oklahoma City, OK 73116

DWJS, Inc.
P.O. Box 156
Paoli, OK 73074

Scott Coates
29761 ELR 1570
Pauls Valley, OK 73075

Inland Machine and Welding
2133 SE 15th Street
Oklahoma City, OK 73129

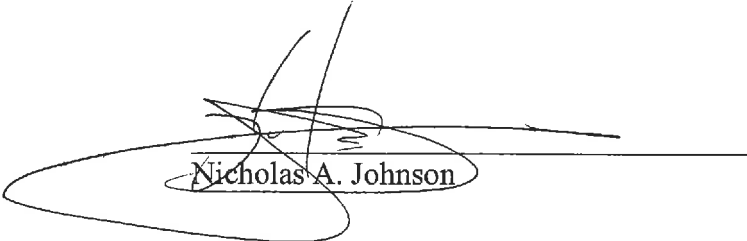
The Corporation Commission
c/o Travis Wheetin
P.O. Box 52000-2000
Oklahoma City, OK 73152-2000

First Bank & Trust Co.
c/o E.J. Buckholts, II
929 W. Willow, Patterson Bldg.
Duncan, OK 73533

RD Tank Service
20947 N. County Road 3216
Pauls Valley, OK 73075-9346

S&H Tank Service of Oklahoma
P.O. Box 773
Lindsay, OK 73052

M&M Supply Co.
PO Box 870164
Kansas City, MO 64187-0164



Nicholas A. Johnson

Authority for Expenditure

<u>Magnum Energy, Inc.</u>	<u>Well Name</u>	<u>Jamie SWD</u>		
<u>12/22/2014</u>	<u>Location</u>	<u>21-3N-1W</u>		
<u>Drill casing shoe for new inj zone</u>	<u>County</u>	<u>Garvin</u>	<u>State</u>	<u>Oklahoma</u>

Workover Rig	\$	13,400.00
BOP & TIW Rental	\$	1,000.00
Fishing tools and hand for drill out	\$	12,000.00
Packer redress	\$	1,000.00
Acidizing	\$	10,000.00
Supervision	\$	3,800.00
Used tubing	\$	2,500.00
Vacuum & pump trucks	\$	3,000.00
Misc trucking	\$	1,000.00
Wellhead repairs	\$	2,000.00
Misc rentals	\$	2,500.00
10% Contingency	\$	5,220.00

Total: \$ 57,420.00

