ReoStar Energy CORP
Form 10-K
July 14, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[x] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2009

Commission file number 000-26139

REOSTAR ENERGY CORPORATION
(Name of small business issuer in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	20-8428738 (IRS Employer Identification Number)
3880 Hulen St., Ste 500, Fort Worth, TX (Address of principal executive offices)	76107 (Zip Code)

Registrant's telephone number: 817-989-7367

Securities registered under Section 12(b) of the Exchange Act:
None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.001 par value
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10 K or any amendment to this Form 10-K o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The aggregate market value of the common stock held by non-affiliates computed by reference to the closing sales price of such common equity as of the last business day of the registrant's most recently completed first fiscal quarter was $2,515,191.

The number of shares outstanding of the registrant's common stock as of July 10, 2009 was 80,353,912 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the registrant's 2009 annual meeting of shareholders to be filed with the SEC within 120 days after the end of the fiscal year ended March 31, 2009 are incorporated by reference in Part III of this Form 10-K.

Transitional Small Business Disclosure Format (check one): Yes o No x

REOSTAR ENERGY CORPORATION
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Disclosures Regarding Forward-Looking Statements

Certain information included in this report, other materials filed or to be filed with the Securities and Exchange Commission (the "SEC"), as well as information included in oral statements or other written statements made or to be made by us contain or incorporate by reference certain statements (other than statements of historical fact) that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used herein, the words "budget," "budgeted," "assumes," "should," "goal," "anticipates," "expects," "believes," "seeks," "plans," "estimates," "intends," "projects" or "targets" and similar expressions that convey the uncertainty of future events or outcomes are intended to identify forward-looking statements. Where any forward-looking statement includes a statement of the assumptions or bases underlying such forward-looking statement, we caution that while we believe these assumptions or bases to be reasonable and to be made in good faith, assumed facts or bases almost always vary from actual results and the difference between assumed facts or bases and the actual results could be material, depending on the circumstances. It is important to note that our actual results could differ materially from those projected by such forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable and such forward-looking statements are based upon the best data available at the date this report is filed with the SEC, we cannot assure you that such expectations will prove correct. Factors that could cause our results to differ materially from the results discussed in such forward-looking statements include, but are not limited to, the following: the factors described in Item 1A of this report under the heading "Risk Factors," production variance from expectations, volatility of oil and gas prices, hedging results, the need to develop and replace reserves, the substantial capital expenditures required to fund operations, exploration risks, environmental risks, uncertainties about estimates of reserves, competition, litigation, government regulation, political risks, our ability to implement our business strategy, costs and results of drilling new projects, mechanical and other inherent risks associated with oil and gas production, weather, availability of drilling equipment and changes in interest rates. All such forward-looking statements in this document are expressly qualified in their entirety by the cautionary statements in this paragraph, we do not undertake, and specifically disclaim any obligation, to update or revise such statements to reflect new circumstances or unanticipated events as they occur, and we urge readers to review and consider disclosures we make in this and other reports that discuss factors germane to our business, including our reports on Forms 10-K, 10-Q, and 8-K subsequently filed from time to time with the SEC.

PART I

ITEM 1. BUSINESS

General

Effective February 1, 2007 three entities contributed certain assets to Goldrange Resources, Inc. ("Goldrange") in exchange for stock. The contributing entities were under common control prior to the transaction, and immediately after the transactions, the former shareholders of the contributing entities owned 80.4% of the issued and outstanding stock of Goldrange. The contribution was accounted for as a reverse merger, therefore, all assets are carried on the balance sheet at historical cost. The predecessor entities kept accounting records based on a calendar year end. However, Goldrange's year end was March 31. Therefore, for 2006 and prior years, all data presented reflects data using a calendar year end.

We are engaged in the exploration, development and acquisition of oil and gas properties, primarily located in the state of Texas. We seek to increase oil and gas reserves and production through internally generated drilling projects on currently owned assets, coupled with complementary acquisitions.

At year-end 2009, we owned approximately 16,000 acres of leasehold, which includes 12,000 acres of exploratory and developmental prospects as well as 4,000 acres of enhanced oil recovery prospects. We have built a multi-year inventory of drilling projects and drilling locations and currently have enough acreage to sustain several years of drilling. We had also entered into a non-binding letter of intent to acquire 13,000 acres of leasehold in south Texas in the Eagle Ford Shale/Edwards trend area.

ReoStar was incorporated in Nevada on November 29, 2004 under the name Goldrange Resources, Inc. In February of 2007 we changed our name to ReoStar Energy Corporation.

Our corporate offices are located at 3880 Hulen Street, Suite 500, Fort Worth, Texas 76107. Our telephone number is (817) 989-7367.

Business Strategy

Our objective is to build shareholder value by establishing and consistently growing our production and reserves with a strong emphasis on cost control and risk mitigation. Our strategy is (1) to control operations of all our leases through our affiliated operating companies, (2) to acquire and develop leasehold in key regional resource development plays while utilizing existing infrastructure and engaging in long-term drilling and development programs, and (3) to acquire leasehold in mature fields and implement enhanced oil recovery programs.

Significant Accomplishments in Fiscal Year 2009

Leasehold Acquisition and Development:

Barnett Shale. Our main area of interest in the Barnett Shale play is located in the "oil window" of the Barnett in southwest Cooke County, Texas.

We completed, and began production in the seven wells that were in process as of March 31, 2008. We also drilled, completed, and began production in six wells. Two other wells were drilled that we anticipate will be completed in the second quarter of fiscal year 2010.

Corsicana Enhanced Oil Recovery (EOR) Project. We began injecting surfactant polymer in phase I of the project in mid-June 2007 and continued injection throughout the current fiscal year. We initiated phase II of the project by drilling 12 wells in June 2008 in an area immediately south of our injection facility adjacent to the phase I wells.

Corsicana deeper zone exploration. We drilled four deeper exploratory wells in the Corsicana acreage. The first two, a Glen Rose well and a Pecan Gap well were dry holes. In December 2008, we successfully completed two Pecan Gap wells.

Eagle Ford Shale. In March 2009, we entered into a non-binding letter of intent to acquire a 100% working interest (75% net revenue interest) in 13,000 acres of leasehold in South Texas. The acreage is in the Edwards trend and has both Edwards and Eagle Ford Shale prospects.

Concentrate in Core Operating Areas. We currently focus in one region: the Southern Mid-continent region of the United States (which includes the Barnett Shale of North Central Texas, and our Corsicana EOR prospect in East Central Texas, and the Eagle Ford/Edwards trend in South Texas). Concentrating our drilling and producing activities in these core areas allows us to develop the regional expertise needed to interpret specific geological and operating trends and develop economies of scale. Operating developmental projects (such as our Barnett Shale prospects) and Enhanced Oil Recovery prospects in the same core area allows us to achieve reserve growth, balance our portfolio between oil and natural gas, and minimize some of the operational risks inherent in our industry, while leveraging the benefits of the existing infrastructure.

Manage Our Risk Exposure. We continue to sell a portion of the working interests in the development wells we drill, which allows us to spread the risk by drilling more wells for the same capital expenditure budget.

Corporate Financing. We secured a $25 million senior secured credit facility with Union Bank of California in October 2008. The credit (borrowing base) available under the credit facility is determined based upon our reserves. The credit facility is secured by all of our assets. The interest rate varies depending upon the

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reference rate (either LIBOR or Prime) and the amount of the borrowing base utilized. At March 31, 2009, the borrowing base was $14 million. We have drawn $9.8 million and the interest rate was 2.82%.

Plans for fiscal year 2010

Barnett Shale

In December 2008, we suspended our Barnett Shale development due to depressed natural gas prices. We do not expect to renew the development program during this fiscal year. However, we have two drilling commitments and expect to drill one cluster of six wells in order to fulfill those commitments. The drilling budget for the Barnett acreage is $6.0 million for fiscal year 2010. The drilling budget will allow us to fulfill our drilling commitments by drilling one cluster and complete the two wells that were in process at year-end. The capital expenditure budget assumes we will retain 100% working interests in the wells. However, our normal practice is to sell a portion of the working interests in our wells under a turn-key contract. We expect to fund the drilling with the proceeds of a debt facility and proceeds from the sale of up to 40% working interest in each well on a turnkey basis.

Corsicana

We have applied for an area wide injection permit, which when granted will allow us to streamline the regulatory permitting process. Upon approval, we expect to begin injection in Phase II of the polymer flood. We expect to begin drilling Phase III of the surfactant-polymer project in the fourth quarter of the fiscal year.

We will drill three more Pecan Gap wells in July 2009. If the wells are successful, we expect to initiate a Pecan Gap drilling program and will drill up to 5 wells per month for the balance of the fiscal year. The Pecan Gap lies at about 1,800 feet and are economical to drill. We will sell up to 50% working interest in these wells on a turn-key contract basis.

During the fiscal year ended March 31, 2009, we acquired and began to refurbish a shallow well oil drilling rig capable of drilling wells up to 3,500 feet deep. The refurbishment was completed during the first quarter of the 2010 fiscal year and the rig will be used on the Pecan Gap drilling program and to drill the surfactant polymer project wells.

The planned surfactant polymer wells are shallow (800 ft.), and cost approximately $60,000 each to drill and complete. The Pecan Gap wells cost approximately $100,000 each to drill and complete. Total capital expenditure budget for fiscal 2010 for the Corsicana project is $3.5 million. The budget will be funded primarily with proceeds from the sale of up to 50% working interest in the Pecan Gap wells, the credit facility, and cash flow.

South Texas

During the first quarter of the fiscal year, we signed a contract to purchase 13,000 acres in South Texas. The purchase price was $5.5 million of cash and 12 million shares of ReoStar stock. The technical team, with significant experience in South Texas, will remain in place, and will be the operator of record. They will provide the technical expertise required to be successful in the Edwards and Eagle Ford Shale plays. The contract requires the Company to arrange $15 million in financing prior to August 1, 2009. The Company is working with an investment bank in Europe and several sources in the United States. The financing may take the form of equity, convertible debt, or a combination of equity and debt. The proceeds of the financing will be used to fund the cash portion of the purchase price and to fund stage I capital expenditures. The first stage will be comprised of a science well and re-entries of three existing vertical well bores.

Given the current state of equity markets, there can be assurance that we will be successful in raising the capital necessary to close the South Texas acquisition.

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Production, Revenues and Price History

The following table sets forth information regarding oil and gas production, and revenues for ReoStar Energy. Data shown for the 2006 and 2005 calendar years are combined results of the predecessor entities.

Years Ending		March 31, 2009		March 31, 2008		December 31, 2006		December 31, 2005
Production								
Oil (Bbl)		45,105		33,602		34,607		8,965
Gas (Mcf)		479,180		351,538		199,282		94,358
Revenues								
Crude Oil	$	4,034,376	$	2,704,468	$	1,772,649	$	555,097
Gas		2,523,693		2,197,604		1,101,642		554,102
Total		6,558,069		4,902,072		2,874,291		1,109,199
Average Sale Price per Bbl		89.44	$	80.49	$	51.22	$	61.92
Average Sale Price per MCF		5.27	$	6.25	$	5.53	$	5.87
Lease Operating Costs (per BOE)		20.79	$	23.05	$	16.68	$	22.59
Severance Taxes (per BOE)		3.00	$	3.13	$	2.41	$	2.67
Average Sale Price (per BOE)		52.48	$	53.17	$	42.38	$	44.92
Average Sale Price (per MCFE)		8.75	$	8.86	$	7.06	$	7.49

(a) Natural Gas was converted to BOE at the rate of 1 barrel equals 6 MCF.

Competition

We encounter substantial competition in developing and acquiring oil and gas properties, securing and retaining personnel, conducting drilling and field operations and marketing production. Competitors in exploration, development, acquisitions and production include the major oil companies as well as numerous independent oil companies, individual proprietors and others. Although our sizable acreage position and core-area concentration provide some competitive advantages, many competitors have financial and other resources substantially exceeding ours. Therefore, competitors may be able to pay more for desirable leases and to evaluate, bid for and purchase a greater number of properties or prospects than our financial or personnel resources allow. Our ability to replace and expand our reserve base depends on our ability to attract and retain quality personnel and our ability to identify and acquire suitable producing properties and prospects for future drilling.

Employees

As of April 1, 2009, ReoStar Energy Corporation had 4 full-time and no part-time employees.

All of ReoStar's full-time employees are eligible to receive equity awards approved by the Compensation Committee of the Board of Directors. No employees are covered by a labor union or other collective bargaining arrangement. We believe that the relationship with our employees is excellent. We regularly utilize independent consultants and contractors to perform various professional services, particularly in the areas of drilling, completion, field and on-site production operation services, mainly through our affiliated operators, Texas M.O.R., Inc. and Rife Energy Operating, Inc.

Available Information

We maintain an internet website under the name "www.reostarenergy.com." Information contained on or connected to our website is not incorporated by reference into this Form 10-K and should not be considered part of this report or any other filing that we make with the SEC. We make available, free of charge, on our website, the

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annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after providing such reports to the SEC. Also, our Code of Ethics is available on our website and in print to any stockholder who provides a written request to Investor Relations at 3880 Hulen Street, Suite 500, Fort Worth, Texas 76107.

We file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, proxy statements and other documents with the SEC under the Securities Exchange Act of 1934. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an internet website that contains reports, proxy and information statements, and other information regarding issuers, including REOSTAR, that file electronically with the SEC. The public can obtain any document we file with the SEC at "www.sec.gov."

Marketing and Customers

We market nearly all of our oil and gas production from the properties we operate for both our interest and that of the other working interest owners and royalty owners. All of our gas produced from the Barnett Shale is sold pursuant to a gas contract with Copano Field Services/North Texas LLC. The contract expires May 31, 2017 and provides for two stages of gathering fees. For all wells in production through December 31, 2010, a gathering fee of $0.55 per MMBTU is assessed against our revenue. Thereafter, for all wells in production as of December 31, 2010, no gathering fee will be assessed. Currently, none of our gas is sold under long-term fixed price contracts. Our Barnett oil is currently sold to Cimmarron Gathering, LP under a month to month contract until such time as either party cancels by providing thirty (30) days advance written notice to the other party of intent to cancel. The contract pays Platts plus minus $1.00 based on Plains - North Texas Sweet posted price.

Oil and gas purchasers are selected on the basis of price, credit quality and service. For a summary of purchasers of our oil and gas production that accounted for 10% or more of consolidated revenue, see Note 13 to our financial statements. Because alternative purchasers of oil and gas are usually readily available, we believe that the loss of any of these purchasers would not have a material adverse effect on us.

Currently, we have no hedges in place. We expect to implement a comprehensive hedging program during this fiscal year with unaffiliated third parties for portions of our production to achieve more predictable cash flows and to reduce our exposure to down-side price risk.

Proximity to local markets, availability of competitive fuels and overall supply and demand are factors affecting the prices for which our production can be sold. Market volatility due to international political developments, overall energy supply and demand, fluctuating weather conditions, economic growth rates and other factors in the United States and worldwide has had, and will continue to have, a significant effect on energy prices.

For additional information, see "Risk Factors".

Governmental Regulation

Federal, state and local laws and regulations substantially affect our operations. In particular, oil and gas production and related operations are, or have been, subject to price controls, taxes and numerous other laws and regulations. All of the jurisdictions in which we own or operate producing crude oil and natural gas properties have statutory provisions regulating the exploration for and production of crude oil and natural gas, including provisions related to permits for the drilling of wells, bonding requirements in order to drill or operate wells, the location of wells, the method of drilling and casing wells, the surface use and restoration of properties upon which wells are drilled, and the abandonment of wells. Our operations are also subject to various conservation laws and regulations. These include the regulation of the size of drilling

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and spacing units or proration units, the number of wells which may be drilled in an area, and the unitization or pooling of crude oil and natural gas wells, generally prohibit the venting or flaring of natural gas, and impose certain requirements regarding the ratability or fair apportionment of production from fields and individuals wells.

In August 2005, Congress enacted the Energy Policy Act of 2005 ("EPAct 2005"). Among other matters, the EPAct 2005 amends the Natural Gas Act ("NGA"), to make it unlawful for "any entity", including otherwise non-jurisdictional producers such as ReoStar, to use any deceptive or manipulative device or contrivance in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to regulation by the Federal Energy Regulatory Commission ("FERC"), in contravention of rules prescribed by the FERC. On January 20, 2006, the FERC issued rules implementing this provision. The rules make it unlawful in connection with the purchase or sale of natural gas subject to the jurisdiction of FERC, or the purchase or sale of transportation services subject to the jurisdiction of FERC, for any entity, directly or indirectly, to use or employ any device, scheme or artifice to defraud; to make any untrue statement of material fact or omit to make any such statement necessary to make the statements made not misleading; or to engage in any act or practice that operates as a fraud or deceit upon any person. EPAct 2005 also gives the FERC authority to impose civil penalties for violations of the NGA up to $1,000,000 per day per violation. The new anti-manipulation rule does not apply to activities that relate only to intrastate or other non-jurisdictional sale or gathering, but does apply to activities or otherwise non-jurisdictional entities to the extent the activities are conducted "in connection with" gas sales, purchases or transportation subject to FERC jurisdiction. It therefore reflects a significant expansion of FERC's enforcement authority. ReoStar does not anticipate it will be affected any differently than other producers of natural gas.

Failure to comply with applicable laws and regulations can result in substantial penalties. The regulatory burden on the industry increases the cost of doing business and affects profitability. Although we believe we are in substantial compliance with all applicable laws and regulations, such laws and regulations are frequently amended or reinterpreted. Therefore, we are unable to predict the future costs or impact of compliance. Congress, the states, the FERC, and the courts regularly consider additional proposals and proceedings that affect the oil and gas industry. We cannot predict when or whether any such proposals may become effective.

Environmental Matters

Our operations are subject to stringent federal, state and local laws governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental departments such as the Environmental Protection Agency ("EPA") issue regulations to implement and enforce such laws, which are often difficult and costly to comply with and which carry substantial civil and criminal penalties for failure to comply. These laws and regulations may require the acquisition of a permit before drilling commences, restrict the types, quantities and concentrations of various substances that can be released into the environment in connection with drilling, production and transporting through pipelines, limit or prohibit drilling activities on certain lands lying within wilderness, wetlands, frontier and other protected areas, require some form of remedial action to prevent pollution from former operations such as plugging abandoned wells, and impose substantial liabilities for pollution resulting from operations. In addition, these laws, rules and regulations may restrict the rate of production. The regulatory burden on the oil and gas industry increases the cost of doing business, affecting growth and profitability. Changes in environmental laws and regulations occur frequently, and changes that result in more stringent and costly waste handling, disposal or clean-up requirements could adversely affect our operations and financial position, as well as the industry in general. We believe we are in substantial compliance with current applicable environmental laws and regulations. Although we have not experienced any material adverse effect from compliance with environmental requirements, there is no assurance that this will continue. We did not have any material capital or other non-recurring expenditures in connection with complying with environmental laws or environmental remediation matters during fiscal year ended 2008, nor do we anticipate that such expenditures will be material in fiscal year ended 2009.

The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), known as the "Superfund" law, imposes liability, without regard to fault or the legality of the original conduct, on certain

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classes of persons who are considered to be responsible for the release of a "hazardous substance" into the environment. These persons include owners or operators of the disposal site or sites where the release occurred and companies that disposed of or arranged for the disposal of the hazardous substances at the site where the release occurred. Under CERCLA, such persons may be subject to joint and several liabilities for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies. Furthermore, although petroleum, including crude oil and natural gas, is not a "hazardous substance" under CERCLA, at least two courts have ruled that certain wastes associated with the production of crude oil may be classified as "hazardous substances" under CERCLA and that such wastes may therefore give rise to liability under CERCLA. Beyond CERCLA, state laws regulate the disposal of oil and gas wastes, and periodically new state legislative initiatives are proposed that could have a significant impact on us. In addition, it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damages allegedly caused by the release of hazardous substances or other pollutants into the environment pursuant to environmental statutes, common law or both.

The Federal Water Pollution Control Act ("FWPCA") imposes restrictions and strict controls regarding the discharge of produced waters and other oil and gas wastes into waters of the United States. Permits must be obtained to discharge pollutants into state and federal waters. The FWPCA and analogous state laws provide for civil, criminal and administrative penalties for any unauthorized discharges of oil and other hazardous substances in reportable quantities and may impose substantial potential liability for the costs of removal, remediation and damages. State water discharge regulations and Federal National Pollutant Discharge Elimination System permits applicable to the oil and gas industry generally prohibit the discharge of produced water, sand and some other substances into coastal waters. The cost to comply with zero discharges mandated under federal and state law has not had a material adverse impact on our financial condition and results of operations.

Some oil and gas exploration and production facilities are required to obtain permits for their storm water discharges. Costs may be incurred in connection with treatment of wastewater or developing and implementing storm water pollution prevention plans. The Resource Conservation and Recovery Act ("RCRA") as amended, generally does not regulate most wastes generated by the exploration and production of oil and gas. RCRA specifically excludes from the definition of hazardous waste "drilling fluids, produced waters, and other wastes associated with the exploration, development, or production of crude oil, natural gas or geothermal energy." However, these wastes may be regulated by the EPA or state agencies as non-hazardous solid waste. Moreover, ordinary industrial wastes, such as paint wastes, waste solvents, laboratory wastes and waste compressor oils, can be regulated as hazardous wastes. Although the costs of managing wastes classified as hazardous waste may be significant, we do not expect to experience more burdensome costs than similarly situated companies.

The Oil Pollution Act ("OPA") requires owners and operators of facilities that could be the source of an oil spill into "waters of the United States" (a term defined to include rivers, creeks, wetlands and coastal waters) to adopt and implement plans and procedures to prevent any spill of oil into any waters of the United States. OPA also requires affected facility owners and operators to demonstrate that they have sufficient financial resources to pay for the costs of cleaning up an oil spill and compensating any parties damaged by an oil spill. Substantial civil and criminal fines and penalties can be imposed for violations of OPA and other environmental statutes.

Stricter standards in environmental legislation may be imposed on the oil and gas industry in the future. For instance, legislation has been proposed in Congress from time-to-time that would alter the RCRA exemption by reclassifying certain oil and gas exploration and production wastes as "hazardous wastes" and make the waste subject to more stringent handling, disposal and clean-up restrictions. If such legislation were enacted, it could have a significant impact on our operating costs, as well as the industry in general. Compliance with environmental requirements generally could have a material adverse effect on our capital expenditures, earnings or competitive position. Although we have not experienced any material adverse effect from compliance with environmental requirements, no assurance may be given that this will continue.

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ITEM 1A. RISK FACTORS

An investment in our common stock is speculative and involves a high degree of risk and uncertainty. You should carefully consider the risks described below, together with the other information contained in our reports filed with the SEC, including the consolidated financial statements and notes thereto of our company, before deciding to invest in our common stock. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we presently consider immaterial may also adversely affect our company. If any of the following risks occur, our business, financial condition and results of operations and the value of our common stock could be materially and adversely affected.

Volatility of oil and natural gas prices significantly affects our cash flow and capital resources and could hamper our ability to produce oil and gas economically.

Oil and natural gas prices are volatile, and a decline in prices would adversely affect our profitability and financial condition. The oil and natural gas industry is typically cyclical, and prices for oil and natural gas have been highly volatile. Historically, the industry has experienced severe downturns characterized by oversupply and/or weak demand. In recent years, higher oil and natural gas prices have contributed to increased earnings industry wide. However, long-term supply and demand for oil and natural gas is uncertain and subject to a myriad of factors such as:

- the domestic and foreign supply of oil and gas;
- the price and availability of alternative fuels;
- weather conditions;
- the level of consumer demand;
- the price of foreign imports;
- world-wide economic conditions;
- political conditions in oil and gas producing regions; and
- domestic and foreign governmental regulations.

Decreases in oil and natural gas prices from current levels could adversely affect our revenues, net income, cash flow and economically recoverable proved reserves. Significant price decreases could have a material adverse effect on our operations and limit our ability to fund capital expenditures. Without the ability to fund capital expenditures, we would be unable to replace reserves and production.

High operating costs are inherent in enhanced oil recovery projects and could impair our ability to produce oil and gas economically.

The Company has initiated a surfactant polymer flood, which is classified as an enhanced oil recovery project. The cost of the surfactants and polymers, the cost of preparing the mixture for injection, the cost of injection, the cost of monitoring the quality of the injected solution, and the cost of monitoring the results all contribute to operating expenses which are significantly higher than operating expenses incurred using primary and secondary recovery techniques. Additionally, the response time, response rate, and overall recovery rate of a surfactant polymer flood are uncertain, which could materially impact the operating cost per unit produced.

Due to the higher operating costs (which for the fiscal year ended March 31, 2008 averaged more than $30.00 per BOE), a significant decline in commodity prices could magnify the negative impact on net income, cash flow and proved reserves.

Hedging transactions may limit our potential gains and involve other risks.

To manage our exposure to price risk, we may, from time to time, enter into hedging arrangements, utilizing commodity derivatives with respect to a significant portion of our future production. The goal of hedging is to lock in prices so as to limit volatility and increase the predictability of cash flow. These transactions may limit

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potential gains if oil and natural gas prices rise above the price established by the hedge. In addition, hedging transactions may cause risk of financial loss in certain circumstances.

Information concerning our reserves and future net reserve estimates is uncertain.

There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves and their values, including many factors beyond our control. Estimates of proved reserves are by their nature uncertain. Although we believe these estimates are reasonable, actual production, revenues and costs to develop will likely vary from estimates, and these variances could be material.

The accuracy of any reserve estimate is a function of the quality of available data; engineering and geological interpretation and judgment; assumptions used regarding quantities of oil and natural gas in place; recovery rates; and future commodity pricing.

Actual prices, production, development expenditures, operating expenses and quantities of recoverable oil and natural gas reserves will vary from those assumed in our estimates, and such variances may be material. Any variance in the assumptions could materially affect the estimated quantity and value of the reserves.

If oil and natural gas prices decrease or exploration efforts are unsuccessful, we may be required to take write-downs of our oil and natural gas properties.

This could occur when oil and natural gas prices are low, if we have downward adjustments to our estimated proved reserves, increases in our estimates of operating or development costs, deterioration in our exploration results, unsatisfactory results in our enhanced oil recovery projects, or mechanical problems with wells where the cost to re-drill or repair does not justify the expenditures required.

Accounting rules require that the carrying value of oil and natural gas properties be periodically reviewed for possible impairment. "Impairment" is recognized when the book value of a proven property is greater than the expected undiscounted future net cash flows from that property and on acreage when conditions indicate the carrying value is not recoverable. We may be required to write down the carrying value of a property based on oil and natural gas prices at the time of the impairment review, as well as a continuing evaluation of drilling results, production data, economics and other factors. While an impairment charge reflects our long-term ability to recover an investment, it does not impact cash or cash flow from operating activities, but it does reduce our reported earnings and negatively impacts our leverage ratios.

Our business is subject to operating hazards and environmental regulations that could result in substantial losses or liabilities.

Oil and natural gas operations are subject to many risks, including well blowouts, craterings, explosions, uncontrollable flows of oil, natural gas or well fluids, fires, formations with abnormal pressures, pipeline ruptures or spills, pollution, releases of toxic natural gas and other environmental hazards and risks. If any of these hazards occur, we could sustain substantial losses as a result of:

- injury or loss of life;
- severe damage to or destruction of property, natural resources, and equipment;
- pollution or other environmental damage;
- clean-up responsibilities;
- regulatory investigations and penalties; or
- suspension of operations.

As we drill to deeper horizons and in more geologically complex areas, we could experience a greater increase in operating and financial risks due to inherent higher reservoir pressures and unknown downhole risk exposures. As we continue to drill deeper, the number of rigs capable of drilling to such depths will be fewer and we may experience greater competition from other operators.

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Our operations are subject to numerous and increasingly strict federal, state and local laws, regulations and enforcement policies relating to the environment. We may incur significant costs and liabilities in complying with existing or future environmental laws, regulations and enforcement policies and may incur costs arising out of property damage or injuries to employees and other persons. These costs may result from our current and former operations and even may be caused by previous owners of property we own or lease. Any past, present or future failure by us to completely comply with environmental laws, regulations and enforcement policies could cause us to incur substantial fines, sanctions or liabilities from cleanup costs or other damages. Incurrence of those costs or damages could reduce or eliminate funds available for exploration, development or acquisitions or cause us to incur losses.

In accordance with our operating agreements, the operator maintains insurance against some, but not all, of these potential risks and losses. We may elect not to obtain insurance if we believe that the cost of available insurance is excessive relative to the risks presented. We do not maintain business interruption insurance.

In addition, pollution and environmental risks generally are not fully insurable. If a significant accident or other event occurs that is not fully covered by insurance, it could have a material adverse affect on our financial condition and results of operations.

We are subject to financing and interest rate exposure risks.

Our business and operating results can be harmed by factors such as the availability, terms of and cost of capital, increases in interest rates or a reduction in credit rating. These changes could cause our cost of doing business to increase, which limit our ability to pursue acquisition opportunities and place us at a competitive disadvantage.

Many of our current and potential competitors have greater resources than ours, and we may not be able to successfully compete in acquiring, exploring and developing new properties.

We face competition in every aspect of our business, including, but not limited to, acquiring reserves and leases, obtaining goods, services and employees needed to operate and manage our business and marketing oil and natural gas. Competitors include multinational oil companies, independent production companies and individual producers and operators. Many of our competitors have greater financial and other resources than we do.

The demand for field services and their ability to meet that demand may limit our ability to drill and produce our oil and natural gas properties.

Due to current industry demands, well service providers and related equipment and personnel are in short supply. This will result in escalating prices, the possibility of poor services coupled with potential damage to down-hole reservoirs and personnel injuries. Such pressures will likely increase the actual cost of services, extend the time to secure such services and add costs for damages due to accidents sustained from the over use of equipment and inexperienced personnel.

The oil and natural gas industry is subject to extensive regulation.

The oil and natural gas industry is subject to various types of regulations in the United States by local, state and federal agencies. Legislation affecting the industry is under constant review for amendment or expansion, frequently increasing our regulatory burden. Numerous departments and agencies, both state and federal, are authorized by statute to issue rules and regulations binding on participants in the oil and natural gas industry. Compliance with such rules and regulations often increases our cost of doing business and, in turn, decreases our profitability.

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Acquisitions are subject to the risks and uncertainties of evaluating reserves and potential liabilities and may be disruptive and difficult to integrate into our business.

We could be subject to significant liabilities related to acquisitions. It generally is not feasible to review in detail every individual property included in an acquisition. Ordinarily, a review is focused on higher valued properties. However, even a detailed review of all properties and records may not reveal existing or potential problems in all of the properties, nor will it permit us to become sufficiently familiar with the properties to assess fully their deficiencies and capabilities. We do not always inspect every well we acquire, and environmental problems, such as groundwater contamination, are not necessarily observable even when an inspection is performed.

In addition, there is intense competition for acquisition opportunities in our industry. Competition for acquisitions may increase the cost of, or cause us to refrain from, completing acquisitions. Our acquisition strategy is dependent upon, among other things, our ability to obtain debt and equity financing and, in some cases, regulatory approvals. Our ability to pursue our acquisition strategy may be hindered if we are not able to obtain financing on terms acceptable to regulatory approvals or us.

Acquisitions often pose integration risks and difficulties. In connection with future acquisitions, the process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant management attention and financial resources that would otherwise be available for the ongoing development or expansion of existing operations. Future acquisitions could result in our incurring additional debt, contingent liabilities, expenses and diversion of resources, all of which could have a material adverse effect on our financial condition and operating results.

Our success depends on key members of our management and our ability to attract and retain experienced technical and other professional personnel.

Our success is highly dependent on our management personnel. The loss of one or more of these individuals could have a material adverse effect on our business. Furthermore, competition for experienced technical and other professional personnel is intense. If we cannot retain our current personnel or attract additional experienced personnel, our ability to compete could be adversely affected.

Our future success depends on our ability to replace reserves that we produce.

Because the rate of production from oil and natural gas properties generally declines as reserves are depleted, our future success depends upon our ability to economically find or acquire and produce additional oil and natural gas reserves. Except to the extent that we acquire additional properties containing proved reserves, conduct successful exploration and development activities or, through engineering studies, identify additional behind-pipe zones or secondary recovery reserves, our proved reserves will decline as reserves are produced. Future oil and natural gas production, therefore, is highly dependent upon our level of success in acquiring or finding additional reserves that are economically recoverable. We cannot assure you that we will be able to find or acquire and develop additional reserves at an acceptable cost.

New technologies may cause our current exploration and drilling methods to become obsolete.

The oil and natural gas industry is subject to rapid and significant advancements in technology, including the introduction of new products and services using new technologies. As competitors use or develop new technologies, we may be placed at a competitive disadvantage, and competitive pressures may force us to implement new technologies at a substantial cost. In addition, competitors may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before we can. One or more of the technologies that we currently use or that we may implement in the future may become obsolete. We cannot be certain that we will be able to implement technologies on a timely basis or at a cost that is acceptable to us. If we are not able to maintain technological advancements consistent with industry standards, our operations and financial condition may be adversely affected.

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Our business depends on oil and natural gas transportation facilities, most of which are owned by others.

The marketability of our oil and natural gas production depends in part on the availability, proximity and capacity of pipeline systems owned by third parties. The unavailability of or lack of available capacity on these systems and facilities could result in the shut-in of producing wells or the delay or discontinuance of development plans for properties. Although we have some contractual control over the transportation of our product, material changes in these business relationships could materially affect our operations. We generally do not purchase firm transportation on third party facilities and therefore, our production transportation can be interrupted by those having firm arrangements.

Federal and state regulation of oil and natural gas production and transportation, tax and energy policies, changes in supply and demand, pipeline pressures, damage to or destruction of pipelines and general economic conditions could adversely affect our ability to produce, gather and transport oil and natural gas.

The disruption of third-party facilities due to maintenance and/or weather could negatively impact our ability to market and deliver our products. We have no control over when or if such facilities are restored or what prices will be charged. A total shut-in of production could materially affect us due to a lack of cash flow, and if a substantial portion of the production is hedged at lower than market prices, those financial hedges would have to be paid from borrowings absent sufficient cash flow.

Indebtedness could limit our ability to successfully operate our business.

If we decide to pursue additional acquisitions, our capital expenditures will increase both to complete such acquisitions and to explore and develop any newly acquired properties. Our existing operations will also require ongoing capital expenditures. We may choose to increase debt in order to finance any of these potential capital expenditure requirements. The degree to which we are leveraged could have other important consequences, including the following:

- we may be required to dedicate a substantial portion of our cash flows from operations to the payment of our indebtedness, reducing the funds available for our operations;
- a portion of our borrowings are at variable rates of interest, making us vulnerable to increases in interest rates;
- we may be more highly leveraged than some of our competitors, which could place us at a competitive disadvantage;
- our degree of leverage may make us more vulnerable to a downturn in our business or the general economy;
- the terms of our credit arrangements could contain numerous financial and other restrictive covenants;
- our debt level could limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
- we may have difficulties borrowing money in the future.

Any failure to meet our debt obligations could harm our business, financial condition and results of operations.

If our cash flow and capital resources are insufficient to fund our current or future debt obligations, we may be forced to sell assets, seek additional equity or restructure our debt. In addition, any failure to make scheduled payments of interest and principal on our outstanding indebtedness would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness on acceptable terms. Our cash flow and capital resources may be insufficient for payment of interest on and principal of our debt in the future and any such alternative measures may be unsuccessful or may not permit us to meet scheduled debt service obligations, which could cause us to default on our obligations and impair our liquidity.

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The current global financial crisis may adversely affect our business, operating results and financial condition.

The United States economy has recently experienced a financial downturn, with some financial and economic analysts predicting that the world economy may be entering into a prolonged economic downturn characterized by high unemployment, limited availability of credit and capital, increased rates of default and bankruptcy and decreased consumer and business spending. These developments could negatively affect our business, operating results and financial condition in a number of ways. For example, this downturn has had, and may continue to have, an unprecedented negative impact on the global credit and capital markets, resulting in financing terms that are less attractive to borrowers, and in many cases, the unavailability of certain types of debt or capital financing. If this crisis continues or worsens, and if we are required to obtain financing in the near term to meet our working capital or other business needs, we may not be able obtain that financing. Further, even if we are able to obtain the financing we need, it may be on terms that are not favorable to us, with increased financing costs and restrictive covenants.

We exist in a litigious environment.

Any constituent could bring suit or allege a violation of an existing contract. This action could delay when operations can actually commence or could cause a halt to production until the courts resolve such alleged violations. Not only could we incur significant legal and support expenses in defending our rights, planned operations could be delayed which would impact our future operations and financial condition. Such legal disputes could also distract management and other personnel from their primary responsibilities.

Common stockholders will be diluted if additional shares are issued.

We may incur debt that provides for a conversion to equity. Additionally, we may issue stock as consideration for additional property acquisitions. If we issue additional shares of our common stock in the future, it may have a dilutive effect on our current outstanding stockholders.

Dividend limitations.

Our ability to pay dividends may be limited by covenants imposed under future debt arrangements.

Our financial statements are complex.

Due to accounting rules, our financial statements continue to be complex, particularly with reference to hedging, asset retirement obligations, equity awards, and deferred taxes. We expect such complexity to continue and possibly increase.

Our stock price may be volatile and you may not be able to resell shares of our common stock at or above the price you paid.

The price of our common stock fluctuates significantly, which may result in losses for investors. To date our stock has been lightly traded, with the average daily volume being quite low. The low trading volume may prevent you from liquidating your position in our stock quickly. Additionally, the low trading volume may contribute significantly to price volatility. We expect our stock to be subject to fluctuations as a result of a variety of factors, including factors beyond our control. These include:

- changes in oil and natural gas prices;
- variations in quarterly drilling, re-completions, acquisitions and operating results;
- changes in financial estimates by securities analysts;
- changes in market valuations of comparable companies;
- additions or departures of key personnel; or
- future sales of our stock.

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We may fail to meet expectations of our stockholders or of securities analysts at some time in the future, and our stock price could decline as a result. Furthermore, the ability to access capital has been somewhat impaired due to the financial downturn, which could impact the Company's ability to do the same.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 2. PROPERTIES

The information below summarizes certain data for our core operating areas for the year ended March 31, 2009. Segment reporting is not applicable to us as we have a single company-wide management team that administers all properties as a whole rather than by discrete operating segments. We track only basic operational data by area. We do not maintain complete separate financial statement information by area. We measure financial performance as a single enterprise and not on an area-by-area basis.

We conduct drilling, production and field operations in the Barnett Shale of North Central Texas, and the Corsicana field of East Central Texas.

Barnett Shale

The Barnett Shale is a non-conventional natural gas resource play located in North Texas. It underlies approximately 5,000 square miles and at least 17 counties. Our leases lie in the north western portion of the Barnett Shale, an area known as the "oil window," due to its production of both oil and gas.

We have drilled and own interests in 68 completed wells, all of which are operated by Rife Energy Operating, Inc., a non-publicly traded affiliated company owned by a shareholder who controls more than 25% of our outstanding stock. Our average working interest is 45%, and our average net revenue interest is 34%. We have approximately 5,743 acres under lease, the majority of which is not classified as proven. During the fiscal year ended March 31, 2009, our Barnett Shale production consisted of 479,000 MCF of natural gas and 32,410 barrels of oil, or approximately 112,250 BOE (673,400 MCFE).

Proved developed producing reserves consisted of 2,812 MMCF of natural gas and 94 M barrels of oil, or, 562 MBOE (3,375 MMCFE). Proved developed non-producing reserves consisted of 494 MMCF of natural gas and 46 M barrels of oil, or, 125 MBOE (750 MMCFE). The majority of the proved developed non-producing reserves represented the reserves associated with 2 wells that were drilled, but were not yet completed. Total proved developed reserves at March 31, 2009 were 687 MBOE (4,125 MMCFE). Total proven, undeveloped reserves consisted of 8,505 MMCF natural gas and 655 M barrels of oil, or, 2,070 MBOE (12,430 MMCFE).

At March 31, 2009, we had a Barnett Shale drilling inventory of more than 200 drilling locations and more than 10 re-completions.

Corsicana Field

We own interests in 77 producing well bores and 199 inactive wells. All of our properties in Corsicana are operated by Texas MOR, Inc, a non-publicly traded affiliate. Our average working interest is 95%, and our average net revenue interest is 76%. We commenced flooding on Phase I of our polymer project in June of 2007. Through March 31, 2009, we have injected 291,060 barrels of fluid. During the fiscal year ended March 31, 2009, our oil production in the Corsicana field totaled 10,500 barrels of oil.

The Nacatoch reservoir is fairly shallow with depths of less than 1,000 feet. While this field has been producing for more than one hundred years, several engineering studies have estimated that more than 80% of the original reserves still remain in place or approximately 100 MMBO.

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In addition to the Polymer flood, we are evaluating optional EOR techniques including the use of steam and fire floods.

There are many alternative reservoirs between 1000 and 7000 feet, which are being evaluated for optimal exploitation. The company feels that there are tremendous opportunities in the multiple zones within this range and it plans on attempting to produce from each one.

During the fiscal year ended March 31, 2009, the Company drilled four Pecan Gap test wells. Two of the wells were successfully completed in December. The Company plans to drill three more Pecan Gap wells in July 2009. If these wells are successful, the Company expects to begin an extensive drilling program, and may drill up to 200 more Pecan Gap wells. The Pecan Gap formation lies at about 1,800 feet, and the wells cost approximately $100,000 to drill and complete. The Company has secured co-financing for these wells from an industry partner who has purchased a 50% working interest in the first three wells and expects to sell up to 50% of any additional Pecan Gap wells we drill.

As of March 31, 2009, total proved developed reserves were 187 MBOE and proved undeveloped reserves totaled 10,320 MBOE.

East Texas Properties

We own interest in 4 leases in eastern Texas and western Louisiana. Our average working interest is 50% and our average net revenue interest is 40%. For the year ended March 31, 2009, our East Texas production consisted of 1,960 barrels of oil.

As of March 31, 2008, total proved developed reserves were 13 MBOE. There were no proved undeveloped reserves.

Fayetteville Shale

We own 6,450 net acres in the Fayetteville Shale located in Arkansas. No wells have been drilled on this acreage and no reserve values have been assigned to the leasehold interests. The leasehold interests are not contiguous and we offered the acreage for sale during fiscal year 2009. During the fall and winter of 2009, natural gas prices tumbled, and we received no offers on the property. The leases begin to expire in late 2010. Because the Company does not plan to drill on the acreage and due to the lack of a market for the leasehold, the entire acreage was written off for financial accounting purposes. The Company will continue to actively seek a buyer for the acreage.

Proven Reserves

Proven oil and gas reserves are defined as the estimated quantities of crude oil, condensate, natural gas liquids and natural gas that geological and engineering data demonstrate with reasonable certainty are recoverable from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

See financial statement footnote number 16, "Supplemental Info on Oil and Gas Exploration, Development, and Production Activities" for the disclosures required by SFAS 69 and more detailed information regarding our proven reserves.

At year-end 2009, the independent petroleum-consulting firm of Forrest Garb and Associates, Inc. reviewed our reserves. These engineers were selected for their geographic expertise and their history in engineering enhanced oil recovery prospects similar to our Corsicana properties. At March 31, 2009, these consultants reviewed 100% of our proved reserves.

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All estimates of oil and gas reserves are subject to uncertainty. The following table sets forth the estimated proven reserves in barrel of oil equivalents and the benchmark prices used in projecting them (in thousands except prices):

Estimated Proved Reserves	***Barnett Shale***	***Corsicana Field***	***E. Texas Field***	***Total***
Proved Developed (MBOE)	688	187	13	888
Proved Undeveloped (MBOE)	2,072	10,320	-	12,392
Total Proven Reserves at March 31, 2009	2,760	10,507	13	13,280
Benchmark Pricing				
Natural Gas per mmbtu	$3.58			
Crude Oil per barrel	$49.65			

There are numerous uncertainties inherent in estimating reserves and related information and different reservoir engineers often arrive at different estimates for the same properties. No estimates of our reserves have been filed with or included in reports to another federal authority or agency.

Wells are classified as crude oil or natural gas according to their predominant production stream.

The day-to-day operations of oil and gas properties are the responsibility of the operator designated under pooling or operating agreements. The operator supervises production, maintains production records, employs or contracts for field personnel and performs other functions. An operator receives reimbursement for direct expenses incurred in the performance of its duties as well as monthly per-well producing and drilling overhead reimbursement at rates customarily charged by unaffiliated third parties. The charges customarily vary with the depth and location of the well being operated. Our operators are affiliated with ReoStar and are owned by shareholders who own more than 15% of our issued and outstanding common stock.

Undeveloped Acreage Expirations

A significant amount of our Barnett Shale acreage is not yet held by production. However, due to our planned drilling schedules and lease renewal provisions, we do not anticipate significant leasehold expirations during the next two years.

Our Corsicana properties and east Texas properties are held by production.

Title to Properties

We believe that we have satisfactory title to all of our producing properties in accordance with generally accepted industry standards. As is customary in the industry, in the case of undeveloped properties, often minimal investigation of record title is made at the time of lease acquisition. Investigations are made prior to the consummation of an acquisition of producing properties and before commencement of drilling operations on undeveloped properties. Individual properties may be subject to burdens that we believe do not materially interfere with the use or affect the value of the properties. Burdens on properties may include:

- customary royalty interests;
- liens incident to operating agreements and for current taxes;
- obligations or duties under applicable laws;
- development obligations under oil and gas leases; or
- burdens such as net profit interests.

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Our headquarters are located at 3880 Hulen St, Suite 500, Fort Worth, Texas. We lease approximately one-half of the 12,000 square feet of office space under a sublease with the remaining half occupied by our affiliated operating entities, each of which contribute to the costs of leasing and maintenance of the leasehold, pro-rata to their respective usage. The term of the sub-lease is three years, and we pay rent at a rate of $1.10 per square foot, per month. Our administrative and office facilities are suitable for their respective uses.

ITEM 3. LEGAL PROCEEDINGS

On September 15, 2008, a royalty owner in the Corsicana polymer pilot, representing approximately one-third of the mineral ownership, filed an amendment to a suit originally filed in 2007. The amendment was filed to include the Company as a defendant. The suit, filed in the 13th Judicial District Court in Navarro County, Texas, alleges the lease has expired because no oil was produced from January 2005 through September 2005. The plaintiff has asked the court to declare the lease to be void; demands payment for any oil produced and sold subsequent to the time the lease expired; demands that all equipment and salvage located on the lease be given by court order to the plaintiff; and asks that any plugging liability be adjudged to be the responsibility of the Company.

The other royalty owners representing the remaining two-thirds mineral ownership have ratified the lease.

In October 2008, the court issued an order requiring the Company and plaintiff to attend mediation to settle the matter. The Company and plaintiff attended mediation in Corsicana, Texas, but were unable to resolve the matter during mediation. In March, the plaintiff filed a motion for summary judgment. The Court has not yet ruled on the motion.

If the plaintiff should prevail in the lawsuit, the amount of the loss contingency cannot be reasonable estimated; therefore no expense for this contingency has been recorded on the accompanying financial statements.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of our security holders during the fourth quarter of 2009.

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is currently quoted for trading on Over-the-Counter Bulletin Board (OTCBB) maintained by the Financial Industry Regulatory Authority (FINRA) under the symbol "REOS". There was no active market or any trading volume with respect to the shares of our common stock in the periods prior to the quarter ended December 31, 2006.

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The following table sets forth the high and low closing sale price of our common stock, as reported by the National Association of Securities Dealers Composite for each quarter during the past two fiscal years.

Fiscal 2009	High	Low
30-Jun-08	$0.95	$0.20
30-Sep-08	$0.74	$0.20
31-Dec-08	$0.50	$0.10
31-Mar-09	$0.30	$0.05

Fiscal 2008	High	Low
30-Jun-07	$1.28	$1.05
30-Sep-07	$1.30	$1.02
31-Dec-07	$1.42	$0.80
31-Mar-08	$1.04	$0.62

Holders of Record

On March 31, 2009, there were approximately 90 holders of record of our common stock.

Dividends

We have not paid any cash dividends on our Common Stock, and do not anticipate paying cash dividends on our Common Stock in the next year. We anticipate that any income generated in the foreseeable future will be retained for the development and expansion of our business. Future dividend policy is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, debt service, debt covenants, capital requirements, business conditions, the financial condition of the Company and other factors that the Board of Directors may deem relevant.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist you in understanding our business and results of operations together with our present financial condition. This section should be read in conjunction with the financial statements and the accompanying notes included elsewhere in this Form 10-K.

Statements in our discussion may be forward-looking. These forward-looking statements involve risks and uncertainties. We caution that a number of factors could cause future production, revenues and expenses to differ materially from our expectations. See "Disclosures Regarding Forward-Looking Statements" at the beginning of this Annual Report and "Risk Factors" in Item 1A for additional discussion of some of these factors and risks.

Overview of Our Business

We are an independent natural gas and oil company engaged in the acquisition, development, and exploration of oil and gas properties, primarily in Texas. Our objective is to build a balanced portfolio consisting of oil and gas producing properties and reserves in both resource (developmental) and enhanced

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oil recovery (redevelopment) plays. We will expand reserves through internally generated drilling projects coupled with complementary acquisitions.

Our revenues, profitability and future growth depend substantially on prevailing prices for oil and gas and on our ability to find, develop and acquire oil and gas reserves that are economically recoverable. Our profitability depends upon our ability to control operations of our oil and gas assets.

We have a single company-wide management team that administers all properties as a whole rather than by independent operating segments. We track only basic operational data by area and we do not maintain complete separate financial statement information by area. We measure financial performance as a single enterprise and not on an area-by-area basis.

Successful Efforts Method of Accounting

We account for our exploration and development activities utilizing the successful efforts method of accounting. Under this method, costs of productive exploratory wells, development dry holes and productive wells and undeveloped leases are capitalized. Oil and natural gas lease acquisition costs are also capitalized. Exploration costs, including personnel costs, certain geological and geophysical expenses and delay rentals for oil and natural gas leases, are charged to expense as incurred. Exploratory drilling costs are initially capitalized, but charged to expense if and when the well is determined not to have found reserves in commercial quantities. The sale of a partial interest in a proved property is accounted for as a cost recovery and no gain or loss is recognized as long as this treatment does not significantly affect the unit-of-production amortization rate. A gain or loss is recognized for all other sales of producing properties.

The application of the successful efforts method of accounting requires managerial judgment to determine the proper classification of wells designated as developmental or exploratory which will ultimately determine the proper accounting treatment of the costs incurred. The results from a drilling operation can take considerable time to analyze and the determination that commercial reserves have been discovered requires both judgment and industry experience. Wells may be completed that are assumed to be productive and actually deliver oil and natural gas in quantities insufficient to be economic, which may result in the abandonment of the wells at a later date. The evaluation of oil and natural gas leasehold acquisition costs requires managerial judgment to estimate the fair value of these costs with reference to drilling activity in a given area.