STATE OF MICHIGAN
DEPARTMENT OF ENVIRONMENTAL QUALITY

ORDER OF THE SUPERVISOR OF WELLS

IN THE MATTER OF:

THE PETITION OF SAVOY ENERGY, L.P., FOR AN ORDER FROM THE SUPERVISOR OF WELLS FORMING A FULL 80-ACRE RUFF FORMATION/GUELPH DOLOMITE DRILLING UNIT BY COMPULSORY POOLING ALL INTERESTS INTO THE DRILLING UNIT, LOCATED IN MANISTEE COUNTY.	)	ORDER NO. 15-2011

OPINION AND ORDER

This case involves the Petition of Savoy Energy, L.P. (Petitioner). The Petitioner has drilled and completed the Wiley 2-4 well for oil and gas exploration within a drilling unit in the stratigraphic interval known as the Niagaran Formation (now referred to as the Ruff Formation/Guelph Dolomite). The proposed unit consists of the NE 1/4 of NE 1/4 of Section 5 and the NW 1/4 of NW 1/4 of Section 4, T22N, R16W, Manistee Township, Manistee County, Michigan. Since not all of the mineral owners within the proposed drilling unit have agreed to voluntarily pool their interests, the Petitioner also seeks an Order of the Supervisor of Wells (Supervisor) designating the Petitioner as operator of the 80-acre drilling unit and requiring compulsory pooling of all tracts and interests within that geographic area for which the owners have not agreed to voluntary pooling.

Jurisdiction

The development of oil and gas in this state is regulated under Part 615, Supervisor of Wells, of the Natural Resources and Environmental Protection Act, 1994 PA 451, as amended. MCL 324.61501 *et seq.* The purpose of Part 615 is to ensure the orderly development and production of the oil and gas resources of this state. MCL 324.61502. To that end, the Supervisor may establish drilling units and compulsorily pool mineral interests within said units. MCL 324.61513(2) and (4). However, the formation of drilling units by compulsory pooling of interests can only be effectuated after an evidentiary hearing. 1996 MR 9, R 324.302 and R 324.304. The

evidentiary hearing is governed by the applicable provisions of the Administrative Procedures Act, 1969 PA 306, as amended, MCL 24.201 *et seq.* See 1996 MR 9, R 324.1203. The evidentiary hearing in this matter was held on December 15, 2011.

FINDINGS OF FACT

The Petitioner specifically requests that the Supervisor issue an Order that:

1. Requires compulsory pooling of all tracts and mineral interests within the proposed drilling unit that have not agreed to voluntary pooling.
2. Names the Petitioner as operator of the Wiley 2-4 well.
3. Authorizes the Petitioner to recover certain costs from the parties subject to the compulsory pooling order.

The Administrative Law Judge determined that the Notice of Hearing was properly served and published. Andrew J. Haliw III, as trustee of the Andrew J. Haliw III Revocable Living Trust (Haliw Trust), an unleased mineral owner in the proposed drilling unit, filed an Answer in protest to the Petition and participated as a full party in this matter. Edward and Patricia Bartos, adjacent property owners, filed an Answer regarding environmental concerns with the well but did not participate as a full party in this matter. The Supervisor designated the hearing to be an evidentiary hearing pursuant to R 324.1205(1)(b) and directed evidence be presented in the form of oral testimony.

In support of its case, the Petitioner offered the testimony of William Sperry, President and General Counsel of Savoy Exploration, Inc. Respondent offered the testimony of Andrew J. Haliw III.

I. Drilling Unit

The spacing of wells in Manistee County targeting the Ruff Formation/Guelph Dolomite is governed by Special Order No. 1-73. This Special Order establishes drilling units of 80 acres, more or less, formed by combining two governmental surveyed quarter-quarter sections of land with one common boundary of approximately 1,320 feet, with allowances being made for the difference in the size and shape of sections as indicated by official governmental survey plats. It has been determined that

one well will efficiently and economically drain an 80-acre unit of hydrocarbons. The Petitioner's proposed drilling unit is described as the NE 1/4 of NE 1/4 of Section 5 and NW 1/4 of NW 1/4 of Section 4, T22N, R16W, Manistee Township, Manistee County, Michigan.

I find that the proposed 80-acre drilling unit is consistent with Special Order No. 1-73 and, as such, is a proper drilling unit for the proposed well.

II. Drilling Unit Operator

Mr. Sperry testified the Petitioner owns or controls oil and gas leases for all but 0.64 acres of mineral interests in the proposed drilling unit. Given this, the Petitioner seeks to be designated as the operator of the Wiley 2-4 well. I find, as a Matter of Fact, the Petitioner is eligible to be designated operator of the Wiley 2-4 well.

III. Compulsory Pooling

The Petitioner was unable to obtain the agreement of all mineral owners to gain full control of the proposed unit. The Petitioner may not produce a well on the drilling unit without first obtaining control of all the oil and gas interests. In cases like this, it is necessary for the Petitioner to request compulsory pooling from the Supervisor. As discussed, a mineral owner who does not agree to voluntarily pool his or her interest in a drilling unit may be subject to compulsory pooling. 1996 MR 9, R 324.304. The compulsory pooling of an interest must be effectuated in a manner that ensures "each owner ... is afforded the opportunity to receive his or her just and equitable share of the production of the unit." *Id.* In addition to protecting correlative rights, the compulsory pooling must prevent waste. MCL 324.61502. An operator must first seek voluntary pooling of mineral interests within a proposed drilling unit prior to obtaining compulsory pooling through an Order of the Supervisor.

Mr. Sperry testified that the Petitioner controls all but 0.64 net acres of oil and gas interests, owned by the Haliw Trust, within the proposed 80-acre drilling unit (this unleased acreage was originally identified as 0.51 acres in Exhibit D to Petitioner's Exhibit 1). Mr. Sperry testified to efforts to voluntarily pool the Haliw Trust interest, included mailing of a lease containing pooling provisions by Petitioner's agent, Quantum Energy, and subsequent telephone conversations between Quantum Energy

and Mr. Haliw, and recently, himself and Mr. Haliw. Mr. Haliw testified that, in his opinion, these contacts did not constitute adequate pooling efforts. Mr. Sperry stated that no additional efforts to contact Mr. Haliw were made between June 2010 and December 2011 due to a letter Quantum Energy received in response to the lease sent to Mr. Haliw, in which Mr. Haliw clearly stated he was not interested in cooperating in any drilling efforts. Mr. Haliw's request as of the date of this hearing, is that his entire property of approximately 1.38 acres be compulsory pooled into the drilling unit or, in the alternative, that his entire property be carved out of the drilling unit.

Based on the foregoing, I find, as a Matter of Fact:

1. Eighty acres is the appropriate drilling unit size for a Ruff Formation/Guelph Dolomite (Niagaran Formation) drilling unit in Manistee County. To include additional acreage or to exclude acreage from the proposed 80-acre drilling unit would be contrary to the intent of MCL 324.61502.
2. The Petitioner was able to voluntarily pool all of the mineral interests in the proposed 80-acre drilling unit except for 0.64 acres.
3. Compulsory pooling is necessary to form a full drilling unit, to protect correlative rights of mineral owners, and to prevent waste by preventing the drilling of unnecessary wells.
4. The Petitioner has made reasonable efforts to voluntarily pool the unleased interest.

Now that it has been determined compulsory pooling is necessary and proper in this case, the terms of such pooling must be addressed. When pooling is ordered, the owner of the compulsorily pooled lands (Pooled Owner) is provided an election on how he or she wishes to share in the costs of the project. 1996 MR 9, R 324.1206(4). A Pooled Owner may participate in the project, or in the alternative be "carried" by the operator. If the Pooled Owner elects to participate, he or she assumes the economic risks of the project, specifically, by paying his or her proportionate share of the costs or giving bond for the payment. Whether the well drilled is ultimately a producer or dry hole is immaterial to this obligation. Conversely, if a Pooled Owner elects not to participate, the Pooled Owner is, from an economic perspective, "carried" by the operator. Under this option, if the well is a dry hole, the Pooled Owner has no financial

obligation because they did not assume any risk. If the well is a producer, the Supervisor considers the risks associated with the proposal and awards the operator compensation, out of production, for assuming all of the economic risks.

In order for a Pooled Owner to decide whether he or she will "participate" in the well or be "carried" by the operator, it is necessary to provide reliable cost estimates. In this regard, the Petitioner must present proofs on the estimated or actual costs involved in drilling, completing, and equipping the proposed well. The Petitioner's Authorization for Expenditure (AFE) form for the well (Exhibit C to its Petition) itemizes the actual or estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. The actual costs are $585,967.42 for drilling and $229,784.01 for completion. Estimated equipping costs are $438,990.46 and actual equipping costs at the time the AFE was prepared were $12,409.54. The total actual and estimated producing well costs for the Wiley 2-4 well are $1,267,151.40. There is no evidence on this record refuting these costs.

I find, as a Matter of Fact, the actual and estimated costs in Exhibit C are reasonable for the purpose of providing the pooled owners a basis on which to elect to participate or be carried. However, I find actual equipping costs shall be used in determining the final share of costs and additional compensation assessed against a Pooled Owner.

The next issue is the allocation of these costs. Part 615 requires the allocation be just and equitable. MCL 324.61513(4). Established practices and industry standards suggest allocation based upon the ratio of the number of mineral acres in the tracts of various owners to the total number of acres in a drilling unit to be a fair and equitable method of allocation of production and costs. Therefore, I find, as a Matter of Fact, utilizing mineral acreage is a fair and equitable method to allocate to the various tracts in the proposed drilling unit each tract's just and equitable share of unit production and costs.

The Petitioner has completed the drilling, completion, and equipping operations on the Wiley 2-4 well and is not requesting additional compensation for the risk of a dry hole. The Petitioner requests, in the event the unleased owner does not elect to participate, that the Operator be allowed to take out of the nonparticipating party's

share of production, said party's share of the actual cost of drilling, completing, and equipping the well, plus the nonparticipating party's share of actual operating costs.

CONCLUSIONS OF LAW

Based on the Findings of Fact, I conclude, as a matter of law:

1. The Petitioner was unable to voluntarily pool all mineral interests within the proposed drilling unit. The Supervisor may compulsorily pool properties when pooling cannot be agreed upon. Compulsory pooling is necessary to prevent waste and protect the correlative rights of the Pooled Owners in the proposed drilling unit. MCL 324.61513(4).
2. This Order is necessary to provide for conditions under which each mineral owner who has not voluntarily agreed to pool all of their interest in the pooled unit may share in the working interest share of production. 1996 MR 9, R 324.1206(4).
3. The Petitioner is an owner within the drilling unit and, therefore, is eligible to operate the Wiley 2-4 well. 1996 MR 9, R 324.1206(4).
4. The Petitioner is authorized to take from each nonparticipating interest's share of production the cost of drilling, completing, equipping, and operating the well. 1996 MR 9, R 324.1206(4).
5. Spacing for wells drilled in Manistee County to the Ruff Formation/Guelph Dolomite is 80 acres as set by Special Order No. 1-73.
6. The Supervisor has jurisdiction over the subject matter and the persons interested therein.
7. Due notice of the time, place, and purpose of the hearing was given as required by law and all interested persons were afforded an opportunity to be heard. 1996 MR 9, R 324.1204.

DETERMINATION AND ORDER

Based on the Findings of Fact and Conclusions of Law, the Supervisor determines that compulsory pooling to form an 80-acre Ruff Formation/Guelph Dolomite drilling unit is

necessary to protect correlative rights and prevent waste by the drilling of unnecessary wells.

NOW, THEREFORE, IT IS ORDERED:

1. A nominal 80-acre Ruff Formation/Guelph Dolomite drilling unit is established for the Wiley 2-4 well comprising the following area: NE 1/4 of NE 1/4 of Section 5 and NW 1/4 of NW 1/4 of Section 4, T22N, R16W, Manistee Township, Manistee County, Michigan. All properties, parts of properties, and interests in this area are pooled into the drilling unit. This pooling is for the purpose of forming a drilling unit only.
2. The Pooled Owner shall share in production and costs in the proportion that his net mineral acreage in the drilling unit bears to the total acreage in the drilling unit.
3. The Petitioner is named Operator of the Wiley 2-4 well. This Pooling Order applies to the drilling of the Wiley 2-4 well only.
4. The Pooled Owner shall be treated as a working interest owner to the extent of 100 percent of the interest owned in the drilling unit. The Pooled Owner is considered to hold a 1/8 royalty interest, which shall be free of any charge for costs of drilling, completing, or equipping the well, or for compensation for the risks of the well or operating the proposed well, including post-production costs.
5. The Pooled Owner shall have ten (10) days from the effective date of this Order to select one of the following alternatives and advise the Supervisor and the Petitioner, in writing, accordingly:
    a. To participate, then within ten (10) days of making the election (or within a later date as approved by the Supervisor), pay to the Operator the Pooled Owner's share of the costs for drilling, completing, and equipping the well, or give bond to the Operator for the payment of the Pooled Owner's share of such cost promptly after the effective date of this Order; and authorize the Operator to take from the Pooled Owner's remaining

7/8 share of production, the Pooled Owner's share of the actual costs of operating the well; or

b. To be carried, then authorize the Operator to take from the Pooled Owner's remaining 7/8 share of production:

(i) The Pooled Owner's share of the actual cost of drilling, completing, and equipping the well.

(ii) The Pooled Owner's share of the actual cost of operating the well.

6. In the event the Pooled Owner does not notify the Supervisor, in writing, of the decision within ten (10) days from the effective date of this Order, the Pooled Owner will be deemed to have elected the alternative described in Paragraph 5(b). If a Pooled Owner who elects the alternative in Paragraph 5(a) does not, within ten (10) days of making their election (or within any alternate date approved by the Supervisor), pay their proportionate share of costs or give bond for the payment of such share of such costs, the Pooled Owner shall be deemed to have elected the alternative described in Paragraph 5(b), and the Operator may proceed to withhold and allocate proceeds for costs from the Pooled Owner's 7/8 share of production as described in Paragraph 5(b)(i)&(ii).

7. For purposes of the Pooled Owners electing alternatives, the amounts of $585,967.42 for actual drilling costs (dry hole costs); $229,784.01 for actual completion costs; and $438,990.46 for estimated equipping costs are fixed as well costs. Only actual costs shall be used in determining the Pooled Owner's final share of well costs. If a Pooled Owner has elected the alternative in Paragraph 5(a) and the actual equipping cost exceeds the estimated cost, the Operator may recover the additional cost from the Pooled Owner's 7/8 share of production. Within sixty (60) days after the effective date of this Order, and every thirty (30) days thereafter until all costs of drilling, completing, and equipping the well are accounted for, the Operator shall provide to the Pooled Owner a detailed statement of actual costs incurred as of the date of the statement and all costs and production proceeds allocated to that Pooled Owner.

8. The Operator shall certify to the Supervisor that the following information was supplied to the Pooled Owner no later than the effective date of the Order:
   a. The Order
   b. The AFE
   c. The Pooled Owner's percent of charges from the AFE if the Pooled Owner were to choose option "a" in Paragraph 5, above.
9. The Pooled Owner shall remain a Pooled Owner only until such time as a lease or operating agreement is entered into with the Operator. At that time, terms of the lease or operating agreement shall prevail over terms of this Order.
10. The Supervisor retains jurisdiction in this matter.
11. The effective date of this Order is March 5, 2012.

DATED: Feb. 22, 2012

HAROLD R. FITCH
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