

STATE OF MICHIGAN
DEPARTMENT OF ENVIRONMENTAL QUALITY

ORDER OF THE SUPERVISOR OF WELLS

IN THE MATTER OF:

THE PETITION OF COBRA OIL & GAS CORPORATION,)
FOR AN ORDER FROM THE SUPERVISOR OF WELLS)
STATUTORY POOLING ALL INTERESTS INTO A) ORDER NO. 05-2018
DRILLING UNIT LOCATED IN SECTIONS 26 AND 27,)
BURLEIGH TOWNSHIP, IOSCO COUNTY, MICHIGAN.)

OPINION AND ORDER

This case involves the Petition of Cobra Oil & Gas Corporation (Petitioner) to statutorily pool all interests into an established Special Order No. 1-86 drilling unit before Petitioner places the State Burleigh 1-26 HD2 well on regular production following a rework and re-completion conducted prior to filing the Petition as to formations below the top of the Glenwood Member of the Black River Group. The established drilling unit consists of the W 1/2 of Section 26 and E 1/2 of Section 27, T21N, R5E, Burleigh Township, Iosco County, Michigan. Since not all of the mineral owners within the 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 616.90-acre drilling unit and requiring statutory pooling of all tracts and interests within that geographic area where 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, Michigan Compiled Laws 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 statutorily pool mineral interests within said units. MCL 324.61513(2) and (4). However, the formation of drilling units by statutory 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 May 21, 2018.

FINDINGS OF FACT

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

1. Requires statutory pooling of all tracts and mineral interests within the existing drilling unit as to all formations below the Glenwood Member of the Black River Group that have not agreed to voluntary pooling.
2. Names the Petitioner as Operator of the State Burleigh 1-26 HD2 well.
3. Authorizes the Petitioner to recover certain costs and other additional compensation from the parties subject to the statutory pooling order.

The Administrative Law Judge determined that the Notice of Hearing was properly served and published. No answers to the Petition were filed. Therefore, the Petitioner is the only party to this case. The Supervisor designated the hearing to be an uncontested evidentiary hearing pursuant to R 324.1205(1)(c) and directed evidence be presented in the form of verified statements. In support of its case, the Petitioner offered the verified statements of Mr. Jerry L. Ritter, Land Consultant for Petitioner and Mr. Charles Gibson, Reservoir Engineer for Petitioner.

I. Drilling Unit

The spacing of wells in Iosco County targeting the Formations below the top of the Glenwood Member of the Black River Group is governed by Special Order No. 1-86 as to gas and Order No. 6-7-90 as to oil. These Orders establish drilling units of 640 acres, more or less, consisting of four contiguous governmental-surveyed quarter sections of land in a square. Under Special Order No. 1-86, it is presumed that one well will efficiently and economically drain hydrocarbons beneath the entire drilling unit. The State Burleigh 1-26 well was drilled in 1993 by PetroStar Energy pursuant to Permit Number 47250. The State Burleigh 1-26 HD1 was drilled in 1995 and the State Burleigh HD2 was drilled and completed in 2002 as a kick from the HD1. The drilling unit remains as previously established and is described as the W 1/2 of Section 26 and E 1/2 of Section 27, T21N,

R5E, Burleigh Township, Iosco County, Michigan. Due to fractional sections, the drilling unit is 616.90 acres.

Mr. Gibson's verified statement indicates the State Burleigh 1-26 well was completed in 1993 in the Prairie du Chien (PdC) Formation and began producing from the Middle PdC "C" zone. The well has produced 2.742 BCF to date. Mr. Gibson reviewed production history, zones originally completed and produced, and the geology of the well to identify new producing zones. The Petitioner has reworked and re-completed the State Burleigh 1-26 HD2 well, which is currently shut-in pending this pooling hearing.

I find that the existing 616.90-acre drilling unit, as established under Special Order No. 1-86 and Order No. 6-7-90, will prevent waste and protect correlative rights and, as such, is approved for the State Burleigh 1-26 HD2 well.

II. Drilling Unit Operator

Mr. Ritter testified that the Petitioner owns the State Burleigh 1-26 HD2 well and owns or controls the majority of oil and gas leases in the drilling unit. Given this, the Petitioner seeks to be designated as the Operator of the State Burleigh 1-26 HD2 well. I find, as a Matter of Fact, the Petitioner is eligible to be the designated Operator of the State Burleigh 1-26 HD2 well.

III. Statutory 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 statutory 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 statutory pooling. 1996 MR 9, R 324.304. The statutory 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 statutory 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 statutory pooling through an Order of the Supervisor.

Mr. Ritter's verified statement indicates that PetroStar had 100 percent leasehold coverage of the State Burleigh 1-26 HD2 drilling unit when the well was originally drilled. The well was subsequently shut in, which caused the private leases to expire. Cobra purchased the well from Whiting Oil & Gas Corporation in 2015.

Mr. Ritter stated that as of May 24, 2018, 611.165 net mineral acres are currently under effective oil and gas leases held by the Petitioner, or the owners have elected to participate in the well. Included in the leased acreage are State of Michigan leases for 233.33 acres which have remained valid (Lease 23743, N-31989, and N-31990) and for which Petitioner will request ratification of the Pooling Declaration (Exhibit 5).

Exhibit 2 to Mr. Ritter's verified statement shows the following mineral owners remain unleased and/or have not elected to participate:

<u>Oil, Gas & Mineral Owner</u>	<u>Net Mineral Acres</u>
Nikolaus & Elsa Lambrecht	0.9050
Candy Tanabe	4.8300
Total:	5.735

Mr. Ritter stated all unleased owners were offered fair and reasonable lease terms. Based on the foregoing, I find, as a Matter of Fact:

1. The Petitioner was able to voluntarily pool all of the mineral interests in the proposed 616.90-acre drilling unit for all formations below the top of the Glenwood Member of the Black River Group, except for the interests described above.
2. Statutory pooling of all mineral interests is necessary to form a full drilling unit, to protect correlative rights of unpooled lease owners, and to prevent waste by preventing the drilling of unnecessary wells.
3. The rework of the State Burleigh 1-26 HD2 well was authorized by the Supervisor as reflected in the Application to Change Well Status approved on October 6, 2017 (Exhibit 7).

Now that it has been determined statutory pooling is necessary and proper in this case, the terms of such pooling must be addressed. When pooling is ordered, the owner

of the statutorily 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 costs involved in drilling, completing, and equipping the proposed well. The Petitioner's Authorization for Expenditure (AFE) form for the State Burleigh 1-26 HD2 well (Exhibit 8) itemizes the actual and estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. Petitioner paid \$125,000 for the well and requests recoupment of that as drilling costs. The estimated costs are \$296,300 for re-completion and \$93,500 for equipping. The total actual and estimated producing well cost for the rework of the State Burleigh 1-26 HD2 well is \$514,800. There is no evidence on this record refuting these costs.

I find, as a Matter of Fact, the actual and estimated costs in Exhibit 8 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 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). The Petitioner requests the actual well costs and production from the well be allocated based upon the ratio of the number of net mineral acres in the tracts of various owners to the total number of net mineral acres in the drilling

unit. Established practices and industry standards suggest this to be a fair and equitable method of allocation of production and costs. Therefore, I find, as a Matter of Fact, utilizing net 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. I find that an owner's share in production and costs should be in proportion to their net mineral acreage.

The final issue is the additional compensation for risk to be assessed against a Pooled Owner who elects to be carried. The Administrative Rules under Part 615 provide for the Supervisor to assess appropriate compensation for the risks associated with drilling a dry hole and the mechanical and engineering risks associated with the completion and equipping of wells. 1996 MR 9, R 324.1206(4)(b). As the well has already been drilled and the rework operation completed, the Petitioner requests no additional compensation for the costs of the reworked St. Burleigh 1-26HD2 well.

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 and working interests within the proposed drilling unit. The Supervisor may statutorily pool interests when pooling cannot be agreed upon. Statutory 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 State Burleigh 1-26 HD2 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 Iosco County from the top of the Glenwood Member of the Black River Group is 640 acres as set by Special Order No. 1-86 and Order No. 6-7-90. Exceptions to these Orders may be granted after notice and hearing.

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 statutory pooling to form a 616.90-acre drilling unit as established by Special Order No. 1-86 and Order No. 6-7-90, applicable to all formations below the top of the Glenwood Member of the Black River Group, is necessary to protect correlative rights and prevent waste by the drilling of unnecessary wells.

NOW, THEREFORE, IT IS ORDERED:

1. A 616.90-acre drilling unit applicable to all formations below the top of the Glenwood Member of the Black River Group Formation shall continue as established for the State Burleigh 1-26 HD2 well comprising the W 1/2 of Section 26 and E 1/2 of Section 27, T21N, R5E, Burleigh Township, Iosco 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. Each Pooled Owner shall share in production and costs in the proportion that their net mineral acreage in the drilling unit bears to the total acreage in the drilling unit.

3. The Petitioner is named Operator of the State Burleigh 1-26 HD2 well. This pooling Order applies to the State Burleigh 1-26 HD2 well only.

4. A 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. A Pooled Owner shall have 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 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 that have been incurred 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 upon completion; 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, and 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 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 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) and (ii).

7. For purposes of the Pooled Owners electing alternatives, the amounts of \$125,000.00 for actual drilling costs; \$296,300.00 for estimated re-completion costs; and \$93,500.00 for estimated equipping costs are fixed as well costs. 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 cost exceeds the estimated cost, the Operator may recover the additional cost from the Pooled Owner's 7/8 share of production. Within 60 days after commencing drilling of the well, and every 30 days thereafter until all costs of drilling, re-completing, and equipping 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 each Pooled Owner no later than the effective date of the Order:

- a. The Order.
- b. The AFE.
- c. Each Pooled Owner's percent of charges from the AFE if the Pooled Owner were to choose option "a" in Paragraph 5, above.

9. A 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. This Order shall terminate immediately after the State Burleigh 1-26 HD2 well has been plugged and abandoned.

11. The Supervisor retains jurisdiction in this matter.

12. The effective date of this Order is July 15, 2018.

DATED: July 5, 2018

Harold R. Fitch
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