RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL & GAS DOCKET NO. 09-0273416

APPLICATION OF XTO ENERGY, INC., PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE PROPOSED WESCO A1 POOLED UNIT, WELL NO. 10H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT:	**APPLICANT:**
David Gross Rick Johnston Rick Hayes Richard Simpson Weston Turner Blake Hueske	XTO Energy, Inc.
PROTESTANTS:	**REPRESENTING:**
Mary Buttram	Self

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE APPLICATION FILED:	November 16, 2011
DATE OF NOTICE OF HEARING:	January 13, 2012
DATE OF HEARING:	April 25, 2012
HEARD BY:	Michael Crnich, Hearings Examiner Richard Atkins, Technical Examiner
DATE TRANSCRIPT RECEIVED:	May 3, 2012
DATE PFD CIRCULATED:	October 25, 2012

STATEMENT OF THE CASE

This is an application by XTO Energy, Inc. ("XTO") pursuant to the Mineral Interest Pooling Act ("MIPA") requesting the Commission to enter an order force-pooling all mineral interests in 591 tracts of land into a proration unit for the Wesco A1 Unit, Well No. 10H, Newark, East (Barnett Shale) Field, Tarrant County, Texas.

The application was heard on April 25, 2012. Marty Buttram appeared at the hearing in protest to the application.

APPLICABLE LAW

The MIPA is a unique act forged by the legislature largely to protect small tract owners and operators in the wake of the *Normanna*[1] decision, which invalidated prorationing formulas with large per well allowable factors allowing substantial uncompensated drainage by wells on small tracts. Traditionally, the MIPA has been construed as limited in function to protect small tract lessees or owners rather than as a broad act designed to protect correlative rights generally, or as an act allowing large tract lessees or owners more flexibility in development.[2]

Subject to limitations found elsewhere in the act, §102.011 of the MIPA provides that when two or more separately owned tracts of land are embraced in a common reservoir of oil or gas for which the Commission has established the size and shape of proration units, whether by temporary or permanent field rules, and where there are separately owned interests in oil and gas within an existing or proposed proration unit in the common reservoir and the owners have not agreed to pool their interests, and where at least one of the owners of the right to drill has drilled or has proposed to drill a well on the existing or proposed proration unit to the common reservoir, the Commission, on the application of an owner specified in Section 102.012 of the act and for the purpose of avoiding the drilling of unnecessary wells, protecting correlative rights, or preventing waste, shall establish a unit and pool all of the interests in the unit within an area containing the approximate acreage of the proration unit, which unit shall in no event exceed 160 acres for an oil well or 640 acres for a gas well plus 10 percent tolerance.

The Commission is a creature of the Legislature and has no inherent authority.[3] Like other state administrative agencies, the Commission has only those powers that the Legislature expressly confers upon it and any implied powers that are necessary to carry out the express responsibilities given to it by the Legislature.[4] It is not enough that the power claimed by the Commission be reasonably useful to the Commission in discharging its duties; the power must be either expressly conferred or necessarily implied by statute. The agency may not exercise what is effectively a new power, or a power contradictory to the statute, on the theory that such a power is expedient for

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[1] *Atlantic Ref. Co. v. R.R. Commn.*, 346 S.W.2d 801 (Tex. 1961).

[2] Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, § 12.1(B) at page 12-5 (LexisNexis Matthew Bender 2011).

[3] *Pub. Util. Commn.. v. GTE-SW Corp.*, 901 S.W.2d 401, 407 (Tex. 1995).

[4] *Pub. Util. Commn.. v. City Pub. Serv. Bd.*, 53 S.W.3d 310, 316 (Tex. 2001).

administrative purposes.[5]

The Commission, therefore, does not have unlimited authority to compel the pooling of mineral interests whenever it is presented with a compulsory pooling application that in some sense may be deemed conceptually sound. Compulsory pooling may be ordered only as expressly authorized by the MIPA, which is a limited compulsory pooling statute unique to Texas.[6] It is immaterial that some may think that the targets of an application under the MIPA have not acted wisely in declining to lease or pool their mineral interests. Unless the application conforms strictly to the requirements of the MIPA, the government has no authority to make this decision for them.

DISCUSSION OF THE EVIDENCE

XTO's Evidence

The proposed force-pooled unit is located approximately one-quarter of a mile south of downtown Fort Worth. The proposed unit is a subsection of XTO's larger Wesco A Unit, the parent unit. XTO has filed a Designation of Unit for the parent unit, which contains 540.016 acres. The drilling pad (surface location) for the MIPA well is off the northeast corner of the parent unit and also serves as the drilling pad for wells on the adjacent XTO Page Street D Unit. The surface area of the proposed unit is developed primarily with residential structures and includes some scattered business properties.

The proposed unit contains 229.597 acres. At the time of hearing, the total number of acres under lease within the unit was 214.9277. XTO had 175.5046 acres under lease; Chesapeake Exploration LLC had 39.4231 acres under lease.[7] Chesapeake and Total have agreed to pool their interests with those of XTO into the proposed unit.

There are 591 separate tracts of land within the proposed force-pooled unit. At the time of hearing, a total of 542 tracts were under lease to XTO, Chesapeake, and Total. There are 44 unleased tracts, one of which is a tax-foreclosed property owned by the City of Fort Worth.[8] Four

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[5] *Id.*

[6] Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.1(B) at page 12-5 (LexisNexis Matthew Bender 2011).

[7] Chesapeake had sold a 25% leasehold interest to Total E&P USA, Inc.

[8] The City of Fort Worth and XTO have agreed that these tax foreclosed tracts may be pooled without execution of a lease agreement. XTO will hold in escrow a 25% royalty attributable to the tracts subject to disposition in the manner provided by law and without risk or obligation to the City. XTO will assure no surface use without the City's consent. XTO will provide the City with an initial and annual report of tax foreclosed acreage included in the unit and revenues attributed to each tax foreclosed property in the unit. XTO will assure compliance with all rules and requirements of the Railroad Commission and with the City's gas drilling and other ordinances. While the City of Fort Worth has agreed to

tracts are partially leased. The total unleased acreage within the proposed unit amounts to 14.1763 acres. One tract owner has agreed to participate in the proposed well and unit as a working interest owner. Appendix 1 to this proposal for decision is a plat showing the proposed force pooled unit, the location of the proposed MIPA well, tracts that were leased at the time of the hearing, and tracts that were unleased at the time of the hearing.

According to XTO, it conducted an extensive and exhaustive search to identify the owners of each of tract for purposes of sending its voluntary pooling offer. If XTO could not find an owner's current address after searching Tarrant County public records, probate records, or district court records, it used various internet resources.

On October 7, 2011, XTO sent a voluntary pooling offer to all owners of tracts within the boundaries of the proposed unit that remained unleased as of that date. The unleased owners were offered three options for inclusion of their interests in the proposed Wesco A1 Unit: (1) a lease option; (2) a participation option; or (3) a farm-out option.

The lease option included a bonus offer of $4,000 per net mineral acre and an offer of a 25% royalty. The lease form the unleased owners were asked to sign had a primary term of four years. The lease provided that no "drilling activity" could be conducted on the surface of the leased premises without the prior written permission of the lessor. The lease provided also that XTO had the right to pool the leased premises with any other lands or leases.

The participation option provided the unleased owners with an opportunity to purchase a working interest in the proposed Wesco A1 Unit, Well No. 10H, by paying to XTO, 15 days prior to commencement of actual drilling operations, the owner's pro rata share of drilling and completion costs. An AFE (Authority for Expenditure) attached to the offer indicated that the estimated cost of drilling and completing the well was $3,828,000.

The farm-out option proposed to the unleased owners that they convey to XTO an 80% net revenue interest attributable to their mineral interests and retain an overriding royalty interest equal to 20% of 8/8ths, proportionately reduced to the extent that each owner's interest bore to all of the mineral interests in the unit, until payout of all well costs to drill, test, fracture stimulate, complete, equip, and connect the well for production. At payout, the unleased owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

In response to XTO's voluntary pooling offer, 27 owners of unleased tracts accepted the lease option, and one owner of an unleased tract accepted the participation option. The owner of one tract affirmatively refused the voluntary pooling offer because she was not willing to lease at the current

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pool its partial interest, the Fort Worth ISD has not agreed to pool its partial interest.

bonus offer.[9] The owners of mineral interests in 43 tracts, constituting 13.0518 acres, received XTO's voluntary pooling offer but did not respond in any way to the offer. XTO was able to verify that these mineral owners received the offer because XTO received signed certified-mail receipts from them. Despite its diligent effort to obtain current addresses, XTO could not locate the owners of two tracts (0.4950 acres). XTO sent the voluntary pooling offer to the last known address, if available, for these mineral owners, but the offer packages were returned marked "unclaimed." The owners of interests in three tracts (0.3275 acres) refused to take delivery of the offer package, which was then returned to XTO. The City of Fort Worth, owner of one tax-foreclosed tract (0.151 acres), did not accept any of the three options, but it agreed to pooling without the execution of an oil and gas lease and subject to certain conditions.

XTO presented a map showing the wells operated by XTO and other operators within a five-mile radius of the surface operations site for the proposed well. Considering that the Wesco A1 Unit is surrounded by Barnett Shale development and production, XTO's petroleum engineer concluded that the Barnett Shale is present and can be reasonably expected to be productive in the area of the proposed unit. Using three wells within the five-mile radius, XTO created a cross-section, which showed thickness of the Barnett Shale ranging from 335 to 325 feet. From the cross-section, the engineer estimated that the thickness of the Barnett Shale at the proposed well would be approximately 330 feet.

The Newark, East (Barnett Shale) Field was discovered on October 15, 1981. This field has special field rules providing for 330-foot lease-line spacing, and there is no between-well spacing requirement. As to horizontal wells, where the horizontal portion of the well is cased and cemented back above the top of the Barnett Shale formation, the distance to any property line, lease line, or subdivision line is calculated based on the distance to the nearest perforation in the well, and not based on the penetration point or terminus. Where an external casing packer is placed in a horizontal well and cement is pumped above the external casing packer to a depth above the top of the Barnett Shale formation, the distance to any property line, lease line, or subdivision line is calculated based on the top of the external casing packer or the closest open hole section in the Barnett Shale.

The standard drilling and proration unit for the Newark, East (Barnett Shale) Field is 320 acres. An operator is permitted to form optional drilling units of 20 acres. Operators must file a Form P-15 (Statement of Productivity of Acreage Assigned to Proration Units) listing the number of acres that are being assigned to each well on the lease or unit for proration purposes. No double assignment of acreage is permitted. There is no maximum diagonal prescribed for proration units. While the allocation formula for the field is suspended, operators are not required to file plats of proration units with Form P-15.

The petroleum engineer retained by XTO performed a volumetric calculation of gas in place beneath the Wesco A1 Unit. Volumetric data introduced by Devon Energy at the 2005 hearing that

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[9] The owner of Tract 519, containing 0.151 acres, affirmatively refused XTO's offer.

amended field rules for the Newark, East (Barnett Shale) Field indicated that original gas in place was 139 BCF per square mile (640 acres) where average thickness was 433 feet. Accounting for Barnett Shale thickness of 330 feet in the area of the proposed unit, unit size of 229.6 acres, and a recovery factor of 30 percent, the engineer calculated the recoverable gas in place beneath the proposed unit to be 11.4 BCF.

The engineer also calculated the estimated ultimate recoveries by decline curve analysis and the estimated lateral drainhole length for 134 wells within the five-mile study area. Using the estimated ultimate recovery as the y-coordinate and the estimated drainhole length as the x-coordinate, he then created a scatter plot of data points. A computer-generated least-squares regression of the data points on the plot developed a line through the data points with a positive slope of 0.1938 and a y-intercept of 1275.1. The implications of this study are that a vertical well would have an estimated ultimate recovery of about 1275 MMCF of gas and that as the drainhole length of a horizontal well increases, the well's estimated ultimate recovery also increases.[10] According to this study, every additional foot of horizontal drainhole will ultimately recover an additional 193.8 MCF of gas. XTO's engineer estimated that if every foot of the proposed well with lateral drainhole length of 5,125 feet will recover 193.8 MCF, then the proposed well will ultimately recover about 2.268 BCF of gas.

Mary Buttram

Ms. Buttram objected to the application for compulsory pooling. She stated that it was her right to force-pool into the operator's unit, and not the operator's right to force-pool her into the unit. She believed that the Commission would be assuming the power of eminent domain by force-pooling. Finally, she felt that XTO's offer was not fair and reasonable because it would not compensate her sufficiently for her gas.

EXAMINERS' OPINION

As an initial matter, the examiners have concluded that the Commission does not have authority to order compulsory pooling in this case. Section 102.011 of the MIPA expressly limits the Commission's pooling authority to tracts embraced in a common reservoir of oil or gas for which the Commission has established the size and shape of proration units, whether by temporary or permanent field rules. Accordingly, the MIPA requires the applicant to plead and prove by substantial evidence that the Commission has established the size and shape of proration units for the common reservoir by temporary or permanent field rules.[11] The shape of a proration unit is determined by the maximum diagonal – the distance between the two farthest away points in the proration unit. Thus, in order for a proration unit to have a shape established by temporary or

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[10] This plot has considerable scatter of the data.

[11] *R.R. Commn. of Tex. v. Bishop Petroleum, Inc.*, 736 S.W.2d 724, 733 (Tex. App.—Waco 1987), *rev'd on other grounds in part and aff'd in part by Bishop Petroleum, Inc. v. R.R. Commn. of Tex.*, 751 S.W.2d 485 (Tex. 1988).

permanent field rules, those rules must establish a maximum diagonal.[12] The permanent field rules for the Newark, East (Barnett Shale) Field do not establish a maximum diagonal for proration units. Since the 2005 amendments, the field rules have indicated that "no maximum diagonal applies." Therefore, as of the date XTO's application was filed, as well as the date this PFD was issued, the Commission has not established the shape of proration units, whether by temporary or permanent field rules, for the Newark, East (Barnett Shale) Field.

Because the Commission has not established the shape of proration units, the Commission does not have authority to establish a unit and force-pool all of the interests in the unit. That the Commission has previously approved MIPA applications in the Newark, East (Barnett Shale) Field does not mean that the Commission now has authority. The Commission's authority to order compulsory pooling is provided solely by statute, and the application of estoppel principles will not affect its subject matter jurisdiction.[13] Estoppel based on previous decisions cannot confer subject matter jurisdiction on the Commission where the requirements of jurisdiction in fact do not exist.

In the event that the Commissioners decide that the Commission does have jurisdiction to order compulsory pooling in this case, the examiners recommend that XTO's application be denied. First, XTO is proposing that the Commission force-pool tracts and acreage in portions of the proposed unit where XTO can drill a feasible Rule 37 well on a voluntarily formed unit without compulsory pooling. Second, XTO did not attempt to prove that the proposed MIPA well will efficiently and effectively drain all of the tracts proposed to be force-pooled. The Commission may order compulsory pooling only if it is necessary to avoid the drilling of unnecessary wells, protect correlative rights, or prevent waste. Compulsory pooling of tracts within the proposed unit that will not be drained will not prevent the drilling of unnecessary wells, prevent waste, or protect correlative rights. Third, the examiners have concluded that XTO is requesting that the Commission create a large force-pooled unit to accommodate future multiple-well development. This is not permissible under the MIPA, which authorizes compulsory pooling into a proration unit for a single well only. These three topics are discussed under their subheadings that follow.

Rule 37 Locations

The application cannot be approved because XTO proposes to force-pool tracts in the center of the proposed unit where XTO can drill a feasible horizontal well on a voluntarily formed unit without compulsory pooling. The proposed MIPA well in its entirety could be drilled as a Rule 37 well without the use of compulsory pooling. Compulsory pooling may be ordered only if it is necessary to avoid the drilling of unnecessary wells, protect correlative rights, or prevent waste. If the applicant has the ability to drill a Rule 37 well on a voluntarily formed unit that will serve these

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[12] A generic example of a provision in field rules that establishes a maximum diagonal is the following: "The two farthermost points in any proration unit shall not be in excess of 2,000 feet removed from each other."

[13] *Pend Oreille Oil & Gas Co., Inc. v. R.R. Commn.. of Tex.*, 788 S.W.2d 878, 883 (Tex. App.—Corpus Christi 1990), *rev'd in part and aff'd in part by R.R. Commn. of Tex. v. Pend Oreille Oil & Gas Co., Inc.*, 817 S.W.2d 36 (Tex. 1991).

statutory purposes just as well as the proposed MIPA well, compulsory pooling under the MIPA may not be ordered.[14] There is no precedent for the proposition that compulsory pooling under the MIPA is justified to avoid the need to obtain a Rule 37 exception.

The proposed well and at least one other well could be drilled as Rule 37 wells within the boundaries of the proposed unit. XTO's drilling engineer testified that since several of the unleased owners in the central portion of the proposed unit signed leases in response to the voluntary pooling offer, a Rule 37 well identical to the proposed MIPA well could now feasibly be drilled. A second Rule 37 well traversing the northern portion of the proposed unit could also be drilled. XTO's drilling engineer expressed that drilling a third Rule 37 well on the southern portion of the proposed unit would be problematic mainly because it would require navigating the wellbore between two unleased tracts (285 and 289). Based on the scale from XTO Exhibit No. 3, these tracts appear to be approximately 100 to 125 feet apart. Drilling Rule 37 wells near to several unleased tracts has not proven to be a problem for XTO with respect to other units in the Barnett Shale. Appendix 2 to the proposal for decision includes copies of six plats attached to Forms W-1 filed recently by XTO seeking internal Rule 37 exceptions for Barnett Shale wells on other units in which horizontal drainholes travel near unleased tracts.[15] Regardless of the feasibility of a third Rule 37 well, the central Rule 37 well would prevent waste and protect correlative rights to the same extent as the proposed MIPA well. Collectively, the central and northern Rule 37 wells that could be drilled on the voluntarily pooled unit would better prevent waste and protect the correlative rights of XTO, Chesapeake, and their lessors than would compulsory pooling into a proration unit for a single MIPA well.[16]

Based on the scale provided in XTO's Exhibit No. 3, a northern Rule 37 well that had an inflection point at the eastern side of Tract No. 191 and traversed to the western boundary of the

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[14] *See* Oil & Gas Docket No. 09-0260202; *Application of XTO Energy, Inc. for Creation of A Force Pooled Unit Pursuant to the Mineral Interest Pooling Act for the Texas Steel "A" Unit, Well No. 1H, Newark, East (Barnett Shale) Field, Tarrant County, Texas* (Final Order served February 10, 2010) wherein a MIPA application was denied based, in part, on Finding of Fact No. 22 to the effect that with a Rule 37 exception, and without compulsory pooling, a horizontal well could be drilled on a voluntarily pooled unit with drainhole length in excess of the proposed MIPA well. A similar finding was adopted in the Final Order served February 10, 2010, in Oil & Gas Docket No. 09-0261248; *Application of XTO Energy, Inc. Pursuant to the Mineral Interest Pooling Act for the Proposed Texas Steel "B" Pooled Unit, Newark, East (Barnett Shale) Field, Tarrant County, Texas* (Motion for Rehearing granted for the purpose of permitting applicant to withdraw application).

[15] The examiners have officially noticed these plats from official permit records of the Commission. The plats relate to Rule 37 Case No. 0265459 (Status No. 694590), Wesco A Unit (53 feet to nearest lease line); Rule 37 Case No. 0265492 (Status No. 694742) Page Street B Unit (57 feet to nearest lease line); Rule 37 Case No. 0265000 (Status No. 682963) Texas Steel C Unit (12 feet to nearest lease line according to plat and 43 feet according to W-1); Rule 37 Case No. 0265538 (Status No. 688146) Page Street D Unit (29 feet to nearest lease line); Rule 37 Case No. 0266950 (Status No. 680246) Wesco C Unit (43 feet to nearest lease line); and Rule 37 Case No. 0265651 (Status No. 691122) TWU B Unit (50 feet to nearest lease line).

[16] Under the MIPA, the Commission may order force-pooling only into a proration unit for a single well only. *See* footnotes 19 and 20.

proposed unit would have a drainhole length of about 3,500 feet, which is longer than 99 of the 134 wells within five miles of the pad site for the proposed MIPA well. If XTO's prediction is correct that a Barnett Shale well in this area can be expected to recover 1,275 MMCF plus and additional 0.1938 MMCF for every foot of drainhole, then this northern Rule 37 well would have an estimated ultimate recovery of 1,953 MMCF. Thus, the central and northern Rule 37 wells would be expected to recover a total of 4.221 BCF, as compared to 2.268 BCF that the proposed MIPA well is predicted to recover.

Drainage Issue

One reason that XTO's proposed unit cannot be approved is that there is no evidence that the proposed well will effectively and efficiently drain all of the tracts within the unit. The drainage issue is significant because compulsory pooling of tracts that will not be drained by the proposed MIPA well is not authorized under the MIPA. Forced pooling of tracts that will not be drained will not prevent the drilling of unecessary wells because additional wells will be required to drain these tracts. Forced pooling of tracts that will not be drained will not prevent waste or protect correlative rights because whatever reserves exist under these tracts will remain there regardless of the drilling of the proposed MIPA well.[17]

XTO has made no claim that its proposed MIPA well will efficiently and effectively drain the entirety of the 229.597-acre unit. In fact, XTO's retained petroleum engineer expected that three to four wells would be needed to develop the MIPA unit. Instead of arguing that the proposed well will drain the entire unit, XTO takes the position that drainage of all tracts by the MIPA well should not be a requirement for creation of a force-pooled unit under the MIPA.

The examiners do not agree with the contention that force-pooling of tracts that will not be drained will protect correlative rights or prevent waste. XTO argues that compulsory pooling will protect correlative rights because in the absence of MIPA pooling, XTO will not be able to efficiently develop the entire proposed unit – in particular the southwestern portion of the unit. In other words, recoverable gas owned by XTO and its lessors would not be recovered in the absence of MIPA pooling. This argument for the protection of correlative rights assumes that additional wells will be drilled on the proposed unit after forced pooling is ordered. But, whether correlative rights will be protected by a MIPA application must be evaluated in the context of what the MIPA permits – forced pooling into a proration unit for a single well only. When a tract will not be drained by the proposed MIPA well, that tract owner's opportunity to produce his fair share of the gas reserves underlying his tract is not being protected because the proposed well will not be producing his fair share of the gas.

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[17] *See* Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, § 12.3[A][6] at pages 12-22.2 ("Conversely, if an additional well is necessary to drain the acreage sought to be forcibly pooled, then pooling should also be denied because the pooling would not avoid the drilling of unnecessary wells, prevent waste, or protect correlative rights.").

Section 102.017 of the MIPA also requires that a compulsory pooling order be made on terms and conditions that are fair and reasonable and will afford the owner of each tract in the unit the opportunity to produce or receive his fair share. An order force-pooling tracts that are not being drained would not afford the owners of those tracts the opportunity to produce or receive their fair share. Further, pooling of tracts that will not be drained – and thus will not contribute to the MIPA well's production – into a large force-pooled unit would serve to dilute the interests of owners of tracts that will contribute to production. Such forced pooling would not appear to afford the owners whose tracts actually contribute to production the opportunity to receive their fair share.

XTO argues that forced pooling will prevent waste because without forced pooling, it will be unable to develop a certain portion of the 229 acres in the MIPA Unit. On the issue of waste, XTO's petroleum engineer testified that forced pooling would allow XTO to place a wellbore in, and thus develop, the southwestern portion of the proposed unit. Thus, XTO's theory of waste assumes that a second – and likely a third – wellbore will be needed to recover the gas reserves under the proposed unit. However, as discussed below, the MIPA permits force-pooling into a proration unit for a single well only. The gas under the tracts that will not be drained by the proposed well will remain under those tracts whether or not the proposed MIPA well is drilled.[18] Further, if XTO chooses not to drill, the gas will not be wasted but will remain in place until some future operator takes leases and drills within the proposed unit area.

Multiple-Well Development Unit

The examiners believe that XTO is asking the Commission to form a large force-pooled unit that can accommodate future development involving multiple wells; however, the MIPA does not contemplate compulsory pooling into a development unit for multiple wells.[19] The Commission's authority to order compulsory pooling under the MIPA is limited to the pooling of separately owned

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[18] This does not necessarily mean that these unleased tracts will forever go undeveloped; rather, it simply means that the tracts cannot be force-pooled into the particular proration unit proposed by XTO. Voluntary pooling, or even compulsory pooling into a different proration unit for another well that will actually drain the tracts, will remain an option for future development.

[19] *See* Oil & Gas Docket No. 06-0245016; *Application of Patricia C. Nowak for Formation of A Pooled Unit Pursuant to the Mineral Interest Pooling Act, Proposed Waldrop Gas Unit 1-A, Carthage (Cotton Valley) Field, Panola County, Texas* (Final Order served July 7, 2006) (Conclusion of Law No. 5: "The Commission's authority to order forced pooling under the Mineral Interest Pooling Act [Texas Natural Resources Code, Chapter 102] is limited to the pooling of separately owned interests in oil and gas into an existing or proposed proration unit for a well, and the Commission may not at once forcibly pool the entirety of the interest of Patricia C. Nowak into a unit which includes the location of multiple wells and all or portions of multiple proration units."); and *See* Oil & Gas Docket No. 09-0261248; *Application of XTO Energy, Inc. Pursuant to the Mineral Interest Pooling Act for the Proposed Texas Steel "B" Pooled Unit, Newark, East (Barnett Shale) Field, Tarrant County, Texas* (Final Order served and then Motion for Rehearing granted for the purpose of permitting applicant to withdraw application) (Conclusion of Law No. 5: "The Mineral Interest Pooling Act does not authorize the Commission to force pool separate tracts into a proration unit requiring multiple well development.").

interests in oil and gas *into an existing or proposed proration unit for a well.*[20] The Commission has authority to form compulsory units having acreage up to the standard proration unit for the field but has frequently approved MIPA units having acreage less than the standard proration unit. Compulsory pooling is authorized only where necessary to prevent the drilling of unnecessary wells, prevent waste, or protect correlative rights. For this reason, the size of a compulsory unit that may be approved should be no larger than the area that the MIPA well will efficiently and effectively drain. XTO has made no claim that its proposed MIPA well will efficiently and effectively drain the entirety of the 229.597-acre unit. In fact, XTO's petroleum engineer expected that three to four wells would be needed to develop the MIPA unit.

XTO argues that the fact that subsequent wells will be needed to develop the MIPA unit should not prevent approval of its application to force pool. As support for its position, XTO points to the *Finley* and *Hunt Oil* MIPA cases in which subsequent wells were drilled on MIPA units.[21] The examiners cannot conclude that these cases should be construed as support for the proposition that contemplation of a multiple-well development unit is permissible when determining the size of a MIPA unit. The facts from *Finley*, at least with respect to unit size and future well development, are distinguishable from the facts here. The unit proposed in *Finley* contained only 96 acres, and the proposed MIPA well had dual laterals (the 1H and 2H) running east to west across the northern and southern sections of the unit. Although Finley Resources did drill a second well (the 3H) after its MIPA well was drilled, the *Finley* decision itself did not focus on drainage or discuss the

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[20] Under Texas Natural Resources Code §102.011, the authority of the Commission to force pool pertains to two or more separately owned tracts of land in a common reservoir *for which the Commission has established the size and shape of proration units*, where there are separately owned interests in oil and gas *within an existing or proposed proration unit* and the owners have not agreed to pool, and where at least one of the owners of the right to drill has drilled or has proposed to drill a well *on the existing or proposed proration unit* to the common reservoir. Under §102.012(1) of the Code, the owner of any interest in oil and gas *in an existing proration unit* may apply under the MIPA for the pooling of mineral interests. Under §102.013(c) of the Code, an offer of the owner of any interest in oil and gas *within an existing proration unit* to share on the same yardstick basis as the other owners *within the existing proration unit* are then sharing is to be considered a fair and reasonable offer. Under §102.014(a) of the Code, the Commission may not require the owner of a mineral interest, the productive acreage of which is equal to or in excess of *the standard proration unit* for the reservoir, to pool his interest with others, unless requested by the holder of an adjoining mineral interest, the productive acreage of which is smaller than such pattern, who has not been provided a reasonable opportunity to pool voluntarily. Under §102.017 of the Code, a Commission compulsory pooling order must describe the land included in the unit, identify the reservoir to which it applies, and designate the location of *the well.* See also *Carson v. R.R. Commn. of Tex.*, 669 S.W.2d 315, 317 (Tex. 1984), wherein the Texas Supreme Court held that the Legislature's intent in adding subsection (c) to §102.013 of the Code was to permit small tract owners to "muscle in" to a larger established "proration unit."

[21] These two cases are Oil & Gas Docket No. 09-0252373; *Application of Finley Resources, Inc., for the formation of a unit pursuant to the Mineral Interest Pooling Act for the proposed East Side Unit, Newark, East (Barnett Shale) Field, Tarrant County, Texas*; and Oil & Gas Docket No. 6-78,404; *Application of Hunt Oil Company to Establish a Pooled Unit in the Carthage (Cotton Valley) Field, Panola County, Texas.*

permissibility of subsequent wells, ostensibly because the unit contained only 96 acres.[22]

The *Hunt Oil* case does not stand for the proposition that contemplation of multiple-well development in the future is permissible when determining the proper size of a proposed unit. In *Hunt Oil*, the Commission approved compulsory pooling of leases into a 311.27-acre unit. XTO highlighted that five wells were permitted and drilled on essentially the same 311-acre unit after the Commission approved the compulsory unit in 1982.[23] However, the first subsequent well was not permitted until 1993, over ten years after compulsory pooling, by a different operator.[24] Further, there was no evidence that the force-pooled unit remained in effect and had not been dissolved by 1993. Perhaps the most poignant fact of the *Hunt Oil* decision was that the Commission specifically relied on the finding that the MIPA well would drain the entire acreage included in the force-pooled unit.[25]

The examiners believe that the application as proposed should be dismissed. XTO has not shown that the Commission's field rules have established the shape of proration units for Newark, East (Barnett Shale) Field. As a result, the Commission lacks jurisdiction to consider the application. In the alternative, the examiners believe the application must be denied. XTO has not established that compulsory pooling as proposed is necessary to avoid the drilling of unnecessary wells, protect correlative rights, or prevent the waste of gas. Based on the record in this case, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. Notice of the hearing was mailed to all interested parties at mailing addresses provided by the applicant XTO Energy, Inc. ("XTO") at least 30 days prior to the hearing date.

2. Notice of this hearing was published in the Fort Worth Star Telegram on January 21, January 28, February 4, and February 11, 2012.

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[22] The only consideration of drainage appeared to be in Finding of Fact 16(e): "Any well that might be drilled on the acreage within the unit area leased by Finley, Chesapeake, and the Dale Companies would have the potential for *draining* hydrocarbons from beneath the unleased tracts, and in the absence of compulsory pooling, the unleased owners would not be compensated for such drainage." (emphasis added). This finding suggests that any proposed MIPA well would have drained, at least partially, all of the tracts within the Finley proposed unit – a situation not present in XTO's current application.

[23] Permit applications for future wells referred to a pooled unit consisting of 311.40 acres.

[24] The 1993 permit application for Well No. 4 was filed by Union Pacific Resources Company. The subsequent wells permitted and drilled on the Smith, J.J. Unit were No. 4 (1993), No. 5 (1994), No. 6 (1994), No. 7 (2008), and No. 8 (2008). Anadarko E&P Company LP is the current operator of these wells.

[25] Finding of Fact No. 7 stated: "The well drilled by Hunt Oil Company on the proposed proration unit will drain the entire pooled unit in this field, while avoiding the drilling of unnecessary wells and recovering hydrocarbons that cannot be recovered by any existing well."

3. By this application, XTO requests that the Commission approve compulsory pooling pursuant to the Mineral Interest Pooling Act, Chapter 102, Texas Natural Resources Code, of all mineral interests in 591 tracts of land into a 229.597-acre proration unit for the Wesco A1 Unit, Well No. 10H, Newark, East (Barnett Shale) Field, Tarrant County, Texas.

4. Appendix 1 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat for the proposed unit (XTO Exhibit No. 3), which distinguishes between tracts that are leased, tracts for which XTO has a partial leasehold interest, and tracts that are unleased ("open").

5. Mary Buttram appeared at the hearing in opposition to the XTO application.

6. The Newark, East (Barnett Shale) Field was discovered on October 15, 1981. This field has special field rules providing for 330-foot lease-line spacing, and there is no between-well spacing requirement. As to horizontal wells, where the horizontal portion of the well is cased and cemented back above the top of the Barnett Shale formation, the distance to any property line, lease line, or subdivision line is calculated based on the distance to the nearest perforation in the well, and not based on the penetration point or terminus. Where an external casing packer is placed in a horizontal well and cement is pumped above the external casing packer to a depth above the top of the Barnett Shale formation, the distance to any property line, lease line, or subdivision line is calculated based on the top of the external casing packer or the closest open hole section in the Barnett Shale.

7. The standard drilling and proration unit for the Newark, East (Barnett Shale) Field is 320 acres. An operator is permitted to form optional drilling units of 20 acres. Operators must file a Form P-15 (Statement of Productivity of Acreage Assigned to Proration Units) listing the number of acres that are being assigned to each well on the lease or unit for proration purposes. No double assignment of acreage is permitted. There currently exists no maximum diagonal rule for proration units. While the allocation formula for the field is suspended, operators are not required to file plats of proration units with Form P-15.

8. The field rules for the Newark, East (Barnett Shale) Field do not establish the shape of proration units.

9. The proposed unit is about one-quarter mile south of downtown Fort Worth. The proposed unit has mixed surface uses, but it is heavily residential.

10. Within the 229.597-acre proposed unit, the total number of acres under lease at the time of hearing was 214.9277. XTO had 175.5046 acres under lease; Chesapeake Exploration LLC had 39.4231 acres under lease. Chesapeake had assigned a 25% working interest in its leases to Total E&P USA, Inc. Chesapeake and Total E&P have agreed to pool their interests with those of XTO into the proposed unit. XTO's leases include the right to pool its leased

acreage.

11. There are 591 separate tracts of land within the proposed force-pooled unit. At the time of hearing, a total of 542 tracts were under lease to XTO, Chesapeake, and Total. There are 44 unleased tracts, one of which is a tax-foreclosed property owned by the City of Fort Worth. There are 4 tracts in which partial interests are under lease. A total of 14.1763 acres remains unleased.

12. On October 7, 2011, XTO sent a voluntary pooling offer to all owners of tracts within the boundaries of the proposed unit that remained unleased as of that date. The unleased owners were offered three options for inclusion of their interests in the proposed Wesco A1 Unit: (1) a lease option; (2) a participation option; or (3) a farm-out option.

    a. The lease option included a bonus offer of $4,000 per net mineral acre and an offer of a 25% royalty. A standard lease form the unleased owners were asked to sign was for a primary term of four years. The lease provided that no "drilling activity" could be had on the surface of the leased premises without the prior written permission of the lessor. The lease provided also that XTO had the right to pool the leased premises with any other lands or leases.

    b. The participation option provided the unleased owners with an opportunity to purchase a working interest in the proposed unit by paying to XTO, 15 days prior to commencement of actual drilling operations, the owner's pro rata share of drilling and completion costs. An AFE (Authority for Expenditure) attached to the offer indicated that the estimated cost of drilling and completing the well was $3,828,000.

    c. The farm-out option proposed to the unleased owners that they convey to XTO an 80% net revenue interest attributable to their mineral interests and retain an overriding royalty interest equal to 20% of 8/8ths, proportionately reduced to the extent that each owner's interest bore to all of the mineral interests in the unit, until payout of all well costs to drill, test, fracture stimulate, complete, equip, and connect the well for production. At payout, the unleased owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

    d. In response to the voluntary pooling offer, 27 owners of mineral interests that had not previously been leased to XTO or Chesapeake accepted the lease option. One mineral interest owner accepted the participation option.

    e. The City of Fort Worth, owner of a tax-foreclosed tract, did not accept any of the options in the voluntary pooling offer, but it did agree to pooling without execution of an oil and gas lease, subject to certain conditions.

f. The owner of one tract containing 0.0.151 acres affirmatively refused the voluntary pooling offer because she was not willing to lease at the current bonus offer.

g. The owners of 13.0518 net mineral acres from 43 tracts received XTO's voluntary pooling offer, as evidenced by certified-mail receipts, but did not respond in any way to the offer.

h. XTO could not contact the owners of two tracts containing 0.4950 acres.

i. The owners of 0.3275 net mineral acres from three tracts refused to take delivery of the offer package.

13. The Barnett Shale is present and reasonably productive in the area of the proposed unit.

14. XTO estimated that volumetrically-calculated gas in place beneath the 229.597-acre unit is 38 BCF. Assuming a recovery factor of 30 percent, the recoverable gas in place beneath the proposed unit is 11.4 BCF.

15. XTO created a scatter plot of the estimated ultimate recoveries versus the estimated drainhole length for 134 Barnett Shale wells within five miles of the proposed units. A computer-generated least-squares regression of the data points on the plot developed a line through the data points with a positive slope of 0.1938 and a y-intercept of 1275.1. XTO interpreted this study to mean that a horizontal well in the Barnett Shale will recover 1,275 MMCF of gas plus an additional 0.1938 MMCF for every foot of horizontal drainhole.

16. The proposed length of the Wesco A1 Unit, Well No. 10H, is 5,125 feet. If this well recovered 1275 MMCF plus an additional 0.1938 MMCF per foot of drainhole, then it would have an estimated ultimate recovery of 2.268 BCF.

17. The owners of unleased tracts within the proposed unit have not agreed to lease to XTO or accept any other aspect of XTO's voluntary offer to pool their interests into the proposed unit.

18. XTO has already formed the WESCO A Unit, a voluntarily pooled unit consisting of 540.016 acres. The proposed 229.597-acre MIPA unit is a subsection of this larger parent unit.

19. There are pathways across the proposed unit for the feasible and economical drilling of multiple horizontal wells with Rule 37 exceptions. These Rule 37 wells would protect the correlative rights of XTO, Chesapeake, and their lessors and prevent waste to a greater extent than the proposed MIPA well.

b. The proposed MIPA well could be drilled as a Rule 37 well having the same

drainhole length and estimated ultimate recovery.

c. A Rule 37 on the northern portion of the proposed unit would have a drainhole length of about 3,500 feet, which is longer than 99 of the 134 Barnett Shale wells within five miles of the pad site for the proposed MIPA well. If this well recovered 1,275 MMCF plus an additional 0.1938 MMCF per foot of drainhole, then it would have an estimated ultimate recovery of 1,953 MMCF.

20. XTO did not establish that the proposed well will drain the entirety of the proposed 229.597-acre unit.

21. XTO likely has proposed the 229.597-acre unit in contemplation of multiple-well development on the unit.

a. There was no evidence that the proposed MIPA well would effectively and efficiently drain the entire proposed unit.

b. Three or four wells would likely be required to develop the proposed unit.

CONCLUSIONS OF LAW

1. Pursuant to Texas Natural Resources Code § 102.016, notice of the hearing was given to all interested parties by mailing the notices to their last known addresses at least 30 days before the hearing and, in the case of parties whose whereabouts were unknown, by publication of notice for four consecutive weeks in a newspaper of general circulation in the county where the proposed unit is located at least 30 days before the hearing.

2. Pursuant to Texas Natural Resources Code § 102.011, the Commission may order compulsory pooling only with respect to two or more separate tracts of land embraced in a common reservoir of oil or gas for which the Commission has established the size and shape of proration units.

3. Pursuant to Texas Natural Resources Code § 102.011, the Commission has no authority to order compulsory pooling where it is not proven that the Commission has established the shape of proration units by temporary or permanent field rules.

4. XTO Energy, Inc. did not prove that the Commission has established the shape of proration units, whether by temporary or permanent field rules, for the common reservoir of oil or gas.

5. The Commission has no jurisdiction to grant the application filed by XTO, and the application should be dismissed.

6. All things have occurred and been accomplished to give the Commission jurisdiction to decide this matter.

7. XTO Energy, Inc. made a fair and reasonable offer to pool voluntarily as required by Texas Natural Resources Code § 102.013.

8. XTO Energy, Inc. did not prove that compulsory pooling as proposed is required to avoid the drilling of unnecessary wells, prevent waste, or protect correlative rights.

9. Pursuant to Texas Natural Resources Code § 102.011, the Commission has no authority to order compulsory pooling where it is not proven that such compulsory pooling is necessary to avoid the drilling of unnecessary wells, prevent waste, or protect correlative rights.

10. The Commission's authority to order compulsory pooling under the Mineral Interest Pooling Act is limited to forced pooling into a proration unit for a single well.

11. The Mineral Interest Pooling Act does not authorize the Commission to force pool separate tracts into a pooled unit that requires multiple-well development to effectively and efficiently drain the unit.

RECOMMENDATION

The examiners recommend that the application of XTO be dismissed because the Commission does not have jurisdiction to grant the application. In the alternative, the examiners recommend that the application be denied.

Respectfully Submitted,

Michael Crnich
Hearings Examiner

Richard D. Atkins
Technical Examiner