RAILROAD COMMISSION OF TEXAS
OFFICE OF GENERAL COUNSEL

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 ITS TEXAS STEEL "A" UNIT, WELL NO. 1, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT:	**APPLICANT:**
David Gross Rick Johnston Tarah Fagan Andree French Griffin	XTO Energy, Inc.

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE APPLICATION FILED:	November 20, 2008
DATE OF NOTICE OF HEARING:	January 16, 2009
DATE OF HEARING:	February 20, 2009
HEARD BY:	James M. Doherty, Hearings Examiner Richard Atkins, Technical Examiner
DATE RECORD CLOSED:	March 2, 2009
DATE TRANSCRIPT RECEIVED:	March 9, 2009
DATE PFD CIRCULATED:	May 5, 2009

STATEMENT OF THE CASE

Pursuant to the Mineral Interest Pooling Act ("MIPA"), Chapter 102, Texas Natural Resources Code, XTO Energy, Inc. ("XTO") requests the Commission to enter an order force pooling all mineral interests in 1,036 tracts of land into a 434.7474 acre proration unit for the Texas Steel "A" Unit, Well No. 1, Newark, East (Barnett Shale) Field, Tarrant County, Texas. Appendix 1 to this proposal for decision is a surveyed plat for the proposed unit. Appendix 2 to this proposal for decision is a plat showing the proposed location of the Texas Steel "A" Unit, Well No. 1. A hearing was held on February 20, 2009, and XTO appeared and presented evidence. No person appeared in opposition to the application. The record closed on March 2, 2009, when XTO

submitted certain late-filed exhibits.

PRELIMINARY OVERVIEW

The MIPA is a unique act forged by the legislature largely to protect small tract owners and operators in the wake of the *Normanna* decision[1] 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. Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.1(B) at page 12-5 (Matthew Bender 2007).

Recently, however, the Commission approved compulsory pooling of the unleased interests of small residential lot owners at the request of an operator which had leased numerous other residential lots in the same area and had the right to pool such lots into a voluntary unit containing sufficient acreage to drill a well under the applicable field rules. See 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* (Final Order served 08/26/08).

In several important respects, the XTO application is similar to the application in *Finley*. The proposed force pooled unit is about four miles south of downtown Fort Worth. Appendix 1 to this PFD is a plat of the proposed unit showing the acreage leased to XTO, two lots leased to other lessees, the unleased acreage, and tracts leased to XTO in which there is an unleased interest. There are commercial or non-residential surface uses of a significant portion of the proposed unit, but residential lots appear from the plats to comprise more than fifty percent of the surface acreage. Either by assignment from other lessees or as a result of oil and gas leases taken directly from the mineral fee owners, XTO has under lease, and the right to pool voluntarily, 412.8538 acres[2] or 94.9641% of the proposed unit acreage. Still there are about 73 small tracts comprising 21.3792 acres in the proposed unit area whose owners have affirmatively refused to lease, have not responded to XTO's voluntary pooling offer, or cannot be found, and another 11 tracts (1.776 gross acres) in which there is an unleased undivided interest because the owner did not respond or could not be found. These unleased tracts have some limiting effect on location and length of horizontal drainholes that XTO might drill on its leased acreage without a Rule 37 exception. XTO extended to all of the unleased owners an offer to pool voluntarily which was, in most respects, similar to the

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[1] *Atlantic Refining Co. v. Railroad Commission*, 346 S.W.2d 801 (Tex. 1961).

[2] This does not include one small residential lot added to the unit during the hearing.

voluntary pooling offer found to be fair and reasonable in *Finley*.[3] XTO takes the position that compulsory pooling is necessary to avoid the need to seek a Rule 37 exception for the Texas Steel "A" Unit, Well No. 1.[4] It also asserts that the length of horizontal lateral that could be drilled if compulsory pooling is ordered will enable the Texas Steel "A" Unit, Well No. 1 to recover 1.292 BCF more than a well with a shorter lateral that could be drilled at a regular location without compulsory pooling or a Rule 37 exception.

There are also important respects in which the XTO application differs from the application in *Finley*. The *Finley* case involved a 96.32 acre unit for a horizontal well to be drilled from an off-lease surface location with two horizontal laterals. The unit proposed by XTO is more than four and one-half times as large, containing 434.7474 acres. There are multiple locations within the area under lease to XTO and within the proposed unit where horizontal wells economically could be drilled at *regular* locations without compulsory pooling *or* a Rule 37 exception.[5] This was not the case in *Finley* where the positioning of unleased tracts within the area of Finley's proposed unit precluded the feasibility of drilling any horizontal well at a regular location. In *Finley*, the Commission found that even with a Rule 37 exception, Finley would not drill on its leased acreage without compulsory pooling because of the impracticality of drilling around unleased tracts. It also found that drilling around the unleased tracts would involve circuitous horizontal laterals or would be impractical because use of directional tools could not foreclose the danger of an unintentional trespass under the unleased tracts. These are not XTO's facts, because even in the absence of compulsory pooling, XTO has more contiguous leased acreage and greater ability to drill a lengthy horizontal drainhole, comparable to XTO's proposed MIPA well, without any risk of an unintentional trespass on an unleased tract. Assuming, without deciding, that XTO's desire to avoid the need to obtain a Rule 37 exception for a horizontal well on the proposed unit is justification for compulsory pooling under the MIPA, the plats presented by XTO disclose that forced pooling of only a few strategically positioned unleased tracts would be necessary to accomplish this purpose. More importantly, XTO has conceded that its proposed unit well *will not drain* unleased tracts in the southwest quadrant and northeast quadrant of the proposed unit, whereas the decision in *Finley* was

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[3] The lease bonus offer made by XTO was materially better than the bonus offer in *Finley*, i.e., $15,000 per net mineral acre as compared to $2,100, and the royalty offered by XTO was 25%, as compared to 20% offered by Finley.

[4] Without compulsory pooling, a Rule 37 exception would be needed, assuming that the perforations in the horizontal drainhole are closer than 330' to any unleased tract interior to the proposed unit.

[5] The examiners have officially noticed Commission permit records disclosing that XTO has already permitted three horizontal wells at regular locations in the Newark, East (Barnett Shale) Field just on the northern 130 acres of the proposed Texas Steel "A" Unit. These permits are for Well Nos. 1H (Permit No. 670089 issued 09/16/08), 2H (Permit No. 670101 issued 09/18/08), and 3H (Permit No. 670113 issued 09/16/08). The as-approved Forms W-1 and associated plats for these three wells are attached to this Proposal for Decision as Appendix 3. Exhibit No. 29 shows XTO's conception of two other horizontal wells that could be drilled at regular locations on XTO's leased acreage without compulsory pooling.

premised on a finding by the Commission that compulsory pooling would afford the owners of each tract or interest in the proposed unit the opportunity to produce their fair share of hydrocarbons and avoid the drilling of unnecessary wells.

The Commission's decision in *Finley* is precedent for XTO's proposed use of the MIPA , but the facts of XTO's case involve more than a simple extension of *Finley's* principles. XTO's case, to a greater extent than *Finley*, tests the limits of the Commission's jurisdiction under the MIPA.

APPLICABLE LAW

The MIPA is a limited compulsory pooling statute unique to Texas which has been characterized by scholars as an "act to encourage voluntary pooling" or a "compulsory voluntary pooling act." Smith and Weaver, *Texas Law of Oil and Gas*, Chapter 12, §12.3(B)(1)(a) at page 12-24 (Matthew Bender 2007). Pursuant to §102.013 of the MIPA, the Commission must dismiss an application for force pooling if it finds that a fair and reasonable offer to pool voluntarily has not been made by the applicant to the owners of other interests in the proposed unit.

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.

DISCUSSION OF THE EVIDENCE

XTO's Exhibit No. 33 is a surveyed plat for the proposed 434.7474 acre Texas Steel "A" Unit (attached as Appendix 1 to this proposal for decision). The plat distinguishes between tracts for which XTO has a leasehold interest, eleven tracts for which XTO has a partial leasehold interest and for which an undivided mineral interest remains unleased, two tracts for which Thornton Gas Ventures or Glencrest Resources has the leasehold interest, and unleased ("open") tracts. Thornton and Glencrest have notified XTO of their agreement to join XTO's proposed unit. The proposed unit derives its name from the fact that a steel mill once occupied a small portion of the acreage. The pad site for XTO's proposed unit well is located on the old steel mill property, the surface estate of which is now owned by XTO. This pad site is located at the northern extremity of the proposed unit. Surface uses of the remainder of the proposed unit are both residential and non-residential. The

largest tracts in the unit are occupied on the surface by the Town Center Mall and the Immaculate Heart of Mary Catholic Church, and XTO holds mineral leases covering these tracts. There are residential surface uses in the southwest, southeast, and northeast quadrants of the unit. Most tracts for which the mineral estate remains unleased are in the residential areas of the unit, although there a few unleased tracts elsewhere on the unit, as more particularly depicted in the unit plat attached to this Proposal for Decision as Appendix 1.

XTO holds the leasehold mineral interest for approximately 960 separately owned tracts comprising about 412.8538 acres[6] within the area of the proposed unit. Leasing activity in the area of the proposed unit commenced in October 2006. Most of the oil and gas leases covering the leased tracts originally were taken either by Fort Worth Energy Co. LLC or Chesapeake Exploration LLC and later assigned to XTO. XTO acquired about 155 oil and gas leases on these tracts directly from the owners of the mineral fee. There are two small tracts within the unit area that are under lease to Thornton Gas Ventures LP (0.1150 net acres) or Glencrest Resources LLC (0.1262 net acres), and these two lessees have notified XTO of their agreement to participate in the proposed unit as working interest owners. Also, the mineral fee owner of one small tract (0.2732 net acres) in the unit area responded to XTO's voluntary pooling offer by electing to participate in the unit as a working interest owner. Although the tracts in the unit area for which XTO holds the mineral leasehold interest include a few larger tracts, such as the 77.0849 acre tract where the Town Center Mall is located, a substantial majority of the tracts are small town lots containing a fraction of an acre. Among the tracts for which XTO holds leases, there are eleven (1.776 gross acres) having an unleased undivided interest because the owner of the unleased interest did not respond to XTO's voluntary pooling offer or could not be found. All of the oil and gas leases held by XTO in the unit area are "no surface use" leases, and these leases grant XTO the right to pool the leased premises with adjoining tracts.

Notwithstanding XTO's efforts to obtain oil and gas leases for all tracts, there are about 73 separate tracts in the proposed unit area that remain entirely unleased. These unleased tracts comprise 21.3792 acres. XTO was unable to obtain leases for these tracts because the owners stated affirmatively that they were unwilling to lease, did not respond to XTO's voluntary pooling offer, or, despite XTO's diligent effort, could not be found. A substantial majority of the unleased tracts are small town lots containing a fraction of an acre.

As required by the MIPA, XTO sent a voluntary pooling offer to all owners of the unleased tracts in the unit area. The unleased owners were offered three options for inclusion of their interests in the Texas Steel "A" Unit: (1) a lease option; (2) a participation option; or (3) a farm-out option.

The lease option included a bonus offer of $15,000 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

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[6] Does not include one additional lot which XTO included in the proposed unit at the hearing.

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. According to XTO, the lease terms offered to the unleased owners were comparable to, or better than, lease terms granted by XTO to its lessors within the unit area. Seventy-one owners who had not previously leased responded to XTO's voluntary pooling offer by accepting the lease option.

The participation option provided the unleased owners with an opportunity to purchase a working interest in the proposed Texas Steel "A" Unit, Well No. 1 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 is $2,056,500. The participation offer cautioned, however, that the estimated cost could change considerably due to numerous unforseen factors. One unleased owner elected to accept this option in response to XTO's voluntary pooling offer.

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, with the option, at payout, to convert the retained override to a 25% working interest, proportionately reduced. None of the unleased owners elected to accept this option in response to XTO's voluntary pooling offer.

XTO's voluntary pooling offer advised the unleased owners to whom the offer was extended that if they did not, within 14 days, make an election of the lease option, participation option, or farm-out option, XTO intended to seek compulsory pooling of their interests "pursuant to a forced pooling order to be issued by the Texas Railroad Commission under the rights granted in the Mineral Interest Pooling Act, §§102.001-102.112 of the Texas Natural Resources Code."

Included among the owners of tracts that remained unleased after expiration of the time for a response to XTO's voluntary pooling offer, are the owners of 13 tracts (3.6309 gross acres) that verbally informed XTO that they were refusing to lease to XTO. The owners of these tracts advised XTO that they were not interested in pooling or leasing their interest, or not interested in pooling or leasing unless a better bonus offer was made, or did not want to lease foreclosed properties where a question of title existed. The owners of another 33 tracts (10.3594 gross acres) who received XTO's voluntary pooling offer, as evidenced by receipts for certified mail, did not respond in any way to the offer. Notwithstanding XTO's diligent effort to obtain current addresses, the owners of another 37 tracts (7.3889 gross acres) could not be located by XTO. The voluntary pooling offer was sent to the last known address for the "not found" owners, but because receipts for certified mail were not signed and returned, XTO could not establish that the offer had been delivered to these owners.

Notice of hearing of XTO's application pursuant to the MIPA was sent to all mineral interest owners in the proposed unit and to offsets. In addition, notice of hearing on the application was published for four consecutive weeks in the Fort Worth Star Telegram.

XTO presented a structure map of the top of the Barnett Shale in the immediate area of the proposed Texas Steel "A" Unit. Color coded on this structure map are existing producing units operated by XTO in the same area. The existing producing XTO units within five miles of the proposed Texas Steel "A" Unit pad location are to the south and east. The structure map shows that the area of the proposed unit is in an east dipping portion of the Fort Worth Basin. XTO also presented a three well north to south cross section showing the top of the lower Barnett Shale in the area. From the structure map and cross section, XTO's geologist concluded that the Barnett Shale is present and reasonably productive throughout the area of the proposed unit. There are some very productive Barnett Shale wells to the southeast and northeast of the unit, and XTO hopes that the proposed unit well will be similarly productive.

The Newark, East (Barnett Shale) Field was discovered on October 15, 1981. This field has special field rules providing for 330' 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. While the allocation formula for the field is suspended, operators are not required to file plats of proration units with Form P-15.

From a plot of estimated ultimate recoveries of area wells versus drainhole length, XTO's consulting petroleum engineer concluded that there is a general trend showing that the longer the drainhole, the greater the ultimate recovery.[7] Calculated regional recovery of horizontal wells in the Newark, East (Barnett Shale) Field is 1.165 MMCF per foot.

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[7] Apparently this is not exact science, however, because the plot appears to include a well with a drainhole of only about 1,700 feet that has one of the best EUR's of all wells in the study (over 9,000 MMCF), while the well in the study with the longest drainhole (about 4,200 feet) has one of the poorest EURs (less than 1,000 MMCF).

XTO presented a series of plats showing development options for the Texas Steel "A" Unit. There are regular locations on the unit 330 feet or more from any mineral property line where a horizontal well might be drilled in the subject field. The "Case 1" plat (Exhibit No. 27 attached to this proposal for decision as Appendix 4) shows one such horizontal well that could be drilled without a Rule 37 exception and without compulsory pooling. The "Case 1" well would have a drainhole length of 4,369 feet and estimated ultimate recovery (calculated on the basis of 1.165 MMCF per foot) of 5,090 MMCF.

Pursuant to this application, XTO proposes to pool all mineral interests in a 434.7474 acre proration unit for the "Case 2" well shown on Exhibit No. 28 (attached as Appendix 2 to this proposal for decision). This is the unit well for which approval under the MIPA is requested. This "Case 2" well would have drainhole length of 5,478 feet and estimated ultimate recovery (calculated on the basis of 1.165 MMCF per foot) of 6,382 MMCF. Thus, based on regional recovery by horizontal wells in the Barnett Shale of 1.165 MMCF per foot, it is estimated that because of its greater drainhole length, the "Case 2" well would have ultimate recovery of 1,292 MMCF more than the "Case 1" well that could be drilled at a regular location. According to XTO's petroleum engineer, the "Case 2" MIPA well will not drain the southwest and northeast quadrants of the proposed unit.

Exhibit No. 29 is a plat (attached to this proposal for decision as Appendix 5) showing the "Case 3" wells, that is, two horizontal wells that could be drilled at regular locations on the Texas Steel "A" Unit without a Rule 37 exception or compulsory pooling. These two wells would have combined drainhole length of 5,836 feet and estimated ultimate recovery (calculated on the basis of 1.165 MMCF per foot) of 6,799 MMCF. These wells at regular locations would have greater ultimate recovery than the "Case 2" MIPA well, but drilling of two wells would be necessary to recover 417 MMCF more than the single "Case 1" MIPA well. XTO's petroleum engineer expressed the opinion that the economics of drilling the shorter of the two Case 3 wells would be "slim."[8]

According to XTO's petroleum engineer, because of surface constraints, the southwest quadrant of the Texas Steel "A" Unit can be developed only by the drilling of a "couple" of horizontal drainholes over that part of the unit. A vertical well could be expected to recover less than 0.5 BCF which would probably be uneconomic. Exhibit No. 30 depicts four Case 4 wells that might be drilled if all interests in the Texas Steel "A" Unit were pooled. These four wells would have combined drainhole length of 16,416 feet and, assuming recovery of 1.165 MMCF per foot, about 19 BCF estimated ultimate recovery.[9]

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[8] This shorter lateral appears from the Case 3 plat to have horizontal drainhole length of about 2,625 feet. Using XTO's regional recovery methodology, and thus assuming that this well would recover 1.165 MMCF per foot, the estimated ultimate recovery of the well would be 3,058 MMCF.

[9] The significance of Exhibit No. 30 to this MIPA application is not clear. The MIPA authorizes compulsory pooling into a proration unit for a single well, and XTO confirmed that the Case 2 well shown in Exhibit No. 28 is the proposed MIPA well. Yet the Case 2 well is not one of the four wells shown on Exhibit No. 30.

In the opinion of XTO's petroleum engineer, compulsory pooling will prevent waste because the Case 2 MIPA well theoretically will recover 1,292 MMCF more than the Case 1 well that could be drilled at a regular location without compulsory pooling. However, with a Rule 37 exception, the drainhole of the Case 1 well could be extended further south on the Texas Steel "A" Unit.[10]

EXAMINERS' OPINION

The examiners proceed from the premise that the Commission is a creature of the Legislature and has no inherent authority. *Public Util. Comm'n v. GTE-SW Corp.*, 901 S.W.2d 401, 407 (Tex. 1995). 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. *Public Util. Comm'n v. City Pub. Serv. Bd.*, 53 S.W.3d 310, 316 (Tex. 2001). 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 administrative purposes. *Id.*

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. Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3(B)(1)(a) at page 12-24 (Matthew Bender 2007). It is immaterial that some may think that the targets of an application under the MIPA have not acted wisely in declining to lease and/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.[11]

Under the MIPA, the Commission may order compulsory pooling only if it is necessary to avoid the drilling of unnecessary wells, protect correlative rights, or prevent waste. Smith & Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3[A][6] at page 12.22.1. The examiners are of the opinion that XTO's application should be denied because XTO failed to prove that compulsory pooling as proposed is necessary to achieve any of these purposes.

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[10] It appears from the Exhibit No. 27 plat (attached to this proposal for decision as Appendix 4) that with a Rule 37 exception, and without moving the inflection point, the drainhole of the Case 1 well could be lengthened by at least 750 feet to the south, which, at 1.165 MMCF per foot, would, according to XTO's methodology, would account for additional ultimate recovery of the Case 1 well of 874 MMCF. With a Rule 37 exception and extension of the drainhole to the south, adjustment of the inflection point of this well might result in even greater ultimate recovery.

[11] Contrary to XTO's suggestion, this is not the same as letting "the tail wag the dog," particularly where, as here, even in the absence of compulsory pooling, the operator has the right to pool all of its leased acreage and an opportunity to drill wells on a voluntary unit that will enable all of its lessors to participate in production of any well drilled on the voluntary unit.

The Commission's authority to order compulsory pooling under the MIPA is limited to the pooling of separately owned interests in oil and gas *into an existing or proposed proration unit for a well.*[12] Compulsory pooling into a development unit for multiple wells is not contemplated by the MIPA. 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.")

XTO proposes that mineral interests in all tracts within the area of the proposed unit be forcibly pooled into a 434.7474 acre proration unit for the Texas Steel "A" Unit, Well No. 1, which is the so-called "Case 2" well depicted on the plat in Appendix 2 to this proposal for decision. As to a significant majority of the unleased tracts sought to be forcibly pooled[13], approval of the XTO application will not prevent the drilling of unnecessary wells, prevent waste, or protect correlative rights for the simple reason that XTO has conceded that the proposed Texas Steel "A" Unit, Well No. 1 *will not drain these tracts*. As to these tracts, the drilling of unnecessary wells will not be prevented by compulsory pooling into the proposed proration unit for the Texas Steel "A" Unit, Well

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[12] 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. Railroad Com'n of Texas*, 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."

[13] Unleased tracts in the southwest and northeast quadrants of the proposed unit.

No. 1 because an additional well or wells will be required to drain the tracts. Waste will not be prevented and correlative rights will not be protected, because whatever gas exists beneath these tracts will remain there, regardless of the drilling of the Texas Steel "A" Unit, Well No. 1.[14] See Smith & Weaver, *Texas Law of Oil & 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.")

There are additional reasons for concluding that XTO failed to prove that compulsory pooling is necessary to prevent the drilling of unnecessary wells, prevent waste, or protect correlative rights. First, there are regular locations on the proposed unit where horizontal wells economically and feasibly may be drilled without a Rule 37 exception or compulsory pooling. The two "Case 3" wells shown on Appendix 5 to this proposal for decision are examples. These two wells would have combined drainhole length, and, using XTO's methodology, greater estimated ultimate recovery than XTO's proposed "Case 2" MIPA well. The drilling of these two "Case 3" wells at regular locations cannot be put in the category of "unnecessary wells" because they will recover gas that will not be recovered by the proposed "Case 2" MIPA well. For the same reason, the two "Case 3" wells will do a more effective job of preventing waste and protecting correlative rights than the "Case 2" MIPA well. Although XTO's petroleum engineer raised some question about the economics of drilling the "Case 3" well having the shorter drainhole, the examiners do not believe that this is a valid concern. Using the scale on the "Case 3" plat, it appears that the "shorter" drainhole would be about 2,625 feet in length. XTO's methodology, which assumes recovery of 1.165 MMCF per foot, provides an estimated ultimate recovery for the "shorter" drainhole of about 3,058 MMCF. Because it must be assumed that this well would be considerably less expensive to drill than the "Case 2" MIPA well which has a drainhole length of 5,478 feet and an estimated cost to drill and complete of $2,056,500, the economics of the well should not be in question. Exhibit No. 17 shows, among other things, other XTO Barnett Shale units in the area of the Texas Steel "A" Unit, and discloses that XTO has drilled many horizontal wells with comparable or even shorter drainholes than those depicted on the "Case 3" plat that could be drilled at regular locations.

XTO's theory that compulsory pooling will prevent waste is predicated entirely upon the premise that the "Case 2" MIPA well would have greater drainhole length and greater estimated ultimate recovery than the single "Case 1" well that might be drilled at a regular location without compulsory pooling.[15] The premise for XTO's theory is highly theoretical and not proven as fact, because it assumes that every foot of drainhole length wherever a well is drilled on the Texas Steel

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[14] This does not mean necessarily that these unleased tracts will forever go undeveloped, just that they cannot be forcibly 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.

[15] As asserted justification for compulsory pooling, this kind of theory is very self-fulfilling because in *most* cases involving a significant number of strategically located unleased tracts interior to a proposed unit, a horizontal drainhole drilled without regard to required spacing to mineral property lines is likely to be longer than a horizontal drainhole that complies with spacing requirements.

"A" Unit will have ultimate recovery of 1.165 MMCF. The "Case 2" MIPA well may or may not achieve this kind of recovery. Even though there is a logical relationship between drainhole length and ultimate recovery, not all Barnett Shale wells are alike. On XTO's plot of estimated ultimate recoveries of area wells versus drainhole length, a drainhole of only about 1,700 feet has one of the best EUR's of all wells in the study (over 9,000 MMCF), while the well in the study with the longest drainhole (about 4,200 feet) has one of the poorest EURs (less than 1,000 MMCF).

XTO's "waste" theory is based on the asserted difference in estimated ultimate recovery that could be achieved by the "Case 2" MIPA well as compared with the estimated ultimate recovery of the "Case 1" well that could be drilled at a regular location without a Rule 37 exception. This suggests that it is XTO's position that it is proper for the Commission to order compulsory pooling because it will enable the applicant to avoid seeking a Rule 37 exception. The examiners are unaware of any precedent for this position.[16] The examiners have officially noticed that XTO has been granted hundreds of Rule 37 exceptions to drill wells in the Newark, East (Barnett Shale) Field. Most of these involved applications where XTO was its own offset, but several necessitated issuance of notices of application to affected offsets or were submitted with waivers. The examiners have been unable to discover any Rule 37 application filed by XTO affecting the Newark, East (Barnett Shale) Field that required a contested case hearing or ultimately was denied.

With a Rule 37 exception, it is apparent from the plat for the "Case 1" well that the horizontal drainhole that could be drilled without compulsory pooling could be extended to the south by at least 750 feet and perhaps even more if the inflection point of the drainhole were adjusted. The "Case 1" well that could be drilled without compulsory pooling would then have a drainhole length of at least 5,119 feet.

A "waste" justification for the proposed compulsory pooling has not been established because (1) it is only theoretically possible that there is additional gas to be recovered by the slightly longer drainhole of the proposed "Case 2" MIPA well; (2) there is no scientifically based evidence that a substantial amount of gas ultimately would be lost in the absence of compulsory pooling; and (3) it is admitted that additional wells would be necessary to drain the entire unit in any event.

FINDINGS OF FACT

1. Notice of this 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.

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[16] This was not the basis for the Commission's decision in the *Finley* case, because there the Commission found that even with the benefit of a Rule 37 exception, Finley could not drill a well without the risk of an unintentional trespass on unleased tracts. Even if avoidance of the need to seek a Rule 37 exception were legal justification for compulsory pooling, in XTO's case the forced pooling of only a few strategically located unleased tracts would accomplish this purpose. Certainly, it would not be necessary to forcibly pool the numerous unleased tracts in the southwest and northeast quadrants of the unit in order to eliminate the necessity for a Rule 37 exception for the "Case 2" MIPA well.

2. Notice of this hearing was published in the Fort Worth Star Telegram on January 18, January 25, February 1 and February 8, 2009.

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 1,036 tracts of land into a 434.7474 acre proration unit for the Texas Steel "A" Unit, Well No. 1, 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 which distinguishes between tracts for which XTO holds a leasehold interest, tracts for which XTO has a partial leasehold interest and for which an undivided mineral interest remains unleased, tracts for which Thornton Gas Ventures LP or Glencrest Resources LLC has the leasehold interest, and unleased ("open") tracts.

5. Appendix 2 to this proposal for decision, incorporated into this finding by reference, is a plat showing the proposed location of the Texas Steel "A" Unit, Well No. 1.

6. No person appeared at the hearing in opposition to the XTO application.

7. The Newark, East (Barnett Shale) Field was discovered on October 15, 1981. This field has special field rules providing for 330' 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.

8. 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. While the allocation formula for the field is suspended, operators are not required to file plats of proration units with Form P-15.

9. The proposed unit is about four miles south of downtown Fort Worth, Texas. There are commercial or other non-residential surface uses of a significant portion of the proposed unit, but residential lots comprise more than fifty percent of the surface acreage.

10. XTO holds the leasehold interest in the mineral estate of about 960 tracts containing 412.8538 acres or 94.9641 % of the proposed unit acreage. Eleven of the tracts for which XTO holds oil and gas leases have undivided mineral interests that remain unleased. XTO has the right to pool all of the tracts for which it holds the leasehold interest.

11. Within the proposed unit, there are two small tracts in which Thornton Gas Ventures LP (0.1150 net acres) or Glencrest Resources LLC (0.1262 net acres) hold the leasehold interest. These two lessees have notified XTO of their agreement to participate as working interest owners in the proposed unit.

12. One mineral fee owner of a small tract (0.2732 net acres) within the proposed unit responded to XTO's voluntary pooling offer by electing to participate in the unit as a working interest owner.

13. There are about 73 separate tracts within the proposed unit that remain entirely unleased for mineral development. These unleased tracts collectively contain 21.3792 acres. XTO was unable to obtain mineral leases for these tracts because the owners stated affirmatively that they were unwilling to lease, did not respond to XTO's voluntary pooling offer, or could not be located by XTO. A substantial majority of the unleased tracts are small town lots containing a fraction of an acre.

14. XTO mailed a voluntary pooling offer to all owners of unleased mineral interests in tracts within the proposed unit. The unleased owners were offered three options for inclusion of their interests in the Texas Steel "A" Unit: (i) a lease option; (ii) a participation option; or (iii) a farm-out option.

    a. The lease option included a bonus offer of $15,000 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 that XTO had the right to pool the leased premises with any other lands or leases. The lease terms offered to the unleased owners were comparable to, or better than, lease terms granted by XTO to its lessors within the proposed unit. Seventy-one owners who had not previously leased responded to XTO's voluntary pooling offer by accepting the lease option.

    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 stated that the estimated cost of drilling and completing the Texas Steel "A" Unit, Well No. 1 was $2,056,500. The participation offer cautioned, however, that the estimated cost could change considerably due to numerous unforseen factors. One unleased owner elected to accept this option in response to XTO's voluntary pooling offer.

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, with the option, at payout, to convert the retained override to a 25% working interest, proportionately reduced. None of the unleased owners elected to accept this option in response to XTO's voluntary pooling offer.

d. XTO's voluntary pooling offer advised the unleased owners to whom the offer was extended that if they did not, within 14 days, make an election of the lease option, participation option, or farm-out option, XTO intended to seek compulsory pooling of their interests "pursuant to a forced pooling order to be issued by the Texas Railroad Commission under the rights granted in the Mineral Interest Pooling Act, §§102.001-102.112 of the Texas Natural Resources Code."

15. The proposed unit is in an east dipping portion of the Fort Worth Basin. The Barnett Shale is present and reasonably productive in the area of the proposed unit.

16. A plot of estimated ultimate recoveries of Barnett Shale wells in the area of the proposed unit shows a relationship between horizontal drainhole length and ultimate recovery. Calculated regional recovery of horizontal wells in the Newark, East (Barnett Shale) Field is 1.165 MMCF per foot of horizontal drainhole.

17. The proposed Texas Steel "A" Unit, Well No. 1 that could be drilled if compulsory pooling were ordered would have drainhole length of 5,478 feet. If this well recovered 1.165 MMCF per foot of horizontal drainhole, it would have estimated ultimate recovery of 6,382 MMCF, or 1,292 MMCF more than a single horizontal well with drainhole length of 4,369 feet that could be drilled on the unit at a regular location without compulsory pooling or an exception to Statewide Rule 37.

18. The proposed Texas Steel "A" Unit, Well No. 1 could not be drilled at the precise location proposed by XTO without compulsory pooling of at least three unleased tracts that would be traversed by the horizontal drainhole, as more particularly shown on Appendix 2 to this proposal for decision.

19. The proposed Texas Steel "A" Unit, Well No. 1 will not drain hydrocarbons beneath a majority of the unleased tracts sought to be forcibly pooled, particularly the unleased tracts in the southwest and northeast quadrants of the proposed unit as shown more particularly on Appendix 1 to this proposal for decision. Additional wells would be required to drain these tracts.

20. Compulsory pooling of no more than three or four of the unleased tracts within the proposed unit would be necessary to enable XTO to drill the proposed Texas Steel "A" Unit, Well No. 1 at the precise location proposed by XTO. Compulsory pooling of about 69 unleased tracts within the proposed unit would not be necessary for this purpose.

21. There are regular locations within the proposed unit where horizontal wells could be drilled economically without compulsory pooling or an exception to Statewide Rule 37. Two north to south horizontal wells could be drilled economically at such regular locations in the central portion of the proposed unit, as depicted on Appendix 5 to this proposal for decision. These two wells would have combined drainhole length of 5,836 feet, and, based on XTO's methodology, combined estimated ultimate recovery of 6,799 MMCF, which is greater than the drainhole length and estimated ultimate recovery of the proposed Texas Steel "A" Unit, Well No. 1. These two wells at regular locations would recover gas from beneath the Texas Steel "A" Unit that would not be recovered by the proposed Texas Steel "A" Unit, Well No. 1.

22. With a Rule 37 exception, and without compulsory pooling, the drainhole of a single north to south horizontal well as shown on Appendix 4 to this proposal for decision could be extended to the south by 750 feet at a minimum in order to achieve total drainhole length of 5,119 feet. This Rule 37 well could be drilled without risk of unintentional trespass on any unleased tract.

23. XTO did not present evidence to establish the amount of current recoverable gas beneath the proposed Texas Steel "A" Unit.

24. XTO did not present evidence to establish the amount of gas that ultimately would be recovered by the proposed Texas Steel "A" Unit, Well No. 1 or horizontal wells that could within the unit without compulsory pooling, other than evidence that assumes that each foot of horizontal drainhole, wherever drilled on the unit, ultimately will recover 1.165 MMCF.

CONCLUSIONS OF LAW

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

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

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

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

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

RECOMMENDATION

The examiners recommend that the application of XTO Energy, Inc., pursuant to the Mineral Interest Pooling Act be denied.

Respectfully submitted,

James M. Doherty
Hearings Examiner

Richard Atkins
Technical Examiner