

**STATE OF MICHIGAN
DEPARTMENT OF ENVIRONMENT, GREAT LAKES, AND ENERGY
ORDER OF THE SUPERVISOR OF WELLS**

IN THE MATTER OF

THE PETITION OF WOLVERINE GAS AND OIL)
COMPANY OF MICHIGAN, LLC, FOR AN ORDER)
FROM THE SUPERVISOR OF WELLS FORMING A)
160-ACRE TRENTON-BLACK RIVER FORMATION) CAUSE NO. 01-2020
DRILLING UNIT AND STATUTORILY POOLING ALL)
INTERESTS INTO THE DRILLING UNIT IN CLIMAX)
TOWNSHIP, KALAMAZOO COUNTY, MICHIGAN.)

OPINION AND ORDER

This case involves the Petition of Wolverine Gas and Oil Company of Michigan, LLC (Petitioner), to drill and complete the proposed Orosz 17-1 well within the stratigraphic interval known as the Trenton-Black River Formation. The Petitioner is requesting a 160-acre drilling unit for the Orosz 17-1 well as an exception to the 40-acre drilling unit size established by Order No. 18-2007, as amended. The proposed unit consists of the NW ¼ of Section 17, T3S, R9W, Climax 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 160-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. 2015 AACS, 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 AACS, R 324.1203. The evidentiary hearing in this matter was set for March 26, 2020.

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 Order No. 18-2007, as amended, by establishing a 160-acre drilling unit for the proposed Orosz 17-1 well consisting of the NW $\frac{1}{4}$ of Section 17, T3S, R9W, Climax Township, Kalamazoo County, Michigan.
2. Requires statutory pooling of all tracts and mineral interests within the proposed Trenton-Black River Formation drilling unit that have not agreed to voluntary pooling.
3. Names the Petitioner as Operator of the Orosz 17-1 well.
4. Authorizes the Petitioner to recover certain costs and other additional compensation from the party subject to the statutory pooling order.
5. Requests that this Order apply to the Orosz 17-1 well and if deemed necessary, to any wells directionally redrilled therefrom and to any later infill wells drilled within the same drilling unit.

The Administrative Law Judge determined that the Notice of Hearing was properly served and published. No answers to the Petition were filed. 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 Verified Statements. In support of its case, the Petitioner offered the Verified Statements of Richard Moritz, Vice President of Land for Petitioner, and Justin Reuter, Senior Geophysicist for Petitioner.

I. Drilling Unit

The spacing of wells in Kalamazoo County targeting the Trenton-Black River Formation is governed by Order No. 18-2007, as amended. This Order establishes

drilling units of 40 acres. Under Order No. 18-2007, as amended, it is presumed that one well will efficiently and economically drain the 40-acre drilling unit of hydrocarbons. The Petitioner's proposed 160-acre drilling unit is described as the NW ¼, Section 17, T3S, R9W, Climax Township, Kalamazoo County, Michigan. The Petitioner proposes to drill and complete the Orosz 17-1 well in the Trenton-Black River Formation.

Mr. Reuter testified that his analysis of available well control in the area, review of Trenton-Black River production and development in the vicinity, and all available seismic data, supports the proposed well location as the optimal location to maximize the likelihood for a successful well within the proposed 160-acre drilling unit. Mr. Reuter testified that the proposed well is targeting an anomalous structure in the reservoir and should adequately and efficiently drain the proposed 160-acre drilling unit. Further he testified he believes the well will recover hydrocarbons of a sufficient volume to economically justify the cost of the well. In Mr. Reuter's view, the proposed well will prevent waste by the drilling of one well on a 160-acre drilling unit, rather than a well on each 40-acre quarter quarter section.

I find that formation of the proposed 160-acre drilling unit, as an exception to Order No. 18-2007, will prevent waste and protect correlative rights, and as such, is approved for the proposed Orosz 17-1 well, and if deemed necessary, any directional redrill(s) therefrom or later drilled infill wells.

II. Drilling Unit Operator

Mr. Moritz's testimony states that the Petitioner holds or controls oil and gas leases covering approximately 154.0 net mineral acres in the proposed 160-acre drilling unit. Given this, the Petitioner seeks to be designated as the Operator of the Orosz 17-1 well. I find, as a Matter of Fact, the Petitioner is eligible to be designated Operator of the Orosz 17-1 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. 2015 AACRS, 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. Moritz’s Verified Statement states that the Petitioner controls or holds oil and gas leases covering approximately 154.0 net mineral acres of oil and gas interest within the proposed 160-acre drilling unit. In addition, he testified that the Petitioner has made several attempts to obtain an oil and gas lease from the only unleased owner, Canadian National Railroad (previously Grand Trunk Western Railroad), who owns approximately 6.0 net mineral acres. Mr. Moritz stated that Wolverine remains willing to negotiate a lease with the railroad. His testimony indicates the railroad was offered fair, reasonable, and appropriate lease terms. The unleased owner, Canadian National Railroad, did not file an answer in this cause.

Mr. Reuter’s Verified Statement establishes that the Petitioner has studied the proposed drilling unit and has determined the optimal bottom hole location for the proposed well based on geological and seismic studies. This bottom hole location is shown on Petitioner’s Exhibit 4. The Petitioner has proposed a directionally drilled well and has obtained the necessary rights to drill at the surface hole location shown on Exhibit 4. The wellbore will not traverse beneath the land owned by the unleased owner.

I find that the Orosz 17-1 well is reasonable and will avoid waste or the potential for waste to occur, and therefore, should be approved.

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 160-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 mineral 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 it wishes to share in the costs of the project. 2015 AACCS, 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, it assumes the economic risks of the project, specifically, by paying its 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 it did not assume any risk. If the well is a producer, the Supervisor considers the risks associated with the proposal and designates the Operator additional compensation, out of production, for assuming all of the economic risks.

In order for a Pooled Owner to decide whether it 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. Mr. Moritz sponsored Exhibit 3, Petitioner’s Authorization For Expenditure (AFE) for the Orosz 17-1 well, which itemizes the estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. The estimated costs to be incurred in drilling, completing, and equipping the well to the Trenton-Black River Formation are \$635,650 for drilling; \$245,600 for completion; and \$379,600 for equipping. The total estimated producing well cost for the Orosz 17-1 is \$1,260,850. There is no evidence on this record refuting these estimated costs.

I find, as a Matter of Fact, the estimated costs in Exhibit 3 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). It is Mr. Reuter's opinion that a 160-acre drilling unit is necessary to provide equitable treatment to all mineral owners within the unit. The Petitioner requests the actual well costs and production from the well be allocated based upon the ratio of the number of mineral acres in the tracts of the various owners to the total number of 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. 2015 AACRS, R 324.1206(4)(b). The Petitioner requests additional compensation of 300 percent for the costs of drilling, 200 percent of completing, and 100 percent of equipping the Orosz 17-1 well.

Mr. Reuter testified the risk associated with drilling the proposed well is significant as this is essentially an exploratory well due to the nature of the reservoir and the distance to the nearest producing well. 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 proposed Orosz 17-1 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 100 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 Owner 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. 2015 AACCS, R 324.1206(4).

3. The Petitioner is an owner within the drilling unit, and therefore, is eligible to drill and operate the Orosz 17-1 well. 2015 AACCS, 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 dry hole, and the mechanical and engineering risks associated with the completion and equipping of the well. 2015 AACCS, R 324.1206(4).

5. Spacing for wells drilled in Kalamazoo County to the Trenton-Black River Formation is 40 acres as set by Order No. 18-2007, as amended. Exceptions to Order No. 18-2007 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. 2015 AACCS, R 324.1204.

DETERMINATION AND ORDER

Based on the Findings of Fact and the Conclusions of Law, the Supervisor determines that statutory pooling to form a 160-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. A 160-acre Trenton-Black River Formation drilling unit is established, as an exception to Order No. 18-2007, for the Orosz 17-1 well comprising the NW $\frac{1}{4}$ of Section 17, T3S, R9W, Climax 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 Orosz 17-1 well. The Operator shall commence the drilling of the Orosz 17-1 well within 180 days from 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 Orosz 17-1 well, and if deemed necessary, any directional redrills from that well and/or any infill wells drilled.

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 $\frac{1}{8}$ royalty interest, which shall be free of any charge for costs of drilling, competing, 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 alternative 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; 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 if the well is put on production, 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 100 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)(1), (ii) and (iii).

7. For purposes of the Pooled Owner electing an alternative, the amounts of \$635,650 for estimated drilling costs; \$245,600 for estimated completion costs; and \$379,600 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 drilling of the well, 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 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. Failure to provide the information above, by the effective date of the Order will result in the nullification of this Order, thereby rendering the statutory pooling null and void as to all parties and interests.

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 Orosz 17-1 well, and all subsequent directional redrills therefrom and infill wells on the drilling unit, have been plugged and abandoned.

11. The Supervisor retains jurisdiction in this matter.

12. The effective date of this Order is April 20, 2020.

Dated: April 10, 2020



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