

**STATE OF MICHIGAN
DEPARTMENT OF ENVIRONMENT, GREAT LAKES, AND ENERGY
OIL, GAS, AND MINERALS DIVISION**

IN THE MATTER OF:

THE PETITION OF NUENERGY OPERATING, INC,)
FOR AN ORDER FROM THE SUPERVISOR OF)
WELLS FORMING A 200-ACRE DUNDEE)
FORMATION DRILLING UNIT AS AN EXCEPTION) CAUSE NO. 01-2023
TO RULE 324.301, AND STATUTORILY POOLING)
ALL INTERESTS INTO THE DRILLING UNIT IN HAY)
TOWNSHIP, GLADWIN COUNTY,)
MICHIGAN.)

OPINION AND ORDER

This case involves the Petition of NuEnergy Operating, Inc. (Petitioner), to drill and complete the proposed VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells within the stratigraphic interval known as the Dundee Formation. At the time of petition, these wells were initially named the Cramer Riddle A2-35 and the Cramer Riddle A3-35 and were renamed subsequent to surface hole location changes made since the petition was filed. The Petitioner is requesting a 200-acre drilling unit for the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells as an exception to Rule 324.301. The proposed unit consists of the SW ¼ of the SE ¼ of Section 26, and the E ½ of the NW ¼ and the W ½ of the NE ¼ of Section 35, Town 18 North, Range 1 East, Hay Township, Gladwin County, Michigan. Since not all of the mineral owners within the proposed unit have agreed to voluntarily pool their interests, the Petitioner seeks an Order of the Supervisor of Wells (Supervisor) designating the Petitioner as Operator of the proposed 200-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, 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 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 May 2, 2023, and adjourned to May 15, 2023.

FINDING OF FACTS

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

1. Grants an exception to the drilling unit size established by Rule 324.301, by establishing a 200-acre drilling unit for the proposed VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells consisting of the SW $\frac{1}{4}$ of the SE $\frac{1}{4}$ of Section 26, and the E $\frac{1}{2}$ of the NW $\frac{1}{4}$ and the W $\frac{1}{2}$ of the NE $\frac{1}{4}$ of Section 35, Town 18 North, Range 1 East, Hay Township, Gladwin County, Michigan.
2. Requires statutory pooling of all tracts and mineral interests within the proposed Dundee Formation drilling unit that have not agreed to voluntary pooling.
3. Names the Petitioner as Operator of the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells.
4. Authorizes the Petitioner to recover certain costs and other additional compensation from the parties subject to the statutory pooling order.
5. Requests that this Order apply to the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells and to any wells directionally redrilled therefrom, and to any later infill wells drilled within the same drilling unit.
6. Authorizes the Petitioner to drill the VanLuven Riddle A2-35 within 180 days of the effective date of the Order in this matter, test the same, and then drill the VanLuven Maxwell A3-35 within the following twelve (12) months thereafter.

The Supervisor determined that the Notice of Hearing was properly served and published. One Answer to the Petition was filed by Alexander Reuter of Myers & Myers, PLLC, on behalf of Larry and Christie VanValkenburg, husband and wife, surface, and mineral owners within the proposed drilling unit. Said Answer was withdrawn on

May 12, 2023. The Supervisor directed the Petitioner to submit testimony in the form of verified statements. In support of its case, the Petitioner offered the testimony of Jeffrey A. Smetzer, President of NuEnergy Operating, Inc. and R. Bradley Carlton, Petroleum Geologist, and consultant for Petitioner.

I. Drilling Unit

The spacing of wells in Gladwin County targeting the Dundee Formation 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 200-acre drilling unit is described as the SW $\frac{1}{4}$ of the SE $\frac{1}{4}$ of Section 26, and the E $\frac{1}{2}$ of the NW $\frac{1}{4}$ and the W $\frac{1}{2}$ of the NE $\frac{1}{4}$ of Section 35, Town 18 North, Range 1 East, Hay Township, Gladwin County, Michigan. The Petitioner proposes to drill and complete the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells in the Dundee Formation.

Mr. Smetzer sponsored Exhibit 1 showing the proposed unit, and approximate course and distance of the proposed VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells as currently designed. Mr. Carlton testified that his analyses of available well control in the area, review of the Dundee 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 200-acre drilling unit. Mr. Carlton further testified he believes the wells will likely recover hydrocarbons of sufficient volume to economically justify the cost of the wells and will likely recover hydrocarbons not currently under development. In Mr. Carlton's view, the proposed wells will prevent waste.

I find that formation of the proposed 200-acre drilling unit, as an exception to R 324.301, will prevent waste and protect correlative rights, and as such, is approved from the proposed VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells, and if deemed necessary, any directional redrill(s) thereof or later drilled infill wells.

II. Drilling Unit Operator

Mr. Smetzer testified that the Petitioner owns or controls oil and gas leases covering approximately 174 net mineral acres in the proposed 200-acre drilling unit. Given this, the Petitioner seeks to be designated as the Operator of the VanLuven

Riddle A2-35 and VanLuven Maxwell A3-35 wells. I find, as a Matter of Fact, the Petitioner is eligible to be designated Operator of the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells.

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. Smetzer testified that the Petitioner controls or holds oil and gas leases covering 174 net mineral acres of oil and gas interests within the proposed 200-acre drilling unit. In addition, he testified that the Petitioner has made numerous attempts to obtain an oil and gas lease from the unleased owners. The owners of oil and gas interests that are not currently leased are:

<u>Tract</u>	<u>Landowner</u>	<u>Net Mineral Acreage</u>
9	James & Karla Hart	16.00
15	Terry & Lucy Erickson	10.00
	TOTAL ACREAGE	26.00

Mr. Smetzer testified that, despite the best efforts of the Petitioner, the Petitioner has not been able to secure an oil and gas lease or other voluntary pooling agreement from the unleased owners. Larry and Christine VanValkenburg, through their attorney, filed an Answer to the Petition in this matter and were indicated as unleased interest in the

initial submitted petition. This Answer was withdrawn on May 12, 2023, and these owners have since executed an oil and gas lease.

Mr. Carlton testified that the Petitioner has studied the proposed drilling unit and has determined the optimal bottom hole locations for the proposed wells based on geological and seismic studies. The bottom hole locations are shown on Exhibit 1. The Petitioner has proposed two directionally drilled wells and has obtained the necessary rights to drill at the surface hole locations shown on Exhibit 1. Both Mr. Smetzer and Mr. Carlton testified that the projected paths of the wellbores will not end or transect under any unleased tract.

I find the proposed unit will help assure that all owners in the unit receive their just and equitable share of any oil and gas and that a fair and reasonable order should not unduly or unnecessarily hamper the opportunity of those owners who have leased to have their natural resources developed. I find that the proposed bottom hole locations for the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells will not harm pooled interests since no portion of the wellbores will transect unleased acreage, are reasonable to prevent 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 200-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 that 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 he or she wishes to share in the costs of the project. 2015 AACRS, 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 designates the Operator additional 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 wells 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 wells. Mr. Smetzer presented Petitioner’s Authorizations for Expenditures (“AFE’s”) as Exhibit 4 for the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells, which itemize the estimated costs to be incurred in the drilling, completing, equipping, and plugging of the wells. The estimated costs are \$933,803 for drilling, \$566,641 for completion, and \$418,553 for equipping for the VanLuven Riddle A2-35 well. The total estimated producing well cost for the VanLuven Riddle A2-35 well is \$1,918,997. The estimated costs for the VanLuven Maxwell A3-35 well are \$697,640 for drilling, \$551,641 for completion, and \$418,553 for equipping. The total estimated producing well cost for the VanLuven Maxwell A3-35 well is \$1,667,834. *Id.* There is no evidence on this record refuting these estimated costs.

I find, as a Matter of Fact, the estimated costs in Exhibit 4 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. Smetzer’s opinion that a 200-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 VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells.

Mr. Carlton testified that the risk associated with drilling the proposed wells is significant due to the nature of the reservoir and distance to the nearest producing well. The proposed wells are considered exploratory, and he testified that there are many mechanical and engineering risks associated with completing and equipping the wells, in addition to the risk of the wells not being economically successful.

I find the Petitioner did present substantial evidence to show that the risks associated with drilling the wells justify a 300 percent additional compensation for risk. 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 VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells being dry holes does support additional compensation from the Pooled Owners of 300 percent of the actual drilling costs incurred, 200 percent of the actual completing costs, and 100 percent of the actual equipping costs. 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 VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells. 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 wells, 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 Gladwin County to the Dundee 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 afford 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 200-acre Dundee 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 200-acre Dundee Formation drilling unit is established, as an exception to R 324.301, for the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells comprising the SW $\frac{1}{4}$ of the SE $\frac{1}{4}$ of Section 26, and the E $\frac{1}{2}$ of the NW $\frac{1}{4}$ and the W $\frac{1}{2}$ of the NE $\frac{1}{4}$ of Section 35, Township 18 North, Range 1 East, Hay Township, Gladwin 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 VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells. The Operator shall commence the drilling of the VanLuven Riddle A2-35 well on or before 180 days after the effective date of this Order, test the same, and then drill the VanLuven Maxwell A3-35 within the 12 months following, or the statutory pooling authorized by this Order shall be null and void as to all parties and interests. This pooling Order applies to the drilling of the VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells and 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 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(s), 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(s); or
- b. To be carried, then if the well(s) is/are 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(s).
 - (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(s).

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 \$933,803 for estimated drilling costs; \$566,641 for estimated completion costs; and \$418,553 for estimated equipping costs are fixed as well as costs for the VanLuven Riddle A2-35, and the amounts of \$697,640 for estimated drilling costs; \$551,641 for estimated completion costs; and \$418,553 for estimated equipping costs are fixed as well as costs for the VanLuven Maxwell A3-35. 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's 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 VanLuven Riddle A2-35 and VanLuven Maxwell A3-35 wells, and all 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 July 10, 2023.



Dated: June 26, 2023

Adam W. Wygant
ASSISTANT SUPERVISOR OF WELLS
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