

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 AN)
80-ACRE TRENTON-BLACK RIVER FORMATION DRILLING)
UNIT AND STATUTORILY POOLING ALL INTERESTS INTO) ORDER NO. 07-2017
THE DRILLING UNIT IN CHARLESTON TOWNSHIP,)
KALAMAZOO COUNTY, MICHIGAN.)

OPINION AND ORDER

This case involves the Petition of Savoy Energy, L.P. (Petitioner), to establish an 80-acre drilling unit for the Trenton-Black River Formations for the Vosburg 1-36 well as an exception to the 40-acre drilling unit size established by R 324.301. The proposed unit consists of the NE 1/4 of NW 1/4 and NW 1/4 of NE 1/4 of Section 36, T2S, R9W, Charleston Township, Kalamazoo 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 proposed 80-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 on December 8, 2017.

FINDINGS OF FACT

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

1. Grants an exception to the drilling unit size established by R 324.301 by establishing an 80-acre drilling unit for the Vosburg 1-36 well consisting of the NE 1/4 of NW 1/4 and NW 1/4 of NE 1/4 of Section 36, T2S, R9W, Charleston Township, Kalamazoo County, Michigan.
2. Requires statutory pooling of all tracts and mineral interests within the proposed Trenton-Black River Formations drilling unit that have not agreed to voluntary pooling.
3. Names the Petitioner as Operator of the Vosburg 1-36 well.
4. 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, 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. Thomas C. Pangborn, Chief Executive Officer, Savoy Energy, L.P. and Mr. William T. Sperry, President, Savoy Exploration, Inc. and General Patner, Savoy Energy, L.P.

I. Drilling Unit

The spacing of wells in Kalamazoo County targeting the Trenton-Black River Formations is governed by R 324.301. This rule establishes drilling units of 40 acres. Under R 324.301, it is presumed that one well will efficiently and economically drain the 40-acre drilling unit of hydrocarbons. The Petitioner's proposed 80-acre drilling unit is described as the NE 1/4 of NW 1/4 and NW 1/4 of NE 1/4 of Section 36, T2S, R9W,

Charleston Township, Kalamazoo County, Michigan. The Petitioner proposes to drill the Vosburg 1-36 well from a surface location in the NE 1/4 of NE 1/4 of NW 1/4 of Section 36, T2S, R9W, Charleston Township, Kalamazoo County, Michigan.

Mr. Pangborn's Verified Statement states that his review of geophysical and geological information indicates the possibility of the existence of productive Trenton-Black River formations beneath the proposed 80-acre drilling unit. It is Mr. Pangborn's opinion that a 80-acre drilling unit is the appropriate unit for the proposed well since the 80-acre unit is substantially underlain by the inferred Trenton-Black River reservoir. It is also Mr. Pangborn's opinion that the proposed 80-acre drilling unit eliminates the drilling of unnecessary wells and minimizes surface disturbance.

I find that formation of the proposed 80-acre drilling unit, as an exception to R 324.301, will prevent waste and protect correlative rights and, as such, is approved for the Vosburg 1-36 well.

II. Drilling Unit Operator

Mr. Sperry's verified statement indicates that the Petitioner owns oil and gas leases covering 76 acres in the proposed drilling unit. Given this, the Petitioner seeks to be designated as the Operator of the Vosburg 1-36 Well. I find, as a Matter of Fact, the Petitioner is eligible to be designated Operator of the Vosburg 1-36 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. Sperry indicates that the Petitioner controls 76.0 net acres of oil and gas interests within the proposed 80-acre drilling unit. Mr. Sperry's verified statement states that Petitioner has made numerous attempts, via telephone and letter, to obtain an oil and gas lease from the unleased owner. The owner of oil and gas interests that are not leased is:

<u>Name</u>	<u>Net Mineral Acres</u>
Canadian National Railroad Company	4.0 +/- (without survey)

Mr. Sperry states that, despite the best efforts of Affiant and others made on behalf of Savoy, Petitioner has not been able to secure an oil and gas lease or other voluntary pooling agreement.

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 80-acre drilling unit except for the acreage described above.
2. Statutory pooling 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.

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. Petitioner’s Authorization for Expenditure (AFE) form for the Vosburg 1-36 Well (Exhibit B to Mr. Pangborn's verified statement) itemizes the estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. The estimated costs are \$524,000 for drilling, \$293,500 for completion, and \$1,695,700 for equipping. The total estimated producing well cost for the Vosburg 1-36 Well is \$2,513,400. *Id.* There is no evidence on this record refuting these actual or estimated costs.

I find, as a Matter of Fact, the estimated costs in Exhibit B 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). It is Mr. Pangborn’s opinion the inferred reservoir substantially underlies the drilling unit. The Petitioner requests the actual well costs and production from the well be allocated based upon the ratio of the number of surface acres in the tracts of various owners to the total number of surface 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 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. However, 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). The Petitioner requests additional compensation of 300 percent for the costs of drilling, 200 percent of completing, and 150 percent of equipping the Vosburg 1-36 well.

Mr. Pangborn's verified statement states there is a risk associated with drilling the proposed well inasmuch as this is an exploratory well more than five miles from any successful well. Mr. Pangborn also states that, as with any Trenton-Black River Formation well, there are certain unavoidable levels of geologic and economic risks; and that there is a component of seismic risk and the component of reservoir quality. In addition, Mr. Pangborn notes that there is a risk that the Trenton-Black River Formation may not be sufficiently dolomitized leading to limited porosity and poor reservoir rock.

Mr. Pangborn states that the risks associated with completion costs are the well may appear to be productive on initial test indicating the completion is warranted, but on production the well produces overtime without returning the costs involved. Mr. Pangborn indicated significant costs are associated with equipping a well with the necessary surface facilities that are required to bring oil and gas production to market. A large portion of these costs are unrecoverable.

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 proposed Vosburg 1-36 well being a dry hole supports additional compensation from the Pooled Owners 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 mineral interests within the proposed drilling unit. The Supervisor may statutorily pool properties 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 Vosburg 1-36 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, 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 Kalamazoo County to the Trenton-Black River Formation is 40 acres as set by R 324.301. Exceptions to R 324.301 may be granted by the Supervisor after a 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 an 80-acre Trenton-Black River Formation drilling unit is necessary to protect correlative rights and prevent waste by the drilling of unnecessary wells.

NOW, THEREFORE, IT IS ORDERED:

1. An 80-acre Trenton-Black River Formation drilling unit is established, as an exception to R 324.301, for the Vosburg 1-36 well comprising the NE 1/4 of NW 1/4 and NW 1/4 of NE 1/4 of Section 36, T2S, R9W, Charleston Township, Kalamazoo 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 Vosburg 1-36 well. The Operator shall commence the drilling of the Vosburg 1-36 well within 90 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 drilling of the Vosburg 1-36 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 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 estimated 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 upon completion. The Pooled Owner shall also 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 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) and (ii).

7. For purposes of the Pooled Owners electing alternatives, the amounts of \$524,200.00 for estimated drilling costs; \$293,500.00 for estimated completion costs; and \$1,695,700.00 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 sixty (60) days after commencing recompletion of the well, and every thirty (30) days thereafter until all recompletion costs 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. If the Operator proposes to drill the Vosburg 1-36 well to a different bottom hole location or as a horizontal drainhole, the Operator shall first notify all statutorily pooled parties. The notification shall be provided by a letter approved by the Supervisor and shall provide the statutorily pooled parties an opportunity to respond within 21 days. If no

statutorily pooled party objects within 21 days of the date of mailing of the notification, the Supervisor may approve a request for an alternate bottom hole location or horizontal drainhole without a hearing.

9. 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.

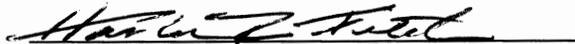
10. A Pooled Owner shall remain a Pooled Owner only until such time as a lease or operating agreement is entered into with the Operator. At that time, terms of the lease or operating agreement shall prevail over terms of this Order.

11. This Order shall terminate immediately after the Vosburg 1-36 well and all subsequent redrills have been plugged and abandoned.

12. The Supervisor retains jurisdiction in this matter.

13. The effective date of this Order is January 22, 2018.

DATED: Jan. 12, 2018


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