

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	)
ESTABLISHING A 640-ACRE DRILLING UNIT	)
CONSISTENT WITH SPECIAL ORDER NO. 1-86 AND	) ORDER NO. 06-2018
STATUTORY POOLING ALL INTERESTS INTO THE	)
DRILLING UNIT LOCATED IN WEST BRANCH	)
TOWNSHIP, OGEMAW 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 of the Crawford 1-28 well for oil and gas within the formations below the top of the Glenwood Member of the Black River Group. The established drilling unit consists of all of Section 28, T22N, R2E, West Branch Township, Ogemaw 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 640-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 October 8, 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 top of the Glenwood Member of the Black River Group that have not agreed to voluntary pooling by ratifying the Pooling Declaration for the unit.
2. Names the Petitioner as Operator of the Crawford 1-28 well.
3. Authorizes the Petitioner to recover certain costs and other additional compensation from the working interest owner not owned or controlled by Petitioner.
4. Requests that this Order apply to the Crawford 1-28 well and any wells directionally redrilled therefrom.

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. Craig Reynolds, Exploration Manager for Petitioner.

#### **I. Drilling Unit**

The spacing of wells in Ogemaw County targeting the Formations below the top of the Glenwood Member of the Black River Group is governed by Special Order No. 1-86. This Order establishes 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.

I find the 640-acre drilling unit, as herein described is consistent with Special Order

No. 1-86, will prevent waste and protect correlative rights and, as such, is approved for the Crawford 1-28 well.

## II. Drilling Unit Operator

Mr. Ritter testified that the Petitioner owns the Crawford 1-28 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 Crawford 1-28 well. I find, as a Matter of Fact, the Petitioner is eligible to be the designated Operator of the Crawford 1-28 well.

## III. Statutory Pooling

### (A) Insufficient Pooling Clauses in Antiquated Leases

Mr. Ritter testified that all owners of oil, gas, and minerals in the proposed drilling unit are subject to effective oil and gas leases. Petitioner owns or controls 91.722% of the working interest in the proposed unit. Due to the ages of the effective oil and gas leases, the drilling unit of 640 acres is not expressly authorized by the pooling clauses of the leases. Petitioner has prepared a Pooling Declaration to pool the leases into the 640-acre unit. Many of the royalty owners have ratified the Pooling Declaration, but not all owners have. The Petitioner was unable to obtain the ratification of all royalty owners of the proposed 640-acre unit. The Petitioner may not produce a well on the drilling unit without first effectively subjecting the antiquated leases to the 640-acre drilling unit. 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. 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 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. As of the date of the hearing in this matter, the following royalty and overriding royalty owners have not voluntarily ratified the 640-acre unit:

Cynthia E. Abbs and Lenore Troia  
Roy E. Barber  
Darlene Boice  
Janice Boyd  
Geraldine Cherverny  
Rose Cope and Judith Danhavsén, JTWROS  
Mary Cramer  
Arthur E. Crawford  
Edward H. & Susan M. Crawford, Trustees under the Sue Crawford Living Trust dated  
12/12/06  
Edward H. & Susan M. Crawford  
Sara A. Crawford  
Tom L. Crawford  
Nancy & Edward Culbertson  
Jodi L. Drake  
Michael K. & Shelly L. Dugan  
Amanda J. Fahlstrom  
Carl K. Finton and Betty J. Finton , Co-Trustees of the Finton Family Trust as of  
1/18/1991  
Arthur C. Galea  
Lewis Gehman  
Norma Gruszczynski  
Patricia A. Hamilton  
Paul & Terilynn Hiben  
Charles Horsell  
Charles K. Horsell  
Charles R. Horsell  
Gerald Horsell  
Robert Horsell  
William D. & Ruth E. Horsell  
Linda L. Hunker  
Clayton Johnson c/o Melissa Larson  
Estate of Melinda M. Johnson  
Norman Edward Johnson  
Geraldine Lefaive  
Deborah S. French-Lovejoy  
Susan L. Martinez  
Mary Jeanne McCarthy  
Claudebelle McLeod  
Carl Mier  
Chester M. & Ethel M. Miller  
Mabel Moore  
Thomas J. Myler  
Charles E. Myler, Jr.  
Melissa M. O'Horo

Teresa Ann Panigay, Trustee of the Teresa Ann Panigay First Restated Revocable Trust Agreement dated February 14, 2017  
William & Lela Shirlin Pearlstein  
Margaret Pilgrim  
Daniel Reminder  
Mary Ellen Bridget Sappington Good, Trustee of the Mary Ellen Bridget Sappington Good Legacy Trust Agreement dated September 17, 2001  
Rose Marie Sappington, Trustee of the Rose M. Sappington Trust Agreement dated December 12, 2007, as amended  
Grant E. Smith  
Mary E. Smith  
Carrie A. Thorson  
Blynn A. & Nina Turner  
Raymond D. Walter  
Claude H. & Cheong Ae Welch  
Susan J. Wilcox  
Norma Wolf  
David R. & Luann Zettle  
Gregory & Judy N. Zettle  
Hazel Zettle  
Bay Trust Co.  
Consumers Power Company  
Co-Trustees of the Lila E. Mann Trust dated 5/17/1981  
Estate of Carol Jo Jensen  
Fairmont Resources Company  
First United Methodist Church  
Successor Trustees of the Gene and Barbara Zettle Revocable Living Trust dated 2/22/12  
The Salvation Army  
Tolfree Memorial Hospital  
Weber Oil

(B) Lessee Interest of BP America Production Company

Mr. Ritter's verified statement indicates that Petitioner is an owner of valid oil and gas leases covering all of the oil and gas interest in the formations beneath the Proposed Unit except as to the leasehold working interest of BP America Production Company ("BP America"). BP America owns an 8.278 percent working interest in the Unit and has not elected to participate in the well. The working interest of BP America is based on a 44.255 percent interest in four oil and gas leases as follows:

Ulysses and Ellen Wilcox, husband and wife, to The Pure Oil Company, dated March 21, 1929, and recorded April 11, 1929, at Liber 2, Page 92;

Albert L. Fisk and Leah B. Fisk, husband and wife; Ralph E. and Mary E. Fisk, husband and wife; Floyd B. Fisk, a single man; and Sadie Fisk, a widow, to Henry Sappington, dated May 29, 1965, and recorded June 1, 1965, at Liber 184, Page 279;

Fred Fisk to W.J. Bernier, dated June 22, 1936, and recorded October 30, 1936, at Liber 72, Page 640;

Ralph E. and Mary A. Fisk, husband and wife, to Harold P. Wade and David R. Stamy, dated June 3, 1937, and recorded June 3, 1937, at Liber 77, Page 10.

Exhibit 6 to Mr. Ritter's verified statement shows the following working interest owner remains uncontrolled and has not elected to participate as of the date of the hearing in this matter:

<u>Interest Owner</u>	<u>Interest</u>
BP America Production Company	8.278% Working Interest in the Proposed Unit

Mr. Ritter stated BP America was offered fair and reasonable sale, assignment, participation and farmout terms.

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

The Petitioner was able to voluntarily pool all of the royalty owner interests in the proposed 640-acre drilling unit for all formations below the top of the Glenwood Member of the Black River Group, except for the interests described in paragraph (A) above.

Statutory pooling of the royalty owners who are leased but the leases contain insufficient pooling clauses is necessary to form a full drilling unit, to protect correlative rights of all owners, and to prevent waste by preventing the drilling of unnecessary wells. The owners of the lessor's interest in such leases are hereby statutorily pooled into the drilling unit. Such lessors' interests shall share in production consistent with their leases.

Petitioner holds valid leases on all oil and gas leases within the drilling unit except for the partial interest of four leases held by BP America described in paragraph (B) above.

Statutory pooling is also necessary and proper in this case as to the lessee working interest of BP America. The terms of such pooling as it applies to BP America 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 Crawford 1-28 well (Exhibit 8) itemizes the estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. The estimated drilling costs are \$2,647,785, estimated completion costs are \$707,355 and \$259,000 for estimated equipping costs. The total estimated producing well costs for the Crawford 1-28 well is \$3,614,140. 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 Owner 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 mechanical and engineering risks associated with the completion and equipping of wells. 1996 MR 9, R 324.1206(4)(b). The Petitioner requests additional compensation (beyond actual costs) of 300 percent of drilling costs, 200 percent of completing costs, and 150 percent of equipping the Crawford 1-28 well.

Mr. Reynolds testified that the risk associated with drilling the proposed well is significant. He stated there are many mechanical and engineering risks associated with completing and equipping the well as well as the risk of the well not being economically successful.

I find the Petitioner did present substantial evidence to show that the risks associated with drilling the well justify a 300 percent penalty. Moreover, past experience shows that drilling results are not always a reliable indicator of whether completing and equipping costs can be fully recovered from eventual production revenues. I find, as a Matter of Fact, the risk of the Crawford 1-28 well being a dry hole supports additional compensation from the Pooled Owner of 300 percent of the actual drilling costs incurred. I find the mechanical and engineering risks associated with the well support additional compensation of 200 percent of the actual completing and 150 percent of the actual equipping costs incurred. Operating costs are not subject to additional compensation for risk.

### **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 royalty, overriding royalty, 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 drill and operate the Crawford 1-28 well. 1996 MR 9, R 324.1206(4).

4. The Petitioner is authorized to take from each nonparticipating working interest owner's share of production the cost of drilling, completing, equipping, and operating the well, plus an additional percentage of the costs as the Supervisor considers appropriate for the risks associated with drilling a dry hole, and the mechanical and engineering risks associated with the completion and equipping of the well. 1996 MR 9, R 324.1206(4).

5. Spacing for wells drilled in Ogemaw County from the top of the Glenwood Member of the Black River Group is 640 acres as set by Special Order No. 1-86. Exceptions to this Order 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 640-acre drilling unit as established by Special Order No. 1-86, 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 640-acre drilling unit applicable to all formations below the top of the Glenwood Member of the Black River Group Formation is established for the Crawford 1-28 well comprising all of Section 28, T22N, R2E, West Branch Township, Ogemaw 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 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 Crawford 1-28 well. The Operator shall commence drilling of the Crawford 1-28 well within 270 days of the effective date of this Order, or the statutory pooling authorized in this Order shall be null and void as to all parties and interests. This pooling Order applies to the Crawford 1-28 well and any directional redrills from that well.

4. The Pooled Owner (BP America) 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 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 re-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) An additional 300 percent of the actual drilling costs, 200 percent of the actual completion costs, and 150 percent of the actual equipping costs attributable to the Pooled Owner's share of production, as compensation to the Operator for the risk of a dry hole.

(iii) 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 Owner electing alternatives, the amounts of \$2,647,785.00 for actual drilling costs; \$707,355.00 for estimated completion costs; and \$259,000.00 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, 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 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 an assignment, farmout, or operating agreement is entered into with the Operator. At that time, terms of the assignment, farmout, or operating agreement shall prevail over terms of this Order.

10. This Order shall terminate immediately after the Crawford 1-28 well has been plugged and abandoned.

11. The Supervisor retains jurisdiction in this matter.

12. The effective date of this Order is Dec. 19, 2018.

DATED: Dec 5, 2018

  
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HAROLD R. FITCH  
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