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LINDIL C. FOWLER, JR., *GENERAL COUNSEL*
COLIN K. LINEBERRY, *DIRECTOR*
HEARINGS SECTION

RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

July 21, 2009

OIL & GAS DOCKET NO. 09-0261375

APPLICATION OF XTO ENERGY, INC. PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE PROPOSED ROSEN HEIGHTS 262.192045 ACRE POOLED UNIT, WELL NO. 1H, NEWARK, E. (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS.

APPEARANCES FOR APPLICANT XTO ENERGY, INC.

David Gross
Rick Johnston
Paten Morrow
Keith Sawyer
Mike Williams
Richard Wilde
Fred Ibarra
Jay Frazier

APPEARANCES BY MINERAL INTEREST OWNERS:

Mark D. Hixson
Ervin Briggs, Sr.

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATION FILED:	March 23, 2009
NOTICE OF HEARING ISSUED:	April 20, 2009
HEARING CONVENED:	May 22, 2009
SUPPLEMENTAL NOTICE ISSUED:	June 3, 2009
RECORD CLOSED:	July 6, 2009
HEARD BY:	Mark Helmueller, Hearings Examiner Donna Chandler, Technical Examiner
PFD CIRCULATION DATE:	July 21, 2009

STATEMENT OF THE CASE

This hearing was called on the request of XTO Energy, Inc. (hereinafter "XTO") pursuant to the Mineral Interest Pooling Act for the proposed Rosen Heights 262.192045 Acre Unit, Well No. 1H, Newark, E. (Barnett Shale) Field, Tarrant County, Texas. Notice of hearing was provided to all mineral interest owners in the proposed unit at the addresses provided by XTO to the Commission. Notice of hearing was also published in the Fort Worth Star Telegram, a newspaper of general circulation in Tarrant County on April 19 and 26, and May 3 and 10, 2009.

Subsequent to the hearing, it was determined that several notices issued by the Commission had been returned with the notation from the post office "no such number." XTO provided supplemental address information to the Commission for nine of the returned notices. A supplemental notice was issued on June 4, 2009. Two of the supplemental notices were also returned to the Commission with the notation from the post office "no such number." The record was closed on July 6, 2009, 30 days after the issuance of the supplemental notice.

DISCUSSION OF THE EVIDENCE

XTO's proposed Rosen Heights No. 1H Well would be drilled underneath a 262.192045 acre unit composed of 770 individually owned tracts.¹ The tracts are in the Rosen Heights neighborhood of Fort Worth, a residential subdivision approximately four miles from downtown. The tracts are primarily single family residences on lots averaging approximately .2 to .25 acres, however, due to the age of the subdivision, there are many vacant tracts.

The proposed Rosen Heights 1H well would be drilled with a 4320' lateral in the Newark, E. (Barnett Shale) Field. The lateral would run roughly north-south from the penetration point in the formation to the terminus of the lateral. The producing portion of the lateral would directly underlie 8 unleased tracts and would be within 330 feet of 53 unleased tracts. XTO has not filed a drilling permit application with the Commission for the proposed Rosen Heights 1H well. A copy of a plat showing the unit configuration and proposed well bore is included as Attachment A.

XTO currently holds the mineral rights in 648 tracts. 66 tracts are unleased and XTO can confirm receipt of their voluntary pooling offer by the record owners of the tracts, but no response was received. 24 tracts are controlled by the City of Fort Worth as a result of various liens. These tracts are not under lease, but the City has agreed to participate in the proposed well. The owner of two tracts rejected XTO's offer to participate because the bonus payment in the offer was too low. For the remaining 30 tracts, XTO was unable to locate the record owner. Under the proposed application, XTO seeks forced pooling authority to add the 68 tracts which have either refused to lease or chose not to participate by declining to respond to XTO's voluntary pooling offer. XTO also seeks to force pool the 30 tracts for which it could not locate the record owner.

¹The surface location for the proposed well would be located outside of the proposed unit.

XTO asserts it has made a fair and reasonable offer to all unleased mineral interest owners to participate in the proposed unit. XTO's basic offer is described in an election letter circulated in February 2009 to unleased mineral interest owners. A copy of the election letter is included as Attachment B to this proposal for decision. The offer focuses on four basic provisions with respect to participation in the proposed Rosen Heights Well No. 1H: 1) a bonus payment of \$2,400.00 per acre; 2) a lease with 4 year primary term; 3) a 25% royalty interest, and 4) participation in production based upon the tract's proportionate contribution to acreage to the entire unit multiplied by the 25% royalty interest. For an average sized lot in the proposed unit, the bonus payment would be \$600.00. The election offer notes that the property owner only had 14 days to respond. The letter further advises that a failure to take any action would be deemed a refusal to voluntarily pool and XTO would seek to involuntarily pool the mineral interest under the Mineral Interest Pooling Act.²

Nine owners entered into a lease agreement after XTO circulated its voluntary pooling offer. Additionally, the City of Fort Worth agreed to participate on an unleased basis with a 25% royalty interest for 24 lots it manages due to various foreclosed liens.

XTO contends that the amount of the bonus payment and royalty interests are consistent with the current leasing market in Tarrant County. XTO asserts that because participation will be on a proportionate acreage basis for both existing leases and any forced pooled tracts, the voluntary pooling offer satisfies the yardstick basis requirement.

XTO acknowledges that the terms of the leases for the 648 tracts it holds are not uniform. XTO acquired leases through its own activities, and by assignment from Keystone Exploration, Inc., and Chesapeake Energy Corporation. The primary terms for leases vary from 2 years to 5 years. Bonus payments range from \$230.00 per acre for leases entered into in 2006 to a high of \$25,000.00 per acre for a lease entered into in September or October 2008 according to the testimony of Mr. Hixson, one of the mineral interest owners who attended the hearing. XTO did not identify by lease the percentage of royalty interest and whether the percentage amount varied from lease to lease.

XTO's summary of the lease terms shows the average bonus payment made to mineral interest owners under lease is \$5,715.33 per acre. XTO urges that this average is skewed by a December 5, 2008 lease it entered into with the City of Fort Worth for the 46.6231 acre Marine Creek Park. The Marine Creek Park Lease was obtained through a public bidding process in May 2008. The bonus payment on this lease was \$17,711.00 per acre. Excluding this acreage, the average lease bonus is \$2,396.10 per acre, an amount consistent with XTO's opinion regarding the current leasing market in Tarrant County.

²XTO also included two other options for participation in the proposed unit. Option 2 allows for participation as a working interest owner. Under this option, a one time payment based on the amount of acreage was estimated for the proportionate share of the costs to drill and complete the well. Option 3 allows for participation through a farmout by the conveyance of an 80% net revenue interest to XTO and the retention of a 20% overriding royalty interest with an option to convert the retained override to a working interest.

XTO's summary also shows that 230 leases were entered into with Keystone in April 2006 and August 2006 for which a flat bonus payment of \$125.00 was made.³ All of these leases included a three year primary term. The nine April leases have already expired. The August 2006 leases all expire on or before August 29, 2009.

XTO admits that not all of the acreage within the perimeter of the proposed unit will be drained by the proposed well. XTO was unable to estimate which acreage would contribute to production and which acreage would be unaffected, but did note that the acreage located in the far western portion of the proposed unit is less likely to be drained.

APPLICABLE AUTHORITY

Texas Natural Resources Code Section 102.011 provides as follows with respect to the authority of the Commission with respect to forced pooling:

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 this code 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.

Texas Natural Resources Code Section 102.013 sets forth the requirements of a voluntary pooling offer:

- (a) The applicant shall set forth in detail the nature of voluntary pooling offers made to the owners of the other interests in the proposed unit.
- (b) The commission shall dismiss the application if it finds that a fair and reasonable offer to pool voluntarily has not been made by the applicant.
- (c) An offer by an owner of a royalty or any other interest in oil or 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 shall be considered a fair and reasonable offer.

³Due to differences in lot size, the per acre bonus payment ranges between \$250.00 and \$950.00 for these leases.

Texas Natural Resources Code Section 102.082 addresses the termination of a pooled unit under the Mineral Interest Pooling Act:

A unit is automatically dissolved:

- (1) one year after its effective date if no production or drilling operations have been had on the unit;
- (2) six months after the completion of a dry hole on the unit; or
- (3) six months after cessation of production from the unit.

EXAMINERS' OPINION

The Mineral Interest Pooling Act requires the Commission to determine whether an offer to voluntary pool interests which are not under lease is fair and reasonable. This jurisdictional determination is required before the Commission can consider an application to force pool any unleased interests into a single unit as requested by XTO in its application. The evidence in this case was not sufficient to establish that a fair and reasonable offer was made. Accordingly, the Commission is required to dismiss XTO's application.

XTO's voluntary pooling offer has four basic provisions regarding participation in its proposed Rosen Heights Well No. 1H: 1) a bonus payment of \$2,400.00 per acre; 2) a lease with 4 year primary term; 3) a 25% royalty interest, and 4) participation in production based upon the tract's proportionate contribution to acreage to the entire unit multiplied by the 25% royalty interest. None of these basic provisions are consistent with a fair and reasonable offer as required under the Mineral Interest Pooling Act.

The standard to be applied to a determination of whether an offer is "fair and reasonable" is judged from the viewpoint of the party being force pooled. (See *Windsor Gas Corp. v. Railroad Commission of Texas* 529 S.W.2d 834, 837 Tex.Civ.App - Austin 1975, writ dism'd as moot) Accordingly, in analyzing whether XTO's voluntary pooling offer is fair and reasonable, it must be viewed from the standpoint of the mineral interest owners which have refused or failed to respond to the pooling offer. Under this standard, XTO failed to show that the offer is fair and reasonable.

The most problematic issue in evaluating XTO's voluntary pooling offer is the amount of bonus payment offered for participation. XTO asserts a bonus payment of \$2,400.00 per acre is consistent with the market conditions for leasing at the time of the offer. XTO urges after excluding the City of Fort Worth Marine Creek Park land that the average bonus payment to its leased owners in the proposed unit is consistent with the market conditions in February 2009.

The issue of the fairness and reasonableness of the lease bonus payment presented in XTO's voluntary pooling offer is distinct from the facts raised in two other recent Mineral Interest Pooling Act cases determined or under consideration by the Commission. In 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, E. (Barnett Shale) Field, Tarrant County, Texas* (Final Order entered August 25, 2008) the applicant, Finley, offered a \$2,100.00 per acre bonus payment, the maximum amount made to any participant in the unit at the time its voluntary pooling offer was circulated in January 2007. Similarly, in Oil & Gas Docket No. 09-0260202: *Application of XTO Energy, Inc., for the Formation of a Unit Pursuant to the Mineral Interest Pooling Act for its Texas Steel "A" Unit, Well No. 1, Newark, E. (Barnett Shale) Field, Tarrant County, Texas* (Oral Argument heard July 14, 2009) XTO offered a \$15,000.00 per acre bonus payment in its voluntary pooling offer circulated in October 2008. The evidence offered by XTO in the Texas Steel "A" docket indicated that the \$15,000.00 per acre lease bonus payment was the maximum amount it had negotiated for other tracts XTO had under lease in the proposed unit.

XTO urges the amount of the bonus payment in its voluntary pooling offer is reasonable based on market conditions existing at the time of the offer. XTO also contends a selective analysis of the actual bonus amounts paid is also consistent with the amount it offered and therefore further supports the reasonableness of its offer.

While XTO urges that market conditions make its offer with respect to bonus payments fair and reasonable, when viewed from the perspective of the mineral interest owner as required under *Windsor*, one cannot accept this contention. XTO's position on this matter is complicated by its acquisition of leases by assignment which were negotiated by third parties in a competitive leasing market. It is also clear from the evidence that more than one company was actively engaged in leasing mineral interests in the Rosen Heights subdivision in the last three years.

There is extensive evidence which conflicts with XTO's position that the \$2,400.00 per acre bonus (approximately \$600.00 for an average sized lot) in its voluntary pooling offer is fair and reasonable when considered from the viewpoint of the unleased mineral interest owners. The testimony of Mr. Hixson indicates that his bonus payment was \$25,000.00 per acre for a lease signed in September or October 2008. XTO's lease terms summary notes several leases signed in August 2008 with a bonus payment of \$22,500.00 per acre. Additionally, the evidence shows that in a competitive public bidding process, XTO offered a bonus payment of \$17,711.00 per acre for the City of Fort Worth Marine Creek Park lands. Finally, XTO's own summary of lease terms indicates that the average for all of the participating tracts was \$5,715.33, more than twice the bonus amount in XTO's voluntary pooling offer to the remaining unleased owners.

Viewing a voluntary offer made in a competitive leasing market from the perspective of an unleased mineral interest owner, it would be reasonable for the mineral interest owner to reject an offer which significantly undercuts the bonus payments paid within the past 6 months to other individuals participating in the unit. When evaluating the issue from the perspective of an unleased mineral interest owner, one cannot conclude a take it or leave it offer with a bonus payment 90% below leases entered into only 4 months before the voluntary offer was circulated and more than 50% less than the average for all properties held by XTO in the proposed unit was fair and reasonable.⁴

The second element to evaluate in the voluntary pooling offer is the four year primary term. The length of the primary term may not be dispositive when standing alone, however, from the vantage of an unleased mineral interest owner, it may be a reasonable basis to reject or refuse to respond to a voluntary pooling offer. Under Texas Natural Resources Code Section 102.082, a forced pooled unit is automatically dissolved one year after its effective date if no production or drilling operations occur. Viewed from the standpoint of the unleased mineral interest owner, an offer for voluntary pooling with a primary term of four years is less advantageous than the one year term provided by the statute. Additionally, it can be argued that an offer may not be "fair and reasonable" when it provides the offeror with greater rights than those provided by statute.

The third and fourth elements of the offer relate to the percentage royalty interest and participation in the unit. In both the *Finley* and *Texas Steel "A"* dockets, the evidence suggests a uniformity in the voluntary pooling offer with the most favorable terms offered to the leased mineral interest owners. Due to the disparity in bonus payment amounts, there is some question whether the a 25% royalty in this voluntary pooling offer to the unleased mineral interest owners is also consistent with the most favorable amount negotiated with leased mineral interest owners. While XTO may be able to establish that the percentage royalty in the voluntary pooling offer to unleased mineral interest owners is consistent with the most favorable amount negotiated for leased mineral interest owners in the unit, no evidence was submitted on whether the percentage royalty was consistent with the amount negotiated with other mineral interest owners in the unit. Therefore it would not be possible to make a finding in this docket that a 25% royalty represents a fair and reasonable offer when evaluated from the viewpoint of the mineral interest owner.

The participation formula is relevant to XTO's argument that all parties are participating equally. XTO asserts that because production is allocated by the ratio of an individual's acreage to the total unit acreage, each owner is participating on the same yardstick basis. However, as in this case, if any acreage is included in the unit which will not be drained by the unit well, the interests of the property owners whose acreage contributes to production are diluted by inclusion in the proposed unit any tracts that will not contribute to the production of the unit well.

⁴If XTO's voluntary offer had been at either the average of \$5,715.33 per acre (approximately \$1,150.00 per average sized lot) or the maximum bonus payment amount of \$25,000.00 per acre (approximately \$5,000.00 per average sized lot), a much stronger argument could be made that the offer was fair and reasonable with respect to the bonus payment amount. It is also likely that more mineral interest owners would have agreed to terms voluntarily.

In *Railroad Commission v. Broussard*, 755 S.W.2d 951 (Tex. App.- Austin 1988, writ denied) the court found that a voluntary pooling offer was not fair and reasonable when it proposed to include acreage in a unit which would not contribute to production, that is, acreage which would not be drained by the unit well. In *Broussard*, the inclusion of acreage which would not be drained by the unit well in a proposed unit was found to violate the fair and reasonable requirement for a voluntary pooling proposal because it improperly diluted the interests of property owners whose acreage was contributing to production. XTO admitted in the hearing that it was unlikely that the proposed well would drain from acreage in the far western portion of the unit. The inclusion of acreage which would not contribute to the production of the unit well is detrimental to the unleased productive acreage XTO seeks to force pool. Accordingly, with respect to the 8 unleased mineral interest owners whose tracts would be traversed by the well bore, and the 56 unleased mineral interest owners whose acreage would contribute to production of the unit well because their property is located within 330 feet of the wellbore, the voluntary pooling offer is not fair and reasonable.

When viewed from the unleased mineral interest owners' perspective, as required under *Windsor*, none of the four basic elements of XTO's voluntary offer meets the fair and reasonable standard. Furthermore, when considered collectively, it cannot be concluded that the voluntary offer as a whole, was fair and reasonable. Accordingly, the examiners recommend XTO's application be dismissed as required by Texas Natural Resources Code Section 102.013.

Based on the record in this docket, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. This hearing was called on the request of XTO Energy, Inc. (hereinafter "XTO") pursuant to the Mineral Interest Pooling Act for the proposed Rosen Heights 262.192045 Acre Unit, Well No. 1H, Newark, E. (Barnett Shale) Field, Tarrant County, Texas. The proposed Rosen Heights Unit, Well No. 1H is a 770 tract pooled unit. Under the proposed application, XTO seeks forced pooling authority to include 68 tracts which have either refused to lease or made an election not to participate by declining to respond to XTO's voluntary pooling offer. XTO also seeks to include 30 tracts for which it could not locate the record owner.
2. Notice of hearing was provided to all mineral interest owners in the proposed unit at the addresses provided by XTO to the Commission issued on April 20, 2009.
3. Notice of hearing was published in the Fort Worth Star Telegram, a newspaper of general circulation in Tarrant County on April 19 and 26, and May 3 and 10, 2009.

4. XTO provided supplemental address information to the Commission for nine returned notices with the notation from the post office "no such number." Supplemental notice was issued on June 4, 2009. Two of the supplemental notices were also returned to the Commission with the notation from the post office "no such number." No response was received to the supplemental notices.
5. The proposed Rosen Heights 1H well would be drilled with a 4320' lateral in the Newark, E. (Barnett Shale) Field. The lateral would run roughly north-south from the penetration point in the formation to the terminus of the lateral. The producing portion of the lateral would directly underlie 8 unleased tracts and would be within 330 feet of 53 unleased tracts.
6. XTO has not filed a drilling permit application with the Commission for the proposed Rosen Heights 1H well.
7. XTO currently holds the mineral rights in 648 tracts of the 770 tract proposed unit.
 - A. 66 tracts are unleased and XTO can confirm receipt of their voluntary pooling offer by the record owners of the tracts but no response was received.
 - B. 24 tracts are controlled by the City of Fort Worth as a result of various foreclosure liens. These tracts are not under lease, but the City has agreed to participate in the proposed well.
 - C. The owner of two tracts rejected XTO's offer to participate.
 - D. XTO was unable to locate the record owner for 30 tracts.
8. The terms of the leases for the 648 tracts XTO holds are not uniform. XTO acquired leases through its own activities, and by assignment from Keystone Exploration, Inc., and Chesapeake Energy Corporation.
 - A. The primary terms for leases vary from 2 years to 5 years.
 - B. Bonus payments range from \$230.00 per acre for leases entered into in 2006 to a high of \$25,000.00 per acre for a lease entered into in September or October 2008.
 - C. XTO did not identify by lease the percentage of royalty interest granted to its lessees of whether the percentage amount varied from lease to lease.
 - D. The average bonus payment made to mineral interest owners under lease is \$5,715.33 per acre.

9. 230 leases held by XTO through assignment were entered into in April 2006 and August 2006. All of these leases included a three year primary term. The nine April 2006 leases have already expired. The remaining August 2006 leases all expire on or before August 29, 2009.
10. In February 2009, XTO made a voluntary pooling offer to unleased interest owners with four basic provisions.
 - A. a bonus payment of \$2,400.00 per acre;
 - B. a lease with 4 year primary term;
 - C. a 25% royalty interest; and
 - D. participation in production based upon the tract's proportionate relationship to acreage in the entire unit multiplied by the 25% royalty interest.
11. The proposed Rosen Heights Well No. 1H will not drain all of the acreage in the proposed unit.


CONCLUSIONS OF LAW


1. Proper notice of hearing was timely issued to the appropriate persons entitled to notice.
2. All things necessary to the Commission attaining jurisdiction have occurred.
3. The voluntary pooling offer made by XTO to unleased interest owners was not fair and reasonable as required under Texas Natural Resources Code Section 102.103.
4. Because the voluntary pooling offer was not fair and reasonable, Texas Natural Resources Code Section 102.013 requires dismissal of this application.

RECOMMENDATION

The examiners recommend XTO's application pursuant to the Mineral Interest Pooling Act for the proposed Rosen Heights 262.192045 Acre Unit, Well No. 1H, Newark, E. (Barnett Shale) Field, Tarrant County, Texas be dismissed.

Respectfully submitted,


Mark J. Helmueller
Hearings Examiner


Donna Chandler
Technical Examiner