STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION

In the Matter of the Integration of Interests within an Individual Spacing Unit Pursuant to Environmental Conservation Law ("ECL") § 23-0901(3) Known as,

FRED ANDREWS 1-A.

SUMMARY REPORT

DEC File No.
DMN 01-2

Appearances:

-- Lipman & Biltekoff, LLP (Michael P. Joy of counsel), for appellant Western Land Service, Inc.

-- Christopher Denton, Attorney at Law (Christopher Denton of counsel), for appellants Harold A. Cutler, Sharon M. Cutler, Gerald M. Welliver, and Carolyn S. Welliver

-- Nixon Peabody, LLP (David H. Tennant of counsel), for respondent-well operator Fortuna Energy Inc.

-- Alison H. Crocker, Deputy Commissioner and General Counsel (Jennifer Hairie, Associate Counsel, of counsel), for staff of the Department of Environmental Conservation

SUMMARY REPORT OF THE CHIEF ADMINISTRATIVE LAW JUDGE

Staff of the Department of Environmental Conservation ("Department"), Division of Mineral Resources ("DMN"), issued an order dated September 8, 2006, integrating interests within the natural gas spacing unit known as Fred Andrews 1-A (API No. 31-015-23182-01). Western Land Services, Inc. ("WLS"), Harold A. Cutler, Jr. and Sharon M. Cutler (the "Cutlers"), and Gerald M. and Carolyn S. Welliver (the "Wellivers") (collectively, "appellants"), respectively, have filed separate notices of appeal and appeals with the Department's Office of Hearings and Mediation Services ("OHMS") challenging the order.

For the reasons that follow, I recommend that the Commissioner deem appellants' appeal to be an application for a ruling re-opening the 2002 Commissioner's orders establishing the Quackenbush Hill Field, grant the application, and modify the

2002 orders as indicated herein. I further recommend that the Commissioner vacate the September 8, 2006 integration order and remand the matter to Department staff for an integration hearing pursuant to the 2005 amendments to article 23 of the Environmental Conservation Law ("ECL").

Procedural Background

On January 23, 2002, Commissioner Erin M. Crotty issued a decision and order establishing natural gas well spacing in a field known as the Quackenbush Hill Field (the "Field"). The Field is located in portions of Steuben and Chemung Counties. The January 2002 decision and order established four of the five spacing units within the Field, and compulsorily integrated the interests of uncontrolled mineral rights owners therein.[1] On December 30, 2002, the Commissioner issued a second decision and order establishing a fifth gas well spacing unit in the Field, and compulsorily integrated the interests of uncontrolled mineral rights owners in the unit. The latter decision and order was judicially reviewed in a combined CPLR article 78 and CPLR 3001 proceeding, and upheld by the court (see Matter of Caflisch v Crotty, 2 Misc 3d 786 [Sup Ct, Chemung County 2003]).

Both the January 2002 and December 2002 decisions and orders incorporated by reference a November 1, 2001 stipulation between Department staff and well operator Pennsylvania General Energy, the predecessor in interest of respondent Fortuna Energy Inc. ("Fortuna"). The stipulation, among other things, established permit application procedures for any future wells in the Field proposed by any applicant (see Stipulation ¶ IV). Those procedures include provisions for Departmental approval of new spacing units in the Field and the compulsory integration of interests therein.

On April 29, 2005, Department staff issued a well permit for the Fred Andrews 1-A well as an extension well in the Field. In various submissions from December 2005 to February 2006, Fortuna as well operator proposed to establish a new spacing unit in the Field known as the Fred Andrews 1-A unit. On February 8, 2006, Department staff notified Fortuna of its approval of the Fred Andrews 1-A unit as an extension unit in the

[1] An uncontrolled mineral rights owner is an owner of mineral rights in a spacing unit that is not under lease to the well operator holding the well permit for the development and operation of the spacing unit.

Field (see Dahl Letter, Feb. 8, 2006, at 1). Staff directed Fortuna to initiate the notice procedures described by paragraph IV.F.4 of the stipulation. Pursuant to those procedures, Fortuna was to notify uncontrolled owners in the unit by certified mail, return receipt requested, among other things, that they had 90 days to contact the Department with any objection or opposition to compulsory integration.

Fortuna sent a letter dated March 13, 2006, to all uncontrolled owners in the unit identified by Fortuna. The letter provided the notice required by paragraph IV.F.4 of the stipulation, including notice of the 90-day period to raise substantive and significant comments explaining the basis of any objection or opposition to compulsory integration and identifying the specific grounds for such objection.

All of the owners in the proposed unit, except for the Millicent Chaney Special Needs Trust (the "Trust"), received the notice during the period from March 15, 2006 to March 27, 2006. The Wellivers received the notice on March 16, 2006, and the Cutlers received the notice on March 23, 2006. The Trust ultimately received the notice on May 1, 2006.

The Department received no objections to compulsory integration within the 90-day time period. Accordingly, Department staff issued an order dated September 8, 2006, establishing the Fred Andrews 1-A well spacing unit, and integrating the mineral interests in the unit. Fortuna was integrated as the only operator of record with a full working interest and the responsibility for costs and expenses of drilling, producing and plugging the Fred Andrews 1-A well. Pursuant to paragraph VII.F of the stipulation, the remaining uncontrolled owners were integrated as royalty interests entitled to receive royalty payments equal to the lowest royalty fraction, but no less than one-eighth, contained in any oil and gas lease within the Fred Andrews 1-A unit.

Meanwhile, in April 2006, WLS recorded three mineral rights leases for three parcels of property in the proposed Fred Andrews 1-A unit.[2] After the Department issued the September 8, 2006 integration order, WLS filed papers denominated a "notice of appeal" and "appeal" dated October 2, 2006. WLS addressed its papers to Commissioner Denise M. Sheehan and Chief Administrative Law Judge ("ALJ") James T. McClymonds. Commissioner Sheehan

[2] WLS has not identified which landowners in the Fred Andrews 1-A unit are the lessors for its three leases.

assigned the matter to the undersigned as presiding ALJ for appropriate disposition.

In its papers, WLS argues, among other things, that the Department failed to follow the procedures for integrating interests in gas well spacing units established after August 2, 2005, as provided for in the 2005 amendments to the Oil, Gas and Solution Mining Law (ECL art 23, as amended by L 2005, ch 386 [the "2005 amendments"]). Accordingly, WLS requests a Commissioner order vacating the September 2006 integration order and remanding the matter to Department staff to convene a compulsory integration proceeding in accordance with the new law.[3]

WLS's "appeal" raised threshold questions concerning which version of ECL article 23 applies, and whether further administrative proceedings were available to review the September 2006 integration order. As the presiding ALJ, by memorandum dated November 17, 2006, I authorized comments and replies to allow the parties to brief these two threshold issues.

Timely comments were filed by WLS, Fortuna, and Department staff. Shortly thereafter, and before replies were due, the Cutlers and the Wellivers, respectively, filed papers also denominated as "appeals." The Cutlers and the Wellivers seek a Commissioner order vacating the September 2006 integration order and remanding the matter to Department staff for further proceedings consistent with the new law. By memorandum dated October 12, 2006, I extended the deadline for the filing of replies to allow the parties to address not only the comments previously filed, but also the appeals filed by the Cutlers and the Wellivers. Timely replies were filed by WLS, Fortuna, Department staff, the Cutlers and the Wellivers.

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[3] In the alternative, WLS argues that notice was defective even under the old law. WLS contends that as a good faith purchaser/lessee of mineral rights in the unit, it was entitled to both actual and publication notice of the pendency of integration proceedings, neither of which was provided to WLS prior to issuance of the integration order. Fortuna argues that WLS received constructive notice of the integration proceedings by virtue of the actual notice provided to WLS's lessors. Given the resolution of this matter that follows, it is not necessary to decide whether WLS received adequate notice under the old law and stipulation, or whether further administrative proceedings are available to WLS to raise the challenge.

DISCUSSION

Applicable Law

As in Matter of Drumm 1 (Ruling of the Chief ALJ, Sept. 26, 2006, appeal before the Commissioner pending), this proceeding involves a "transition well." A transition well is a well where the permit to drill the well was issued prior to August 2, 2005, but where establishment of the spacing unit and the compulsory integration of interests therein was completed after that date (see id. at 3).

According to Department staff, however, this proceeding differs from Drumm 1 in a key respect. Department staff contends that Drumm 1 involved a "discovery well" in a new natural gas field known as the Zimmer Hill Field. Staff argues, as it did in Drumm 1, that the 2005 amendments to ECL article 23 apply to the establishment of the spacing unit and the integration of interests therein in a unit such as Drumm 1, even though the permit to drill the well in the unit was issued prior to the effective date of the 2005 amendments.

In this case, in contrast, Department staff notes that the two 2002 Commissioner orders in Matter of Quackenbush Hill Field adopted rules for the establishment of spacing units for extension wells in the Field, and the compulsory integration of interests therein. On this basis, staff distinguishes this case from Drumm 1. Department staff asserts that for extension wells permitted prior to the effective date of the new law, and subject to Commissioner orders establishing the terms of compulsory integration, the old law continues to apply when completing spacing and integration for such extension wells, even when such spacing and integration occurs after the effective date of the new law.

WLS, on the other hand, argues that by its express terms, the new law applies to integration of any spacing unit established after the effective date of the 2005 amendments. To the extent past administrative orders provide otherwise, WLS contends that the 2005 amendments superceded such orders. WLS argues that to continue to apply the old law for the integration of interest in spacing units established after August 2, 2005 defeats the main purpose of the 2005 amendments, which was to reduce the uncertainty that plagued proceedings under the old law.

I conclude that the express terms of the 2005 amendments, and the legislative purposes sought to be achieved by

those amendments, evince the Legislature's clear intent that the 2005 amendments be applied to all spacing order issued after the effective date of the amendment, notwithstanding any prior orders of the Department. Section 10 of the Laws of 2005, chapter 386, expressly provides that "[t]his act shall take effect immediately [Aug. 2, 2005] and shall apply to any oil or gas well permit or spacing order issued on or after such effective date except as otherwise specifically provided in this act" (emphasis added). Thus, by its express terms, the 2005 amendments apply to the spacing order in this case, which was issued after August 2, 2005. Because compulsory integration of interests in a spacing unit follows establishment of the unit, it necessarily follows that the compulsory integration of interests in the unit is also governed by the new law.

Significantly, nothing in the express terms of section 10 makes the distinction urged by Department staff between "discovery wells" and "extension wells" subject to Commissioner orders. To the contrary, section 10 refers to "any" spacing order issued after the effective date.

In addition, Department staff contends that a separate spacing order was required to establish the Fred Andrews 1-A unit (see Department Staff Reply, Dec. 1, 2006, at 4-5).[4] ECL 23-0503 contains an express provision that supports the conclusion that the Legislature intended the 2005 amendments to apply to any spacing unit established by a spacing order after August 5, 2005. ECL 23-0503(5) provides "[f]or wells permitted prior to the effective date of this section where a spacing order is required but has not been issued, the department shall issue a notice of intent to issue a spacing order." Such notice is to be published by the well operator in a form and manner prescribed by the Department. If the proposed spacing unit complies with the State-wide spacing requirements of the 2005 amendments, and no substantive and significant objections to unit boundaries are received within 30 days after publication of the notice by the well operator, the Department is authorized to issue a spacing order without hearing. Otherwise, the Department is directed to schedule an adjudicatory hearing.

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[4] In Drumm 1, Department staff took the position that spacing orders are not required in all cases. Staff explained that such orders were not required where the proposed spacing unit for a well conforms to the Statewide spacing rules established by the 2005 amendments (see Drumm 1, Ruling at 4-5). In such cases, the spacing unit is established by law (see id.).

ECL 23-0503(5) confirms that the Legislature intended to apply the new law to wells where the permit to drill was issued prior to the effective date of the amendments, but for which a spacing unit had not been established (see Matter of Drumm 1, Ruling, at 4). Again, nothing in section 23-0503(5) makes the express distinction between "discovery wells" and "extension wells" in natural gas fields subject to prior administrative orders.[5]

To read Department staff's interpretation into the 2005 amendments, in the face of the above referenced express language of the statute, would defeat several of the legislative purposes of the 2005 amendments. Among other things, the 2005 amendments were intended to eliminate the uncertainty associated with the old law, to simplify the potential methods for integrating ownership interests in a unit in the absence of voluntary agreement, and to ensure that unitization and integration processes are open and transparent (see New York State Senate Mem in Support, 2005 McKinney's Session Laws of NY, at 2254-2255). The 2005 amendments, and the Department's guidance interpreting those amendments (see DMN-1: Public Hearing Processes for Oil and Gas Well Spacing and Compulsory Integration, DEC Program Policy, Feb. 22, 2006 ["DMN-1"]), accomplish these legislative purposes by, among other things, providing actual and publication notice of integration proceedings, providing for an integration hearing, clearly delineating the categories of participation in unit well development available to mineral rights owners in a unit, and affording the mineral rights owners the clear right to participate in the integration hearing and elect the terms of their integration. The integration procedures provided for in the November 1, 2001 stipulation and incorporated into the Commissioner's orders lack the procedural safeguards and clarity with respect to integration of interests provided by the 2005 amendments.

In addition, staff's interpretation adds further uncertainty to the process. Instead of applying the new law to any spacing unit established after the effective date of the 2005 amendments, as the express terms of those amendments indicate,

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[5] Fortuna argues that a spacing order is not required for the Fred Andrews 1-A unit. I need not determine whether such an order is required for this unit or not. Even assuming a spacing order is not required, ECL 23-0503(5) nonetheless supports the conclusion that the new law applies to units established after the effective date, whether by order or by law, without regard to whether such units are for discovery wells or extension wells.

staff's interpretation instead requires a threshold determination whether a well is a discovery well or an extension well. Whether a well is a discovery well or extension well might engender litigation that, in turn, could lead to further delay as the issue is subjected to further administrative and judicial proceedings.

There can be no doubt that the Legislature has the power to supersede any prior administrative orders. Indeed, Department staff acknowledges that ECL 23-0501 as amended supercedes the Commissioner's orders with respect to well permits issued for any wells proposed in the Field after August 2, 2005 (see Department Staff Comments, Nov. 8, 2006, at 3 n 2). Fortuna argues, however, that applying the 2005 amendment's integration proceedings to the Fred Andrew 1-A unit would constitute an impermissible retroactive application of the new statute in derogation of vested economic rights and obligations under the 2001 stipulation and the Commissioner's orders (see Fortuna Comments, at 6; Fortuna Reply, at 3).

Fortuna's argument is unconvincing. First, Fortuna does not specify the vested economic rights it claims are implicated, and none are apparent from the submissions. Certainly, if the 2005 amendments were applied to modify those portions of the Commissioner's orders as established the five existing spacing units in the Field, or to modify the interests already integrated into those units, vested economic rights and obligations might be infringed. On the effective date of the 2005 amendments, however, the Fred Andrews 1-A unit was not established, the mineral rights owners therein were not identified, and their ownership interests were not integrated. Thus, no economic interests in the unit were vested.[6] Applying the integration procedures from the 2005 amendments to the Fred Andrews 1-A unit would have a prospective effect only, and would not infringe upon any identified vested rights fixed by the Commissioner's prior orders. Accordingly, applying the integration procedures under the 2005 amendments to the Fred

[6] Department staff's contention that the terms of integration for future wells in the Field were adjudicated in the prior proceedings is overstated. Even assuming for the sake of argument that the categories of interests -- such as working interests or royalty interests -- were adjudicated, it cannot be concluded that petitioners' interests were adjudicated. Petitioners had no interest in five spacing units established in the Commissioner's orders and, thus, were not parties to the prior integration proceedings for the Field.

Andrews 1-A unit is not inconsistent with the general rule favoring prospective application of statutory amendments (see Kelly v Yannotti, 4 NY2d 603, 606 [1958]).

Second, an exception to the presumption of prospective application applies to statutes that are remedial or procedural in nature (see Matter of OnBank & Trust Co., 90 NY2d 725, 730 [1997]). Such statutes are to be applied retroactively to better achieve their beneficial purpose (see id.). Here, the most the 2001 stipulation and the prior Commissioner's orders determined with respect to the Fred Andrews 1-A unit were the procedures for establishing the unit and integrating interests therein. As noted above, the 2005 amendments were intended to clarify and remedy deficiencies in the procedures for the integration of interests under the old law. The remedial purpose of the 2005 amendments would be frustrated if the procedures provided for in the 2001 stipulation and the Commissioner's orders were not modified (see id. at 731).

In sum, the express language of the 2005 amendments indicates that those amendments are to be applied to any spacing unit established after the effective date of the amendment. Nothing in the express language of the amendments or their legislative history supports Department staff's distinction between "discovery wells" and "extension wells." To the contrary, the remedial purpose of the 2005 amendments supports their application, notwithstanding prior stipulations and Commissioner's orders providing for different procedures.

Administrative Appellate Remedies

Having concluded that the 2005 amendments supercede those portions of the 2001 stipulation and Commissioner's order that established procedures for the integration of interests in new gas well units in the Field created after August 2005, the issue is whether administrative remedies are available to appellants to correct the Fred Andrews 1-A integration order, or whether appellant must resort to judicial proceeding to obtain the relief sought. I conclude that administrative remedies are available to appellants.

Similar to the circumstances explained in Matter of Drumm 1, the integration order issued by the Director of the Division of Mineral Resources without a hearing referral pursuant to 6 NYCRR part 624 is not directly appealable to the Commissioner. No Part 624 permit hearing proceedings were invoked by Department staff before issuing the integration order.

Therefore, the integration order is not a ruling of an administrative law judge ("ALJ") issued during the course of a Part 624 proceeding (see 6 NYCRR 624.8[d]). Moreover, appellants do not identify any legal basis or legal requirement, either under the 2001 stipulation or otherwise, for a hearing to review the integration order. Although the general practice under the old law was to refer all proceedings establishing new gas well fields for hearings under Part 624, the portions of the 2001 stipulation concerning procedures for future wells in the Field provide for a hearing only after substantive and significant issues are raised in objection to compulsory integration (see Stipulation ¶ IV.F[5][a]).

Notwithstanding the above, the essence of appellants' "appeal" is a challenge to those portions of the Commissioner's 2002 orders that adopted those portions of the 2001 stipulation as established procedures for the future wells in the Field. The appropriate procedural mechanism to challenge prior Commissioner orders is a motion to reopen those prior orders (see Matter of Stagecoach Field, Commissioner's Ruling on Petition for Modification or Vacatur, March 12, 2004; Matter of Mohawk Valley Organics, LLC, Commissioner's Ruling on Motion to Suspend and Reopen Hearing Record, Sept. 8, 2003).

The Department has long recognized its inherent authority to reopen or otherwise reconsider a final decision or order (see Matter of Mohawk Valley Organics, at 4-5 [citing Matter of Charles Pierce, Sr., (Commissioner) Ruling on Motion for Reconsideration, June 9, 1995]). When exercising its authority to reconsider a prior decision or order, the Department employs the standards applied by the courts when considering an application to modify or vacate a prior court order. Among the grounds for reopening or reconsidering a prior decision or order are those specified in CPLR 5015(a) (see Matter of Mohawk Valley Organics, at 5). In addition to the specific grounds listed in CPLR 5015(a), the courts have also recognized a decision maker's inherent discretionary power to vacate its own judgment for "sufficient reason and in the interests of substantial justice" (Woodson v Mendon Leasing Corp., 100 NY2d 62, 68 [2003]).

In this case, the "interests of substantial justice" standard is met. A substantial change in the underlaying statutory law provides a sufficient reason for revisiting the integration procedures adopted by the 2002 orders (see Matter of Jericho Union Free School Dist. No. 15 v Board of Assessors of County of Nassau, 131 AD2d 482 [2d Dept 1987] [change in decisional law provided proper case for exercise of inherent power in the furtherance of justice]). This is so, particularly

given that no party had any vested rights in those procedures. Moreover, as noted above, the 2005 amendments, and the Department's guidance thereto, provide for enhanced public notice by newspaper publication, clear notice to mineral rights owners of the right to elect participation in the well's production, specific delineation of the categories of participation available to mineral rights owners, and the right to participate in an integration hearing, none of which were afforded appellants in this case. Thus, the interests of substantial justice warrant revisiting the 2002 orders to modify the integration procedures adopted in those orders.

Recommendation

Accordingly, I recommend that the Commissioner deem appellants' appeal to be an application for a ruling re-opening the 2002 Commissioner's orders. I further recommend that the Commissioner grant the application and modify the 2002 orders to the extent of vacating those portions of the orders that adopted those portions of the 2001 stipulation that established procedures for the compulsory integration of interests in spacing units created after August 2005 and to substitute the compulsory integration procedures established by the 2005 amendments.

I also recommend that the Commissioner vacate the September 2006 integration order for the Fred Andrews 1-A gas well, and remand the matter back to Department staff for further proceedings consistent with the Commissioner's ruling.

/s/

James T. McClymonds
Chief Administrative Law Judge

Dated: May 22, 2007
Albany, New York