

**RAILROAD COMMISSION OF TEXAS
OFFICE OF GENERAL COUNSEL
HEARINGS SECTION**

OIL & GAS DOCKET NO. 09-0265924

APPLICATION OF CHESAPEAKE OPERATING, INC. PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE FORMATION OF THE PROPOSED 50.371-ACRE GLEN GARDEN MIPA UNIT, WELL NO. 1H, NEWARK, EAST (BARNETT SHALE) FIELD, TARRANT COUNTY, TEXAS

FINAL ORDER

The Commission finds that, after statutory notice in the above-numbered docket, heard on September 10, 2010, the examiners have made and filed a report and proposal for decision containing findings of fact and conclusions of law, which was served on all parties of record, and that this proceeding was duly submitted to the Railroad Commission of Texas at conference held in its offices in Austin, Texas.

The Commission, after review and due consideration of the proposal for decision and the findings of fact and conclusions of law contained therein, and any exceptions and replies thereto, hereby adopts as its own Findings of Fact Nos. 1-2 and 5-8 and Conclusions of Law Nos. 1-2 contained therein, and incorporates said findings of fact and conclusions of law as if fully set out and separately stated herein. In addition, the Commission makes the following substitute finding of fact:

Substitute Finding of Fact No. 9

9. On April 28, 2010, Chesapeake sent the unleased owners within the perimeter of the proposed MIPA unit a formal offer to pool voluntarily. This was an offer of a working interest participation only and the offer stated that all offers to lease were withdrawn. Taking into consideration those relevant facts, existing at the time of the offer, which would be considered important by a reasonable person in entering into a voluntary agreement considering oil and gas properties, and when judged from the standpoint of the unleased owners being forced to pool, the Chesapeake voluntary pooling offer was not fair and reasonable.
 - a. The only option provided to the unleased owners by the offer was a working interest participation, which required the unleased owners to commit to contributions in the range from \$4,571.14 to \$27,482.74 prior to the drilling of the well. The proportionate cost to the three unleased residential owners, as stated in Chesapeake's voluntary pooling offer, was \$27,482.74 in the case of Erma Taylor Mitchell, \$22,351.21 in the case of Christine Barrett, and \$19,037.70 in the case of Ricardo Sanchez.

- b. The Chesapeake voluntary pooling offer stated that “All offers to lease your tract are hereby withdrawn.” Chesapeake’s voluntary pooling offer to the unleased owners required by §102.013 of the MIPA did not include an option to lease on terms comparable to those on which other tracts in the proposed unit were leased, taking into consideration the facts that existed at the time the lease offers were made. Providing the unleased owners with an option to lease would not have required the unleased owners to pay a pro rata share of the costs of the proposed well.
- c. Chesapeake’s voluntary pooling offer of a working interest participation required the unleased owners of small residential tracts of land to commit, within 14 days, to pay to Chesapeake substantial sums of money, up to \$27,482.74, in advance of drilling the proposed MIPA well as their pro rata share of drilling and completion costs, or, if the unleased owners did not have the money to invest in Chesapeake’s well, to bear a 100% risk penalty in order to have their pro rata share of well costs reimbursed out of their pro rata share of production.
- d. A voluntary pooling offer of a working interest participation, standing alone, may be unfair and unreasonable when judged from the standpoint of unleased owners of small residential tracts of land who are unable to accept the offer without subjecting themselves to a 100% risk penalty.
- e. Drilling of horizontal gas wells in the Barnett Shale formation does not involve extraordinary risk. Imposition of a 100% risk penalty on the unleased owners of small residential tracts of land proposed to be force pooled for the privilege of being carried as working interest owners in a horizontal gas well to be drilled in this area of the Barnett Shale is not fair and reasonable.
 - i. At the time of Chesapeake’s voluntary pooling offer, Chesapeake already had drilled four horizontal wells on the 192.161-acre Glen Garden voluntary pooled unit, with apparent success. No evidence was presented by Chesapeake to establish that any extraordinary operational difficulties or costs were experienced in the drilling of these four wells.
 - ii. The Barnett Shale is present and productive throughout the area of the proposed MIPA unit and there is consistent formation thickness and rock quality across the acreage in the proposed MIPA unit.
 - iii. Chesapeake projected that the proposed MIPA well will recover a sufficient amount of gas to achieve a 10% rate of return on investment.

- f. There are risks inherent in the ownership of working interests that are not associated with the ownership of royalty interests. Owners of working interests are liable for their pro rata share of all well costs, including drilling and completion costs, standard operating costs, costs of workovers or other well repairs, and plugging costs, among others. The owner of a working interest realizes a return on investment only if the well in which he has invested pays out all of its costs. Depending on the terms of his lease, a royalty owner is the owner of an interest that is basically cost free. A royalty owner is entitled to be paid his royalty on production of the well from the first day of production regardless of whether the well ever pays out all of its costs.
- g. The risks, liabilities, and obligations of working interest owners, as compared to the attributes of royalty interest ownership, are reasons why a voluntary pooling offer of a working interest participation only may be a disincentive to unleased owners of small residential tracts of land to accept the offer and be unfair and unreasonable when judged from the standpoint of such owners.
- h. The fact that ownership of a working interest over the life of a well possibly will result in greater earnings to the owner than a royalty interest if the well has average well costs and is highly successful in its recovery does not necessarily mean that an offer to pool voluntarily that provides no alternative other than a working interest participation is fair and reasonable when judged from the standpoint of an unleased owner of a small residential tract of land. What a well ultimately will recover, and what well costs will be experienced, cannot be judged by unleased owners of small residential tracts of land at the time the voluntary pooling offer is extended, and from the standpoint of these owners, the possible greater reward may be outweighed by the greater risk.
- i. Chesapeake's failure to provide the unleased owners with a copy of Chesapeake's proposed Joint Operating Agreement with the voluntary pooling offer was not fair and reasonable.
 - i. A Joint Operating Agreement did not accompany the voluntary pooling offer sent to the unleased owners by Chesapeake.
 - ii. The voluntary pooling offer stated that if the unleased owners elected to participate as working interest owners, Chesapeake would forward to the unleased owners a Joint Operating Agreement which would be a standard AAPL Joint Operating Agreement, being the same form Chesapeake had used for working interest owners participating in Chesapeake's wells in the area.

- iii. Chesapeake's voluntary pooling offer required the unleased owners to elect to participate in the proposed unit as working interest owners before the unleased owners were provided with a copy of the Joint Operating Agreement.
- iv. A Joint Operating Agreement is the basic agreement that defines the rights, obligations, and liabilities of the working interest owners and the relationship of the operator and the non-operating working interest owners.
- v. The Joint Operating Agreement in effect for the 192.16-acre Glen Garden voluntary pooled unit, which is the agreement that Chesapeake expected the unleased owners to sign if they elected to become working interest participants, is an AAPL Form 610-1982 Model Form Operating Agreement with more than 40 modifications made by Chesapeake by strike through of pre-printed provisions in the AAPL form, or by insertions of additional provisions.
- vi. Some of the modifications in the AAPL Form 610-1982 Model Form Operating Agreement made by Chesapeake concern matters which might be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties.

Therefore, it is **ORDERED** by the Railroad Commission of Texas that the application of Chesapeake Operating, Inc., for formation of the Glen Garden MIPA Unit, Newark, East (Barnett Shale) Field, Tarrant County, Texas, pursuant to the Mineral Interest Pooling Act is hereby **DISMISSED WITHOUT PREJUDICE**.

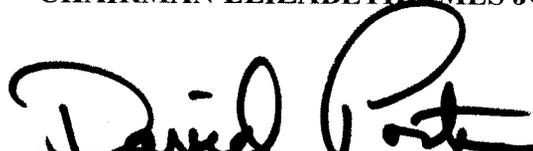
It is further **ORDERED** by the Commission that this order shall not be final and effective until 20 days after a party is notified of the Commission's order. A party is presumed to have been notified of the Commission's order three days after the date on which the notice is actually mailed. If a timely motion for rehearing is filed by any party of interest, this order shall not become final and effective until such motion is overruled, or if such motion is granted, this order shall be subject to further action by the Commission. Pursuant to TEX. GOV'T CODE §2001.146(e), the time allotted for Commission action on a motion for rehearing in this case prior to its being overruled by operation of law, is hereby extended until 90 days from the date the parties are notified of the order.

Each exception to the examiner's proposal for decision not expressly granted herein is overruled. All requested findings of fact and conclusions of law which are not expressly adopted herein are denied. All pending motions and requests for relief not previously granted or granted herein are denied.

Done this 25th day of October, 2011, in Austin, Texas.

RAILROAD COMMISSION OF TEXAS

CHAIRMAN ELIZABETH AMES JONES

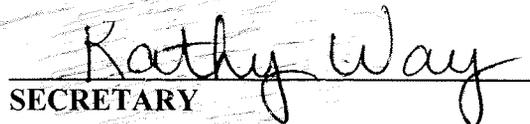


COMMISSIONER DAVID PORTER



COMMISSIONER BARRY T. SMITHERMAN

ATTEST:



SECRETARY