RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

PROPOSAL FOR DECISION

OIL & GAS DOCKET NO. 09-0288329

APPLICATION OF VANTAGE FORT WORTH ENERGY LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE FORMATION OF A POOLED UNIT FOR THE ROSEDALE NORTH 3H MIPA UNIT, WELL NO. 3H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

OIL & GAS DOCKET NO. 09-0288331

APPLICATION OF VANTAGE FORT WORTH ENERGY LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE FORMATION OF A POOLED UNIT FOR THE ROSEDALE NORTH 4H MIPA UNIT, WELL NO. 4H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

OIL & GAS DOCKET NO. 09-0288332

APPLICATION OF VANTAGE FORT WORTH ENERGY LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE FORMATION OF A POOLED UNIT FOR THE ROSEDALE NORTH 5H MIPA UNIT, WELL NO. 5H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

OIL & GAS DOCKET NO. 09-0288333

APPLICATION OF VANTAGE FORT WORTH ENERGY LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE FORMATION OF A POOLED UNIT FOR THE ROSEDALE NORTH 6H MIPA UNIT, WELL NO. 6H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

APPEARANCES

FOR APPLICANT VANTAGE FORT WORTH ENERGY LLC:

John Hicks, Attorney
Flip Whitworth, Attorney
Matthew J. Montgomery, Land Manager
Mark Brown, Vantage
Rick Johnston, Consulting Petroleum Engineer Expert

IN PROTEST OF THE APPLICATION:

William Anthony Garner, Representing Himself
Avis Brackeen-Qualls, Representing Herself

PROCEDURAL HISTORY

DATE APPLICATIONS FILED:	April 10, 2014
DATE OF NOTICE OF HEARING:	May 2, 2014
DATE OF HEARING:	June 5, 2014
HEARD BY:	Michael Crnich, Hearings Examiner Paul Dubois, Technical Examiner
PFD ISSUED BY:	Laura Miles-Valdez, Hearings Examiner
DATE TRANSCRIPT RECEIVED:	June 14, 2014
DATE PFD CIRCULATED:	November 12, 2014

STATEMENT OF THE CASE

This Proposal for Decision addresses four applications filed by Vantage Fort Worth Energy LLC ("*Vantage*") under the Texas Mineral Interest Pooling Act (the "*MIPA*"), Chapter 102 of the Texas Natural Resources Code. At the hearing, Vantage requested that the four separate docket numbers be consolidated for the purpose of the hearing record, and the examiners granted that request. By its applications, Vantage is requesting that the Commission enter an order creating four force-pooled units: the Rosedale North 3H MIPA Unit (the "*3H Unit*") with its proposed Well No. 3H, the Rosedale North 4H MIPA Unit (the "*4H Unit*") with its proposed Well No. 4H, the Rosedale North 5H MIPA Unit (the "*5H Unit*") with its proposed Well No. 5H, and the Rosedale North 6H MIPA Unit (the "*6H Unit*") with its proposed Well No. 6H. If the applications are approved, Vantage intends to drill the corresponding MIPA wells as horizontal wells in the Newark, East (Barnett Shale) Field in Tarrant County, Texas. After Vantage filed its applications, six (6) unleased tract owners filed Notices of Intent to Appear at the Hearing in Protest. However, at the hearing, only Ms. Avis Brackeen-Qualls appeared in protest of the 3H Unit (Oil & Gas Docket No. 09-0288329), and William Garner appeared in protest of the 6H Unit (Oil & Gas Docket No. 09-0288333).

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. Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, § 12.1(B) at page 12-5 (LexisNexis Matthew Bender 2013).

Subject to limitations found elsewhere in the act, Section 102.011 of the MIPA (or the Act) 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

VANTAGE'S EVIDENCE

All four of the proposed MIPA units are located due east from downtown Fort Worth and immediately west of Lake Arlington. The proposed units adjoin one another. The proposed units for Well Nos. 3H, 4H, 5H and 6H include acreage from Vantage's Rosedale North Unit, Vantage's Rosedale West Voluntary Pooled unit and unleased acreage.

The proposed 3H Unit contains 47.86 total acres and 143 separate tracts.[2] At the time of hearing, Vantage had obtained 129 tracts, 45.66 mineral acres and 95.4% of the total acreage, under lease. The proposed unit includes 14 unleased tracts, containing 2.2 acres and 4.6% of the total

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

[2] Data provided is taken from Vantage's Exh. 8.

acreage. Protestant Brackeen-Qualls owns 0.064824 net unleased acres within the proposed 3H Unit, which is 0.135% of the total acres.[3]

The proposed 4H Unit contains 47.44 total acres and 133 separate tracts.[4] At the time of hearing, Vantage had obtained leases on 135 tracts, containing approximately 45.12 net acres; approximately 95.1% of the total acreage. The proposed unit includes 15 unleased tracts, containing 2.32 acres and 4.9% of the total acreage.

The proposed 5H Unit contains 44.73 total acres and 173 separate tracts.[5] At the time of hearing, Vantage had 153 tracts, containing 42.156 mineral acres and 94.2% of the total acreage, under lease. The proposed unit includes 20 unleased tracts, containing 2.57 acres and 5.8% of the total acreage.

The proposed 6H Unit contains 69.18 total acres and 288 separate tracts.[6] At the time of hearing, Vantage had 249 tracts, containing 63.29 mineral acres and 91.5% of the total acreage, under lease. The proposed unit includes 39 unleased tracts, containing 5.88 acres and 8.50% of the total acreage. Protestant William Garner owns 0.26732 net unleased acres within the proposed 6H Unit, which is 0.386% of the total acres in the 6H Unit.[7]

Based on testimony proposed by Vantage's witness, the proposed MIPA units lie within the Newark, East (Barnett Shale) Field, which was discovered September 15, 1981 -- after March 8, 1961.[8] The State of Texas does not own any of the interests affected by the proposed applications.[9]

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[3] Data provided is taken from Vantage's Exh. 18A & by calculating the percent: [0.064824 / 47.86 net acres].

[4] Data provided is taken from Vantage's Exh. 8.

[5] Data provided is taken from Vantage's Exh. 8.

[6] Data provided is taken from Vantage's Exh. 8.

[7] Data provided is taken from Vantage's Exh. 18D & by calculating the percent: [0.26732 / 69.18 net acres].

[8] Tex. Nat. Res. Code § 102.003 (MIPA does not apply to any reservoir discovered and produced before March 8, 1961).

[9] Tex. Nat. Res. Code § 102.003 (MIPA does not apply to land owned by the State).

The Voluntary Pooling Offer

On April 22, 2014, Vantage Energy sent a voluntary pooling offer to all owners of unleased tracts within the boundaries of the proposed units. Vantage Energy offered these unleased owners four options for inclusion of their interests in the respective proposed units: two lease options, a working-interest participation option, and a farm-out option.

The first lease option included a 25% royalty and a bonus offer of $3,000 per net mineral acre. The oil, gas, and mineral lease attached to the offer letter had a primary term of three years.

The second lease option included a 20% royalty and a bonus offer of $3,500 per net mineral acre. Except for the different royalty and bonus amounts, this second lease option was identical to the first lease option. The oil, gas, and mineral lease attached to the offer letter provided that Vantage was authorized to pool the tract owner's mineral interest into a pooled unit. The lease also allowed Vantage to drill a horizontal well beneath the surface of the leased premises, but could not conduct drilling operations on the surface of the lease.

The participation option provided each unleased owner an opportunity to participate as a working interest owner in the respective proposed unit. By electing this option, the owner would be responsible for his or her proportionate share of the costs of drilling and completing the well or wells in the unit and would share proportionately in the production from the well. Each offer letter had as an attachment an AFE (Authorization for Expenditure) indicating the estimated cost to complete and drill the relevant well. The estimated cost for Well No. 3H was $3,259,300; for the 4H, $3,259,100; for the 5H, $3,258,700; and for the 6H, $4,235,600. This option mandated that if the owner failed to fully pay his or her proportionate share of costs to Vantage within 15 days prior to commencement of actual drilling operations, then the owner would be subject to the non-consent penalties set forth in the standard Joint Operating Agreement (the "*JOA*") proposed by Vantage. Vantage represented to each owner that the proposed JOA would not contain any of the following: (1) a preferential right of the operator to purchase mineral interests in the unit; (2) a call on or option to purchase production from the unit; (3) operating charges that may include any part of district or central office expenses other than reasonable overhead charges; or (4) a prohibition against non-operators questioning the operation of the unit.

The farm-out option proposed to each unleased owner that he or she convey to Vantage an 80% net revenue interest attributable to his or her mineral interest and retain an overriding royalty interest equal to 20% of 8/8ths, proportionately reduced to the extent that each owner's mineral interest bears 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 electing owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

Matthew Montgomery, Vantage's landman, testified as to the pool offers made by Vantage for each of the four proposed pooled units involved. In response to Vantage's voluntary pooling offers, only one unleased owner within the proposed 5H Unit chose the first option - a 25% royalty with a $3,000 per acre bonus. Mr. Montgomery testified that Vantage received an "overwhelming non-response" by the majority of the voluntary pooling offers made by Vantage. Testimony indicated that Vantage sent each of the offer letters via certified mail and, therefore, received signed certified-mail receipts for those unleased owners who accepted the mail, but who did not respond.

Vantage believed that the lease terms included in its voluntary offer were fair and reasonable. Mr. Montgomery stated that Vantage has been successfully signing leases on the same terms ($3,000 per-acre bonus with a 25% royalty or $3,500 per-acre bonus with a 20% royalty) within the area since April 2012. The lease form attached to the offer letter was the same lease form that Vantage has used with the overwhelming number of lessors in the area, including the Rosedale North Unit and Rosedale West Unit. Montgomery considered Vantage's leasing terms competitive and consistent with the current market for Barnett Shale leases.

Estimated Recovery of MIPA Wells

Vantage's expert petroleum engineering witness, Mr. Rick Johnston, prepared a model to predict recovery from Barnett Shale wells with varying drainhole length. Johnston first presented a map showing Barnett Shale wells within a five-mile radius of the terminus point of the Rosedale North Unit No. 1H. Within this five-mile radius, Johnston found 434 wells for which there was adequate production data to consider them as a data point. He calculated the estimated ultimate recoveries (the "*EUR's*") by decline curve analysis and the estimated lateral drainhole length for these 434 wells. Using the EUR as the y-coordinate and the estimated drainhole length as the x-coordinate, he then created a scatter plot of the data points. A computer-generated least-squares regression of the plotted data points resulted in a line through the points with a positive slope of 0.3965 and a y-intercept of 949. The inference of this resulting equation is that an average well within the five-mile radius will recover 0.389 MMCF of gas for each incremental foot of drainhole length.

Mr. Johnston performed a volumetric calculation of gas in place beneath the four MIPA units. Relying on two cross-sections, he was confident that the Barnett Shale is approximately 330 feet thick throughout the MIPA units. Volumetric data introduced by Devon Energy at the 2005 field rules hearing indicated that original gas in place was 139 BCF per square mile (640 acres) where the average thickness of the Barnett Shale was 433 feet. Accounting for 330 feet thickness and a recovery factor of 45 percent, Johnston was able to calculate the volume of recoverable gas beneath each MIPA unit.

3H Unit: With 45.66 leased acres, the 3H Unit has, according to Devon's data, 3.4 BCF of recoverable gas beneath the leased acreage. The No. 3H Well has a proposed drainhole length of 5,351 feet. Using this length, the equation derived from the least-squares regression predicts that the No. 3H will have an EUR of 3.03 BCF. Mr. Johnston calculate that Protestant Brackeen-Qualls

has 4.09 MMCF of recoverable gas beneath her net unleased acreage, which is approximately 0.14% of the recoverable gas beneath the proposed 3H Unit.

4H Unit: With 45.12 leased acres, the 4H Unit has, according to Devon's data, 3.4 BCF of recoverable gas beneath the leased acreage. The No. 4H Well has a proposed drainhole length of 5,356 feet. Using this length, the equation predicts that the No. 4H will have an EUR of 3.03 BCF.

5H Unit: With 442.16 leased acres, the 5H Unit has, according to Devon's data, 3.1 BCF of recoverable gas beneath the leased acreage. The No. 5H Well has a proposed drainhole length of 5,332 feet. Using this length, the equation predicts that the No. 5H will have an EUR of 3.02 BCF.

6H Unit: With 63.29 leased acres, the 6H Unit has, according to Devon's data, 4.7 BCF of recoverable gas beneath the leased acreage. The No. 6H Well has a proposed drainhole length of 8,230 feet. Using this length, the equation predicts that the No. 6H will have an EUR of 4.15 BCF. Mr. Johnston also calculated Protestant Garner has 19.91 MMCF of recoverable gas beneath his net unleased acreage, which is approximately 0.42% of the recoverable gas beneath the proposed 6H Unit.

Based on these predicted EUR's, Mr. Johnston testified that he believes the MIPA wells will efficiently and fully drain the entirety of their respective units. The EUR equation predicts what an average well within the entire five-mile radius will recover, and Mr. Johnston expects the MIPA wells to perform better than average because they are located in a relatively high-performing area of the Barnett Shale.

Vantage's ideal development plan for the Rosedale North Unit is ultimately to drill 10 wells. The No. 1H has been drilled as the southernmost well on the Rosedale North Unit, and Vantage's Well No. 2H is planned to be drilled within the Unit. Additionally, Vantage received approval for Units 7H, 8H, 9H, and 10H in recently held Oil & Gas Docket Nos. 09-0284751, 09-0284752, 09-0284753, and 09-0284754, approved by Commission Final Orders on April 22, 2014. Further, Vantage has proposed to space these four MIPA wells in way in which the between-well spacing will result in the maximum recovery of the Barnett Shale gas reserves beneath each proposed unit and will allow the proposed wells to efficiently and effectively drain the entirety of the proposed units. This belief is based on Vantage's experience operating wells in the area, particularly to the east underneath Lake Arlington. Vantage contends, absent MIPA approval of the proposed wells, the underlying reserve could not be recovered and would therefore, be wasted.

Risk Penalty

Vantage believes that there still exists a certain amount of risk that drilling a Barnett Shale well in the area of the MIPA units will be uneconomic, meaning the well will not recover the cost of drilling and completing the well. Using a cost of drilling and completing equal to roughly $3.25 million, a monthly operating expense of $3,500, a gas price of $3.73 per MCF, a ten-year severance

tax exemption, and discounted to present value of 10%, Mr. Johnston calculated that the break-even recovery point, at which this cost would be recouped, was roughly 1.7 BCF.

Vantage stated that the petroleum evaluation industry characterizes the reserves underlying the proposed MIPA units as proved undeveloped, for which the industry applies a 50 to 60 percent risk factor. Applying a 60% risk factor, the anticipated recovery break-even point would be approximately 2.8 BCF.

Mr. Johnston used the Society of Evaluation Engineers 32nd Annual Survey of Parameters Used in Property Evaluation, dated June 2013, to support the applicability of the 10% discount factor and the 60 percent risk factor for proved, undeveloped reserves. In addition, Mr. Johnston provided a copy of the Texas Comptroller's Manual for Discounting Oil and Gas Income and testified that the method he used of discounting future cash flow and applying reserve adjustment factors is the same method required by the Comptroller.

Mr. Johnston also plotted the non-zero EURs for the wells within a 5-mile radius of the Rosedale North No. 1 well on a probability plot and determined that 30% of the wells are expected ultimately to recover at least 2.8 BCF, which is the risked break-even point. Conversely, 70% of the wells are expected ultimately to recover less than 2.8 BCF. He then testified that the results of this risked, probabilistic analysis support a charge for risk of three times payout. In his opinion and recognizing that the MIPA capped the charge for risk at 100%, or two times payout, Mr. Johnston testified that the 100% charge for risk would be appropriate.

As further evidence supporting a charge for risk of 100%, Vantage's petroleum land management expert, Mr. Montgomery, testified that at least seven private operating agreements in the area provide for a 400% recovery of costs advanced to a non-consenting owner.

Vantage requested that the Commission's forced-pooling order include a 100% risk penalty attached to the working-interest component. Vantage argued that the overriding purpose of the MIPA is to encourage voluntary pooling. According to Vantage, without imposition of a risk penalty, unleased small-tract owners would be encouraged to refrain from voluntarily leasing and negotiating so that they might benefit from forced pooling. Vantage believes this result would be contrary to its interpretation of the purpose of the statute.

PROTESTANTS' EVIDENCE

In protest of Vantage's 3H Unit application, Ms. Brackeen-Qualls testified that she did not believe Vantage's offer was fair and reasonable, as the highest per-acre lease bonus offer that she had received on her property in Vantage's Rosedale project was $5,000 per acre, but that she had received an offer of $26,000 per acre for her property in North Arlington. In her opinion, there was such a difference between the two offers because of the difference between the two areas. She stated that the disparity was based on racial prejudice because the Rosedale area was

originally a predominantly black community. Ms. Brackeen-Qualls stated that the lease offer of $26,000/acre on her North Arlington property was made in 2008. In response to Vantage's voluntary offer, Ms. Brackeen-Qualls made a counter offer of $26,000/acre and a 30% royalty, which in her opinion was a fair and reasonable offer.

In protest of Vantage's application for the 6H Unit, Mr. Garner testified that he considered Vantage's voluntary pooling offer not to be fair and reasonable because Vantage did not provide a copy of a joint operating agreement or a farm-out agreement with its offer, but instead offered to send copies of those agreements to the unleased owner if the unleased owner informed Vantage that he was interested in one of those options. However, it was evidenced that Mr. Garner did not request a copy of either agreement from Vantage, nor did Mr. Garner make any counter-offer to Vantage.

EXAMINERS' OPINION

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.[10] The evidence in this proceeding demonstrates that compulsory pooling is necessary to protect correlative rights.

Proposed MIPA Wells 3H, 4H, and 6H are wells that because of the locations of the unleased tracts within the respective proposed units, could not be drilled without compulsory pooling. Well 3H would cross three unleased tracts; Well 4H would cross four unleased tracts; Well 5H would cross three unleased tracts; and Well 6H would cross seven unleased tracts and six partially unleased tracts. Vantage will not – and cannot – drill these wells, as proposed, unless compulsory pooling is ordered because of the impracticality, if not impossibility, of drilling around the unleased tracts. Therefore, in the absence of compulsory pooling, each mineral interest owner within these proposed units would not be afforded a reasonable opportunity to recover his fair share of hydrocarbons.

Vantage's proposed compulsory pooling will protect correlative rights because the proposed wells will efficiently and effectively drain the proposed units. Forced pooling as proposed by Vantage, wherein the proposed well will drain the entire proposed unit, protects correlative rights because each tract owner, whether leased or unleased, will have his fair share of hydrocarbons produced. In contrast, forced pooling of tracts that will not drain the entire proposed unit fail to protect correlative rights because whatever reserves exist under those

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[10] Tex. Nat. Res. Code 102.011 (Authority of Commission); Smith & Weaver, Texas Law of Oil and Gas, Chapter 12, § 12.3[A][6] at page 12-23.

undrained tracts will remain unrecovered regardless of the drilling of the proposed MIPA well.[11] Vantage has undoubtedly learned from previous MIPA applications involving the Barnett Shale, and as a result, its applications do not suffer from this infirmity.

Furthermore, the wells and units proposed by Vantage would allow the Commission to fashion an order in compliance Section 102.017 of the MIPA, which requires that a compulsory pooling order be made on terms 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. Since all tracts within the proposed units would be drained by their respective wells, the owners of each tract would realize the opportunity to produce or receive their fair share.

The examiners believe that Vantage's voluntary pooling offer was fair and reasonable. Its offer followed the framework – providing a lease, participation, and farm-out option – that the Commission has determined to be fair and reasonable in other approved MIPA applications for the Barnett Shale. The one different element is that while the previously-approved offers gave unleased owners only one lease option to accept, Vantage offered two lease options involving a trade-off between lease bonus and royalty amounts. Assuming that the two offered lease options were comparable to one another and fair and reasonable, which the examiners believe they were, Vantage's offer appears even more flexible than the offers that provided only one lease option. Further, the options Vantage included in these voluntary pooling offers for the 3H, 4H, 5H, and 6H proposed units are the same options that were in the voluntary pooling offers presented in Oil & Gas Docket Nos. 09-0284751, 09-0284752, 09-0284753, and 09-0284754, which the Commission found to be fair and reasonable in April 2014.

Risk Penalty

Section 102.052 of the MIPA states the Commission shall make "provision in the pooling order for reimbursement ... of all actual and reasonable drilling, completion, and operating costs PLUS a charge for risk not to exceed 100 % of the drilling and completion costs."[12] The clear implication from the MIPA is that imposition of a "risk penalty" is to assure that the economic risk assumed in the drilling and completing of a well is reasonably shared by the operator and the working interest owners. The Commission has previously recognized the "standard for assessing a fair and reasonable risk penalty is the actual chance of a successful completion at the time the

[11] Smith and Weaver comment that "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." Texas Law of Oil and Gas, Vol. 3, Chapter 12, § 12.3[A][6] at pages 12-23 to 12-24.

[12] Tex. Nat. Res. Code 102.052 (emphasis added).

well [is] drilled."[13] Further, the Commission has also recognized that in the absence of evidence of risk, and where most wells drilled in the field appear to be commercially producible, the RRC has concluded a nominal risk penalty (e.g. 10%) is appropriate.[14]

Vantage has requested that a 100% risk penalty be assessed to the working interest portion of the force-pooling basis. Vantage contends without the imposition of a risk penalty, unleased small-tract owners would be encouraged to refrain from voluntarily leasing and negotiating so that they might benefit from forced pooling. However, the evidence presented by Vantage shows that there is virtually no risk of drilling a dry hole on the unit, and there was no evidence of dry holes, junked wells or marginal or otherwise uneconomic wells anywhere in the area. The only risk identified was the same mechanical risk encountered when any horizontal well is drilled. As stated in the Finley case: "it is the opinion of the examiners that imposition of a risk penalty against owners who have not consented to lease their tracts and are being pooled against their will is not fair or reasonable."[15]

Traditionally, Commission precedent has been to not assess a risk penalty against unleased owners who are being forcibly pooled. The working-interest portion of the force-pooled basis has been subjected to a zero risk penalty in the majority of the MIPA applications, starting with Finley, that the Commission has approved.[16] However, in the Commission's most recent Barnett Shale MIPA cases,[17] the Commission determined that a 50% risk penalty was fair and reasonable. At conference in discussing the assessment of the 50% risk penalty in the previous Vantage MIPA

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[13] Oil & Gas Dockets 3-77,090 & 3-79,517, the *Applications of General Production Corp. Et. Al., Giddings (Austin Chalk, Gas) Field, Lee County, Texas*, at page 6 (Final Order signed April 9, 1984.)

[14] Oil & Gas Docket 6-75,587, *Application of Panola Producing Company, Carthage (Cotton Valley) Filed, Panola County, Texas* (Final Order signed September 7, 1982).

[15] 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*, Amended PFD at page 8.

[16] The Commission has approved compulsory pooling in the Barnett Shale in the following dockets: 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; Oil & Gas Docket No. 09-0261375, Application of XTO Energy Inc. Pursuant to the Mineral Interest Pooling Act for the Proposed Rosen Heights 262-Acre Pooled Unit, Well No. 1H; Oil & Gas Docket No. 09-023416, Application of XTO Energy Inc. Pursuant to the Mineral Interest Pooling Act for the Proposed Wesco A1 Pooled Unit, Well No. 10H; Oil & Gas Docket No. 09-023417, Application of XTO Energy Inc. Pursuant to the Mineral Interest Pooling Act for the Proposed Page Street D1 Pooled Unit, Well No. 11H.

[17] Oil & Gas Docket Nos. 09-0284751, 09-0284752, 09-0284753, and 09-0284754, Applications of Vantage Fort Worth Energy LLC Pursuant to the Mineral Interest Pooling Act for the Formation of a Pooled Unit for the Rosedale North 7H-10H MIPA Units, Well Nos. 7H-10H, Newark, East (Barnett Shale) Field, Tarrant County, Texas.

cases, the Commisisoners indicated that a 50% risk penalty would establish precident that the Commission will allow risk penalty in appropraite circumstances.[18]

Here, while Vantage requested a 100% risk penalty be assessed to the working interest portion, the examiners believe that such a high penalty is not supported either by precident or the evidence provided by Vantage and therefore, it is not "fair and reasonable" as required by Section 102.017 of the MIPA. As explained below, the examiners believe that imposition of a 50% risk penalty based on the facts of this case, is fair and reasonable as is required by Section 102.017 of the MIPA.

First, under the Commission's practice of providing the unleased owners with a cost-free royalty at the market rate for leases in the area, the unleased owners are in as good or better position than all of the other lessors in the MIPA units. The charge for risk is applicable only to the reimbursement to the parties advancing costs that is required under MIPA Section 102.052 and that is made solely out of production. This would apply only to the portion of the unleased owners' mineral interest that is treated as a cost-bearing working interest.

Second, to support its position that there is significant risk involved in drilling Barnett Shale wells in the area, Vantage testified that, under its probabilistic analysis, only 1/3rd of the wells in the 5-mile radius are expected ultimately to recover 2.8 BCF, which Vantage calculates to be the risked break-even point under the existing petroleum evaluation engineering standards. Based on this analysis, Vantage contends that in its opinion a three-times-payout charge for risk would be appropriate. However, Vantage failed to substantiate its testimony with adequate underlying evidence which led to its conclusion that 1/3 of the wells in the area are expected to recover 2.8 BCF. In arriving at the 1/3 calculation, Vantage relied upon operator filings with the Commission. Specifically, Vantage concluded that a well had not been successful, and therefore a "zero producing" well, where a "Well Record Only" or Form G-1 (Gas Well Back Pressure Test,Completion or Recompletion Report, and Log) had been filed, but no other paperwork had been subsequently filed on that well. Mr. Montgomery testified that he concluded 38 wells within the 5-mile radius were unsuccessful based solely on no further paperwork being filed after the filing of a Form G-1.[19] Vantage's expert concluded that "there's something wrong with an operator would let them (the unsuccessful wells) sit that long."[20] However, the examiners do not find Mr. Montgomery's determination that the mere lack of an operator's failure to file additional paperwork as conclusive proof that a well is non-productive or otherwise unsuccessful. As such, they failed to carry their burden in support of the assessment of 100% penalty. Therefore, while the MIPA caps the charge for risk at 100%, or two times payout, Vantage failed to carry its burden in support of assessment of 100% risk penalty here. Additionally, historically

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[18] RRC Conference of March 25, 2014, video transcript at 26 mintues, 15 seconds.

[19] Mr. Montogomery's testimony was that 38 wells had a "zero value" production; however, a review of Exhibit 15 indicates actually 36 wells had the "WRO" (well record only) designation.

[20] Trans. Vol. 1, Pg. 50, ln. 13-14.

Commission precedent has been to not assess a maximum risk penalty against forced-pooled interest owners.

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, Vantage Fort Worth Energy ("*Vantage*"), at least 30 days prior to the hearing date.

2. Notice of the hearing was published in the Commercial Recorder on May 6, 13, 20 and 27, 2014.

3. Appendix 1 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat for the Rosedale North Unit and Rosedale West Unit (Vantage Exhibit No. 7), which also shows the external boundaries of the four proposed MIPA units, the proposed paths of the MIPA wells, and the unleased tracts within the Rosedale North Unit and Rosedale West Unit.

4. Appendix 2 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat (Vantage Exhibit No. 11A) for the proposed Rosedale North 3H MIPA Unit (the "*3H Unit*") showing the proposed wellbore path of Well 3H and the unleased and partially-leased tracts within the 3H Unit.

5. Appendix 3 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat (Vantage Exhibit No. 11B) for the proposed Rosedale North 4H MIPA Unit (the "*4H Unit*") showing the proposed wellbore path of Well 4H and the unleased and partially-leased tracts within the 4H Unit.

6. Appendix 4 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat (Vantage Exhibit No. 11C) for the proposed Rosedale North 5H MIPA Unit (the "*5H Unit*") showing the proposed wellbore path of Well 5H and the unleased and partially-leased tracts within the 5H Unit.

7. Appendix 5 to this proposal for decision, incorporated into this finding by reference, is a surveyed plat (Vantage Exhibit No. 11D) for the proposed Rosedale North 6H MIPA Unit (the "*6H Unit*") showing the proposed wellbore path of Well 6H and the unleased tracts within the 6H Unit.

8. Ms. Avis Brackeen-Qualls appeared at the hearing in opposition to Vantage's application for the 3H Unit.

9. Mr. William Garner appeared at the hearing in opposition to Vantage's application for the 6H Unit.

10. No one appeared at the hearing in opposition to Vantage's application for the 4H and 5H Units.

11. On April 22, 2014 Vantage sent a voluntary pooling offer to all mineral owners of unleased tracts within the boundaries of the proposed MIPA units. The unleased mineral owners were offered four options for inclusion of their interests in the proposed units: two lease options, a working-interest participation option, and a farm-out option.

a. The first lease option included a 25% royalty and a bonus offer of $3,000 per net mineral acre, for a three-year primary term. The oil, gas, and mineral lease attached to the offer letter provided that Vantage was authorized to pool the tract owner's mineral interest into a pooled unit and drill a horizontal well beneath the surface of the leased premises but could not conduct drilling operations on the surface of the lease.

b. The second lease option included a 20% royalty and a bonus offer of $3,500 per net mineral acre. Except for the different royalty and bonus amounts, this second lease option was identical to the first lease option.

c. The participation option provided each unleased owner an opportunity to participate as a working interest owner in the respective proposed unit. By choosing this option, the owner would be responsible for his or her proportionate share of the costs of drilling and completing the well or wells in the unit and would share proportionately in the production from the well. Each offer letter had as an attachment an AFE (Authorization for Expenditure) indicating the estimated cost to complete and drill the relevant well.

12. The estimated cost for Well No. 3H was $3,259,300; for the 4H, $3,259,100; for the 5H, $3,258,700; and for the 6H, $4,235,600. This option stated that if the owner failed to fully pay his or her proportionate share of costs to Vantage within 15 days prior to commencement of actual drilling operations, then the owner would be subject to the non-consent penalties set forth in the standard Joint Operating Agreement (the "JOA") proposed by Vantage.

13. Vantage represented to each owner that the proposed JOA would not contain any of the following: (1) a preferential right of the operator to purchase mineral interests in the unit; (2) a call on or option to purchase production from the unit; (3) operating charges that may include any part of district or central office expenses other than reasonable overhead charges; or (4) a prohibition against non-operators questioning the operation of the unit.

14. The farm-out option proposed to each unleased owner that he or she convey to Vantage an 80% net revenue interest attributable to his or her mineral interest and retain an

overriding royalty interest equal to 20% of 8/8ths, proportionately reduced to the extent that each owner's mineral interest bears 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 electing owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

15. Vantage provided the essential terms of the participation option and the farm-out option in its offer letter. Vantage did not enclose copies of its participation agreement or farm-out agreement, but instead offered to provide a copy of its participation agreement and farm-out agreement to any mineral owner who was interested in one or both of those options. None of the mineral owners expressed an interest in either the participation option or the farm-out option.

16. In response to Vantage's voluntary pooling offer, one unleased owner in the proposed 5H Unit accepted the option to lease at a 25% royalty with a $3,000 per acre bonus.

17. Protestant Avis Brackeen-Qualls responded to Vantage's offer by asking for a royalty of 30% and a lease bonus of $26,000/acre. There was no evidence of leases in the area with a 30% royalty, and Ms. Brackeen-Qualls based her counter-offer of $26,000/acre on an offer to lease in a different part of Tarrant County that was made in 2008, prior to the collapse in gas prices and the corresponding collapse in market value of leases. There was no evidence that Ms. Brackeen-Qualls counter-offer was fair and reasonable.

18. Protestant William Garner did not make a counter-offer to Vantage's voluntary pooling offer or enter into any negotiations with Vantage.

19. The lease bonus and royalty amounts included in Vantage's voluntary pooling offer are the same as those on which Vantage has been signing leases since spring 2012, and reflect the current market value for bonus and royalty and are fair and reasonable terms.

20. The lease form included in the voluntary pooling offer is the same form that Vantage entered into with the majority of lessors in the Rosedale North Unit, the Rosedale West Unit, and the surrounding area.

21. The options included in the voluntary pooling offer made by Vantage contained the same options as the voluntary pooling offer the Commission found to be fair and reasonable in April 2014 in Oil & Gas Docket Nos. 09-0284751, 09-0284752, 09-0284753, 09-0284754.

22. The tracts within each proposed MIPA unit are located in the Newark, East (Barnett Shale) Field, a common reservoir of oil or gas for which the Commission has established the size and shape of proration units. The Newark, East (Barnett Shale) Field is present and reasonably productive in the area covering all of the proposed units.

23. The Newark, East (Barnett Shale) Field was discovered in 1981. This field has special field rules providing for 330-foot lease-line spacing, and there is no between-well spacing

requirement. The standard drilling and proration unit for the Newark, East (Barnett Shale) is 320 acres. An operator is permitted to form optional drilling units of 20 acres.

24. Vantage estimated the volumetrically-calculated gas in place beneath the leased acreage within four proposed units. Using a 45 percent recovery factor, Vantage calculated that the recoverable gas in place beneath the leased acreage of the 3H Unit is 3.4 BCF; the 4H Unit is 3.4 BCF; the 5H Unit is 3.1 BCF; and the 6H Unit is 4.7 BCF.

25. Vantage created a scatter plot of the estimated ultimate recoveries (the "EURs") versus the estimated drainhole length for Barnett Shale wells within five miles of the Rosedale North Unit Well No. 1H. A computer-generated least-squares regression of the data points on the plot resulted in a line with a positive slope of 0.389 and a y-intercept of 949 MMCF. Vantage inferred that the equation for this line means that an average well in the area will recover 949 MMCF of gas plus an additional 0.389 MMCF for each incremental foot of drainhole length.

a. The proposed drainhole length of Well No. 3H is 5,351 feet. Based on this length, the equation predicts an EUR of 3.03 BCF.

b. The proposed drainhole length of Well No. 4H is 5,356 feet. Based on this length, the equation predicts an EUR of 3.03 BCF.

c. The proposed drainhole length of Well No. 5H is 5,332 feet. Based on this length, the equation predicts an EUR of 3.02 BCF.

d. The proposed drainhole length of Well No. 6H is 8,230 feet. Based on this length, the equation predicts an EUR of 4.15 BCF.

26. Vantage cannot and will not drill the four proposed wells unless compulsory pooling is ordered as requested.

a. Proposed Well 3H cannot be drilled without compulsory pooling of multiple tracts. The 3H would traverse three unleased tracts.

b. Proposed Well 4H cannot be drilled without compulsory pooling of multiple tracts. The 4H would traverse four unleased tracts.

c. Proposed Well 5H cannot be drilled without compulsory pooling of multiple tracts. The 5H would traverse three unleased tracts.

d. Proposed Well 6H cannot be drilled without compulsory pooling of multiple tracts. The 6H would traverse seven unleased and six partially unleased tracts.

27. There are no regular locations within the proposed units where a feasible horizontal well that would efficiently and effectively drain the proposed unit might be drilled.

28. The proposed MIPA wells will efficiently drain the proposed MIPA units.

29. Compulsory pooling within each of the four units as requested by Vantage will protect the correlative rights and prevent waste. Without compulsory pooling, Vantage will not be able to drill the proposed wells, Vantage and its lessees will not have a reasonable opportunity to recover their fair share of hydrocarbons from the reservoir, and the underlying hydrocarbons will be left unrecovered.

30. Vantage presented evidence supporting a charge for risk of 50 percent of the drilling and completion costs of the respective well.

a. Vantage's engineering expert plotted the estimated ultimate recoveries for the wells within a 5-mile radius of the Rosedale North No. 1 well on a probability plot and determined that 33% of these wells are expected ultimately to recover at least 2.8 BCF, which is the risked break-even point. Under this probabilistic analysis,66% of the wells are expected ultimately to recover less than 2.8 BCF.

b. Seven private operating agreements in the area provide for a non-consent penalty equivalent to a charged risk penalty of 300%.

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. The Commission has jurisdiction over the parties and the subject matter and has authority to issue a compulsory pooling order pursuant to Texas Natural Resources Code § 102.011.

3. Vantage made a fair and reasonable offer to pool voluntarily to the owners of the unleased tracts within each of the proposed units, as required by Texas Natural Resources Code § 102.013.

4. Compulsory pooling of the owners of the unleased tracts within each of the proposed proration units as owners of a 25% royalty and 75% working interest, proportionately reduced, with these owners' share of expenses, subject to a charge for risk of 50%, payable only from the owners' working-interest component, and subject to a no-surface-use restriction, is fair and reasonable within the meaning of Texas Natural Resources Code § 102.017.

5. Compulsory pooling of the mineral interests in all tracts within the boundaries of the 3H Unit, 4H Unit, 5H Unit, and 6H Unit will serve the purpose of protecting correlative rights.

6. The terms and conditions of the Commission's Final Order in this proceeding are fair and reasonable and will afford the owner of each tract or interest in each respective unit the opportunity to produce or receive his fair share.

RECOMMENDATION

The examiners recommend that Vantage's applications be **APPROVED**, subject to conditions, as set forth in the attached recommended Final Orders.

Respectfully Submitted,

Laura E. Miles-Valdez
Hearings Examiner

Paul Dubois
Technical Examiner