STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION

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

BEACH W 1.

INTERIM DECISION OF THE COMMISSIONER

DEC Order No. DMN 07-12

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

DZYBON 1.

DEC Order No. DMN 06-37

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

EOLIN 1.

DEC Order No. DMN 06-33

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

GILLIS 1.

DEC Order No. DMN 06-34

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

LITTLE 1.

DEC Order No. DMN 06-13

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

LUCAS 1.

DEC Order No. DMN 07-11

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

MESSING 1-B.

DEC Order No. DMN 07-07

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

PIETILLA 1.

DEC Order No. DMN 07-05

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

J. DRUMM 1.

DEC Order No. DMN 07-23

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

WINKKY 1.

DEC Order No. DMN 07-18

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

DRUMM 1.

DEC Order No. DMN 06-09

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

BOSKET 1.

DEC Order No. DMN 08-15

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

SRA3 1.

DEC Order No. DMN 07-39

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

USACK 1.

DEC Order No. DMN 07-34

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

WINTER 1-A.

DEC Order No. DMN 08-04

INTERIM DECISION OF THE COMMISSIONER

INTRODUCTION

This interim decision addresses common issues in the above captioned administrative proceedings, which arise out of compulsory integration of mineral interests in natural gas wells pursuant to Environmental Conservation Law (ECL) § 23-0901. Various parties in these proceedings appealed from three separate rulings of the Chief Administrative Law Judge, James T. McClymonds, as follows:

- Ruling of the [Chief] Administrative Law Judge on Issues and Party Status (March 14, 2008) in Beach W 1, Dzybon 1, Eolin 1, Gillis 1, Little 1, Lucas 1, Messing 1-B, and Pietella 1.

- Ruling of the [Chief] Administrative Law Judge on Issues and Party Status (June 11, 2008) in J. Drumm 1 and Winkky 1.

- Ruling of the Chief Administrative Law Judge on Issues and Party Status, and Orders of Disposition (Nov. 4, 2009) in Drumm 1, Allington 1, Bosket 1, SRA3 1, Stage 1, Usack 1, Winter 1-A.[1]

Compulsory Integration – General Background

In my interim decision in Matter of Dzybon 1, et al., I discussed the general background of compulsory integration (Matter of Dzybon 1, Interim Decision of the Commissioner, March 18, 2011). That background information is summarized below.

In New York State, the ECL requires oil and gas wells to be spaced in a way that promotes efficient production of the wells. See ECL 23-0301. The area around each well is called a "spacing unit." "Compulsory integration" refers to the process of determining the mineral interests of landowners within the spacing unit who do not enter into a lease with the well operator. These landowners who have not entered into leases are called "uncontrolled owners."

[1] All of the issues in Allington 1 and Stage 1 were resolved, and final orders of integration were issued; thus, they are not part of any appeal.

By statute, uncontrolled owners may elect one of three "integration options," which subject their mineral interests to different levels of risks and benefits:

(1) integrated participating owner (IPO) – the uncontrolled owner pays all costs associated with the exploration as they are incurred;

(2) integrated non-participating owner (NPO) – the uncontrolled owner agrees to reimburse the well operator out of production proceeds for its proportionate share of all costs incurred for the development of a successful oil or gas well within the spacing unit, and also agrees to pay an additional risk penalty to the well operator equal to two hundred percent of the costs; or

(3) integrated royalty owner – the uncontrolled owner agrees to receive a set royalty for its share of production, free of any charges, taxes, liabilities, or other obligations that might be incurred by the well operator or other non-royalty owners within the spacing unit.

(ECL 23-0901[3][c][1][i]; 23-0901[3][a][1], [2], [3].)

Uncontrolled owners who do not elect an option will automatically be integrated into the spacing unit as "integrated royalty owners" (option three above), who only receive a royalty for their share of a well's production.

The process for establishing the status of uncontrolled owners within a spacing unit proceeds to a compulsory integration hearing, which culminates in a draft compulsory integration order. Depending on any issues raised as to the draft order, the matter may then be referred to the Office of Hearings and Mediation Services (OHMS) of the New York State Department of Environmental Conservation (DEC or Department) for adjudicatory proceedings under 6 NYCRR Part 624. If no issues are referred to OHMS for adjudication, staff will issue a final compulsory integration order.

Staff held a compulsory integration hearing for each of the captioned matters and referred all but two to OHMS for adjudicatory proceedings. The remaining two matters were

referred to OHMS pursuant to litigation in Supreme Court, Albany County.[2]

PROCEDURAL BACKGROUND AND SUMMARY OF THE CHIEF ALJ'S RULINGS AND ISSUES APPEALED

Beach W 1, et al.

Staff of the Department's Division of Mineral Resources proposes to issue compulsory integration orders pursuant to ECL 23-0901, integrating mineral interests within the spacing units for each of the eight captioned natural gas wells in Beach W 1, et al. The wells and their locations are as follows:

- Beach W 1, Spencer, Tioga County
- Dzybon 1, Corning, Steuben County
- Eolin 1, Corning, Steuben County
- Gillis 1, Caton, Steuben County
- Little 1, Veteran, Chemung County
- Lucas 1, Van Etten, Chemung County
- Messing 1-B, Southport, Chemung County
- Pietilla 1, Van Etten, Chemung County

All eight wells target the Trenton-Black River natural gas formation.

Pursuant to ECL 23-0901(3)(b), Department staff conducted separate compulsory integration hearings for each of the eight wells. Pursuant to ECL 23-0901(3)(d), based upon objections raised at those hearings, Department staff referred the matters, except for the Little 1 matter, to OHMS for administrative adjudicatory hearings pursuant to 6 NYCRR Part 624. As

[2] At their respective compulsory integration hearings, staff did not refer the Drumm 1 or Little 1 matters to OHMS for an adjudicatory hearing. Western Land Services (WLS) filed article 78 proceedings challenging staff's integration orders for those wells. By decision and order of Supreme Court, Albany County (December 26, 2006, Teresi, J., Index No. 6647-06), the Drumm 1 matter was remanded to the Department for further administrative adjudication, and staff subsequently referred the matter to OHMS for adjudicatory hearings pursuant to Part 624 (see Commissioner Ruling on Motion for an Expedited Appeal, Nov. 30, 2007). In Little 1, the parties stipulated to a remand, and Little 1 was then referred to OHMS for an adjudicatory hearing (see So-Ordered Stipulation of Discontinuance and Order of Remand, Matter of Western Land Services, Inc. v Department of Envtl. Conservation, Sup Ct, Albany County, Jan. 18, 2007, Donohue, J., Index No. 8739-06 [IC Ex 5C]).

previously noted, Little 1 was referred to OHMS upon remand from Supreme Court, Albany County, in a pending CPLR article 78 proceeding. All eight matters were assigned to the Chief ALJ. Because common issues were presented, the Chief ALJ conducted the eight proceedings on a joint record.

An issues conference was convened on July 18, 2007. The parties represented by counsel included Department staff, Fortuna Energy, Inc. (the well operator in each of the eight captioned wells), Western Land Services (WLS), and uncontrolled owners, represented by Christopher Denton, Esq. (collectively, Denton owners). Dorchester Minerals L.P. filed a petition for amicus party status, but no one appeared on its behalf at the issues conference. No additional parties sought to intervene.

As noted above, the Chief ALJ issued his Rulings on Issues and Party Status (Issues Ruling) in Beach W 1, et al., on March 14, 2008. As to party status, the Chief ALJ

(1) ruled that Department staff, the well operator, and all uncontrolled owners in the respective captioned spacing units are mandatory parties to any subsequent adjudicatory proceedings;

(2) granted WLS amicus party status for all proceedings concerning the Messing 1-B well; and

(3) denied Dorchester Minerals, L.P., amicus party status in the proceedings because it "failed to establish that it has any expertise, special knowledge, or unique perspective that will make a material contribution to the record on the issues raised."

(Beach W 1, et al., Issues Ruling, at 2, 31).

As to issues for adjudication, the Chief ALJ ruled that a hearing will be convened on four issues:

(1) to develop the factual record concerning whether the productivity of the Little 1 and Eolin 1 wells was known or reasonably could have been known by WLS at the time of the respective integration hearings on those two wells;

(2) to develop the factual record concerning natural gas industry practice and the practices in other states concerning the sharing of well data and well site access among well operators and working interest owners;

(3) to develop the factual record concerning the confidentiality of well data and the terms of confidentiality customarily used in the industry; and

(4) to confirm elections in the Beach W 1 unit.

(Beach W 1, et al., Issues Ruling, at 30-31.)

The well operator for each of these wells, Fortuna, and uncontrolled owner WLS[3] appealed, challenging the Chief ALJ's Issues Ruling on the first three issues for adjudication. Fifteen other uncontrolled owners, represented by Christopher Denton, Esq. (collectively, Denton owners),[4] appealed, challenging the Chief ALJ's Ruling on the second and third issues.

Department staff filed a limited appeal on one issue, asserting that a factual record would not need to be developed on the cost and revenue of the Eolin 1 well because that information could be determined from publicly available documents, including information posted to the Department's website (Staff Appeal of Ruling on Issues and Party Status, April 7, 2008, at 1-2, 5-6). Department staff also requested that the Commissioner clarify that the risk penalty issue, as applied to IPOs, only arises in the context of transition wells (id. at 4-5).[5]

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[3] WLS acquired mineral interests from landowners in the spacing unit through lease agreements with those landowners and participates in these proceedings as an uncontrolled owner.

[4] The Denton owners are comprised of M & D Land and Cattle Company, LLC, and a group of fourteen other leaseholders of mineral interests. Of the eight wells in the Beach W 1 proceeding, these leaseholders have an interest in all but one well, the Eolin 1 well.

[5] Transition wells are wells that were issued a permit to drill before August 2, 2005 (the effective date of the amendments to ECL article 23), but for which a spacing order had not been issued and compulsory integration had not been completed.

By letter dated July 8, 2008, Chesapeake Appalachia, LLC, requested leave to appear as amicus on the pending appeals.

J. Drumm 1 and Winkky 1

Department staff conducted compulsory integration hearings on two additional wells: J. Drumm 1 (Thurston, Steuben County), and Winkky 1 (Veteran, Chemung County). Both wells target the Trenton-Black River natural gas formation. Based upon objections raised at those hearings, Department staff referred the matters to OHMS for adjudicatory proceedings pursuant to Part 624. The matters were assigned to the Chief ALJ, who conducted the two proceedings on a joint record.

An issues conference was convened on May 13, 2008. The parties represented by counsel included Department staff, Fortuna Energy (the well operator for each well), and three NPOs represented by Christopher Denton, Esq. (collectively Denton owners).

As noted above, the Chief ALJ issued his Ruling on Issues and Party Status (Issues Ruling) in J. Drumm 1 and Winkky 1, on June 11, 2008. Fortuna, the well operator, filed a notice of appearance to participate in the issues conference and objected to staff's inclusion of a condition in the draft integration orders requiring Fortuna to provide well data and well site access to the IPOs and NPOs in these two matters without imposing terms of confidentiality. The Chief ALJ ruled that Fortuna and Department staff were full parties to this proceeding and joined these two proceedings with the appeals in Beach W 1 (J. Drumm 1 and Winkky 1, Issues Ruling, at 4).

Both staff and Fortuna agreed that since the same issue of access to well data and the well site was presented in Beach W 1, they would abide by the Interim Decision in Beach W 1, and not brief the issue in these matters (id.).

Drumm 1, et al.

Department staff also conducted compulsory integration hearings on the following wells:

- Drumm 1, Bradford, Steuben County
- Bosket 1, Campbell, Steuben County
- SRA3 1, Orange, Schuyler County
- Usack 1, Erin, Chemung County
- Winter 1-A, Spencer, Tioga County

All five wells target the Trenton-Black River natural gas formation.

At the respective compulsory integration hearings, Department staff referred the matters except Drumm 1 to OHMS for hearings pursuant to Part 624. As noted above, the Drumm 1 matter was referred to OHMS after remand from Supreme Court, Albany County, in a pending CPLR article 78 proceeding. The matters were assigned to the Chief ALJ, who conducted proceedings on a joint record.

The issues conference on the Drumm 1, SRA3 1, Usack 1, and Winter 1-A wells was conducted on May 13, 2008, with J. Drumm 1 and Winkky 1. Parties represented by counsel included Department staff, Fortuna (well operator in Drumm 1, SRA3 1, and Winter 1-A), Chesapeake Appalachia, LLC (well operator in Usack 1), WLS, and Whitmar Exploration Company, Inc. The issues conference on the Bosket 1 well was conducted on October 20, 2008. Parties represented by counsel included Department staff, well operator Fortuna Energy, and one uncontrolled owner represented by Christopher Denton, Esq.

As noted above, the Chief ALJ issued his Ruling on Issues and Party Status (Issues Ruling) in Drumm 1, et al. on November 4, 2009.

Adhering to his prior rulings in Dzybon 1 and Beach W 1, the Chief ALJ ruled that the well operator, Department staff, and all uncontrolled owners were mandatory parties for purposes of adjudicatory proceedings on proposed compulsory integration orders under ECL article 23 (Drumm 1, et al., Issues Ruling, at 9).

As to issues for adjudication, the Chief ALJ ruled on the following issues:

(1) well operators can drill prior to issuance of an integration order;

(2) the 2005 statutory amendments regarding spacing units and compulsory integration apply to transition wells (Chief ALJ reconsidered his prior ruling in Drumm 1 on this issue, and adhered to that prior ruling);

(3) the 2005 amendments do not authorize the application of a risk penalty to IPOs; and

(4) access to well data and the well site without terms of confidentiality is an adjudicable issue.

(See Drumm 1, et al., Issues Ruling, at 37-38.)

Fortuna appealed from the Chief ALJ's November 4, 2009, Ruling, challenging two of the four issues.[6] First, Fortuna argued that the new law does not apply to transition wells. Second, Fortuna argued that the 2005 amendments authorizes staff to impose a risk penalty for uncontrolled owners who elect IPO status in transition wells and that imposing a risk penalty in those circumstances was an appropriate exercise of staff's discretion under the "just and reasonable" clause of ECL 23-0901(3). Fortuna did not appeal the well data and site access issue, but instead agreed to abide by my decision on this issue in Beach W 1, et al.

SUMMARY OF THIS INTERIM DECISION

Party Status

I concur in part with the Chief ALJ's rulings on party status. I confirm the Chief ALJ's grant of amicus party status to WLS and his denial of party status to Dorchester Minerals, L.P. For the reasons that follow, however, I decline to adopt the remainder of the Chief ALJ's Rulings with respect to party status. As I previously held in Dzybon 1, I conclude that only Department staff is a mandatory party to any subsequent adjudicatory proceedings. To participate in those proceedings, uncontrolled owners and well operators have automatic standing, but must also demonstrate that the issues they raise are both substantive and significant. Upon a review of the record in these matters, however, I conclude that the well operator and the uncontrolled owners who have raised objections in these proceedings have met this burden.

Issues

I concur with the Chief ALJ's rulings that the 2005 statutory amendments apply to the transition wells involved in these proceedings. I also concur with the Chief ALJ's ruling in Drumm 1, et al. that the 2005 amendments do not authorize Department staff to apply a risk penalty to IPOs in the context of transition wells.

[6] Staff and WLS did not file an appeal.

As to those factual issues that the Chief ALJ ruled should be advanced to adjudication in Beach W 1, et al., I concur that an adjudicatory hearing is necessary to confirm the elections in the Beach W 1 unit. However, as discussed below, the statutory right of WLS to elect integrated participating owner (IPO) status is exclusive to it alone and may not be altered by any exercise of Department staff's discretion. Accordingly, no factual record needs to be developed concerning "whether the productivity of the Little 1 and Eolin 1 wells was known or reasonably could have been known by WLS at the time of the respective integration hearings on those two wells" (Beach W 1, Issues Ruling, at 31).

The Little 1 and Eolin 1 matters must be remanded, however, for a factual determination of the well costs due and payable to Fortuna by WLS as an IPO.

Finally, I determine that working interest owners are entitled to reasonable site access and data – after the time periods in ECL 23-0313 for release of that information have expired. I further conclude that royalty owners are also entitled to data, though not to site access, subject to the time periods in ECL 23-0313.

PARTY STATUS

Citing his ruling in Matter of Dzybon 1, the Chief ALJ ruled that Department staff, the well operator, "and all uncontrolled owners in a spacing unit are mandatory parties under Part 624 for purposes of administrative adjudicatory proceedings on proposed integration orders under Article 23" (Beach W 1, Issues Ruling, at 6; citing Matter of Dzybon 1, Chief ALJ Ruling on Procedural Issues, June 6, 2007; see also Drumm 1, Issues Ruling, at 9). Thus, for these proceedings, the Chief ALJ concluded that not only were Department staff and Fortuna mandatory parties, but that all uncontrolled owners in a spacing unit are mandatory parties, as well. I reverse this ruling.

In my decision in the interim appeal of Matter of Dzybon 1, I concluded that only Department staff were automatic or mandatory parties to any subsequent adjudicatory proceeding (Matter of Dzybon 1, Interim Decision of the Commissioner, March 18, 2011). I further concluded that well operators and uncontrolled owners had automatic standing, but would also need to establish that an issue they wish to adjudicate is both substantive and significant. As I stated in Dzybon 1:

> "[W]ell operators and uncontrolled owners have automatic standing to participate in Part 624 proceedings that follow compulsory integration hearings. This recognition of automatic standing is based on the mineral interests that well operators and uncontrolled owners possess and are directly affected by compulsory integration. The well operators and uncontrolled owners would then have to demonstrate that any issues they wish to pursue in a Part 624 proceeding are substantive and significant, as ECL 23-0901(3)(d) requires." (Id., at 11.)

I see no reason to depart from this precedent, in which I also set forth the procedural steps an objector would be required to take in raising an issue it asserts to be substantive and significant, warranting adjudication, and the manner by which the issue would be considered. (See id., at 11-14.)

Beach W 1, et al.

I affirm the Chief ALJ's grant of amicus party status to WLS in Messing 1-B. I also affirm the Chief ALJ's denial of amicus party status to Dorchester Minerals, L.P. Finally, I grant the request by Chesapeake Appalachia, LLC, to appear on the appeal as an amicus, and I accept its filing.

Upon my review of the record in the Beach W 1, et al. matters, I am remanding the Little 1 and Eolin 1 matters for a factual determination of the well costs due and payable by WLS as an IPO to Fortuna, and to remand the Beach W 1 matter to confirm the elections of certain uncontrolled owners. These are the only matters presented warranting further adjudication. The remaining issues raised are legal issues that may be decided now without the development of a factual record (see 6 NYCRR 624.4[b][5][iii]). The Denton parties have not raised any affirmative issues for adjudication in these matters.

J. Drumm 1 and Winkky 1; Drumm 1, et al.

As discussed further below, all issues raised on the appeals in J. Drumm 1 and Winkky 1 and Drumm 1, et al., are resolved in this interim decision. Accordingly, no further adjudication is warranted. The matters are remanded to the Chief ALJ for the issuance of any necessary spacing orders for the transition wells, and the preparation of final orders of integration.

Issue No. 1
Application of a Risk Penalty to Uncontrolled Owners Who Elect IPO Status within a Spacing Unit for Transition Wells

In the Eolin 1, Little 1, Drumm 1, SRA3 1, and Usack 1 matters, Department staff imposed a risk penalty on WLS. These matters involve transition wells – that is, the Department issued drilling permits for those wells before August 2, 2005 (the effective date of the amendments to ECL Article 23, Chapter 386 of the Laws of 2005) (the new law) but for which spacing orders had not been issued and compulsory integration had not been completed. The complete procedural history of the matters and the positions of the parties are set forth in the Chief ALJ's issues rulings, and need not be repeated here (see Beach W 1, Issues Ruling, at 10-18; Drumm 1, Issues Ruling, at 20-36). The facts in this matter are summarized briefly below.

Department staff concluded that the new law applied, accepted the spacing units proposed by the well operator for the wells, and scheduled integration hearings in each matter, pursuant to new ECL section 23-0901(3)(d). At the time of their respective integration hearings, the wells were producing commercially viable quantities of natural gas.

At each of the integration hearings, WLS appeared as an uncontrolled owner and asserted that it was electing to be integrated into the respective spacing unit as an integrated participating owner (IPO). As an IPO, WLS would pay all costs associated with the well exploration (ECL 23-0901[3][a][2]). No risk penalty attaches to WLS as an IPO under ECL 23-0901(3)(a)(2). At each hearing, WLS tendered to Fortuna the funds reflecting its proportionate share of well costs as an IPO. However, because the Eolin 1 and Little 1 wells were in production at the time of their respective integration hearings, Department staff asserted that a risk penalty should be assessed against WLS in each matter. The imposition of a risk penalty was just and reasonable, in Department staff's view, because the risk ordinarily inherent in drilling a well had been removed.

WLS objected to the imposition of a risk penalty in each case. However, not wishing to be relegated to integrated royalty status, WLS also filed at each integration hearing a protective election, under protest, as an IPO subject to a risk penalty and an election, also under protest, as an integrated non-participating owner (NPO). At each of the hearings, Department staff only accepted WLS's election as an NPO, subject to a risk penalty. Well operators Fortuna and Chesapeake

Appalachia, LLC (Usack 1) concurred in the position taken by Department staff (see Integration Hearing Trans [6-1-06], at 121-125 [Little 1]; Integration Hearing Trans [10-3-06], at 45-52 [Eolin 1]; Integration Hearing Trans [5-30-06], at 34, 40-41 [Drumm 1]); Integration Hearing Trans [10-23-07], at 18-21 [SRA3 1]; Integration Hearing Trans [9-25-07], at 15-16 [Usack 1].

At the issues conferences, the Chief ALJ heard argument with respect to the Department's authority under the new law to impose a risk penalty on an uncontrolled owner electing IPO status in a transition well case. In particular, the circumstances here suggest that the risk of exploration has been removed because the drilling effort resulted in a well producing commercially viable quantities of natural gas.

With respect to the Eolin 1 and Little 1 wells, in the Chief ALJ's view, whether staff's imposition of a risk penalty was just and reasonable would depend on whether the uncontrolled owner knew of the well's successful production at the time it made its election as an IPO. The Chief ALJ stated the following:

> "The questions whether the Department has the authority under the current Article 23 to impose a risk penalty upon an IPO pursuant to its 'just and reasonable' power and, if so, whether it is 'just and reasonable' to impose a risk penalty based upon the circumstance that risk has been removed from the election process, are significant open questions that should not be decided without a developed factual record. The former question implicates the scope of the Department's powers under the new law. In particular, the issue concerns whether the statute's general provisions granting the Department discretionary 'just and reasonable' power (see ECL 23-0901[3]; ECL 23-0901[3][c][1][ii][J]) may be used to vary the specific provisions governing an IPO's rights and interests (see ECL 23-0901[3][a][2]). This question may be rendered academic if the facts demonstrate that the productivity of the well in issue was not known, or could not reasonably have been known, at the time of the integration hearing. Resolution of the latter question depends on facts that are in material dispute" (Beach W 1, Issues Ruling, at 18).

Thus, the Chief ALJ determined that an adjudicatory hearing would be held to develop the factual record concerning whether the productivity of the Little 1 and Eolin 1 wells was known or reasonably could have been known by WLS at the time of the respective integration hearings on those two wells.

With respect to the Drumm 1, SRA3 1, and Usack 1 wells, the Chief ALJ did not find any threshold factual issues to adjudicate (see Drumm 1, Issues Ruling, at 28). On the merits, the Chief ALJ concluded that Department staff lacked the authority under the 2005 amendments to impose a risk penalty on a party seeking to participate as an IPO in a transition well (id. at 28-36).

Upon my review of the record in these matters and my reading of current ECL article 23, I conclude that Department staff may not impose a risk penalty on an uncontrolled owner electing IPO status. This is true even as to transition wells; even if the well was commercially viable and in full production at the time of the integration hearing; and even if the uncontrolled owner was fully aware of the well's viability and productivity when it elected IPO status.

Thus, I further determine that the hearing contemplated by the Chief ALJ in Eolin 1 and Little 1 is precluded under the new law. Whether the terms of integration under prior ECL 23-0901 or new ECL 23-0901 are to be applied in these transition wells depends upon when the spacing unit was created. (See Fred Andrews 1-A, Interim Decision and Order of the Commissioner, Jan. 7, 2009, at 8-9.) If the spacing unit was created after the new law became effective, the new law's provisions apply with respect to risk penalty (see ECL 23-0503[5]).

Indeed, the legislature provided for the application of the new law in the circumstances presented in these matters. The new law became effective on August 2, 2005, and the bill enacting the new law expressly stated that the amendments "apply to any oil or gas well permit or spacing order issued on or after" that date. (L 2005, ch 386, § 10.) In these matters, although the well permits were issued prior to the effective date of the new law, the spacing orders were not. Therefore, the new law applies.

Under the prior law, drilling always commenced before the spacing unit was established. Only when a productive well was established would operators be required to establish spacing units and commence the integration process. If the well drilling effort yielded a dry hole, exploration might be

abandoned. Only with the establishment of a productive well would the integration of interests be relevant and necessary.

Under the new law, where the well operator has not completed drilling prior to the integration hearing, uncontrolled owners would, obviously, be making their elections prior to the results of any drilling operation. The playing field would thus be level with "risks and responsibilities [allocated] among operators and owners of mineral interests (either leased or unleased) on a reasonable basis" (Senate Introducer Mem in Support, 2005 McKinney's Session Laws of NY, at 2253).

Nothing in the new law, however, forbids an operator from drilling before the integration hearing. ECL 23-0503(2) directs the Department to issue a drilling permit when the application submitted by the well operator satisfies the requirements of ECL 23-0501(2). Where the well operator controls at least sixty percent but not all of the acreage within the spacing unit, ECL 23-0501(3) merely states that the Department will conclude the integration process "as expeditiously as possible." The section does not preclude drilling before integration.

That drilling prior to integration is permissible is demonstrated by the one exception in ECL 23-0501 where drilling prior to integration is expressly not permissible. ECL 23-0501(2)(b) states that when the well operator does not control the applicable oil or gas rights in the target formation to be penetrated by a wellbore, its permit to drill is conditioned upon the completion of the integration process before it "can exercise the right to drill . . . under the permit." Thus, the time at which an operator decides to drill pursuant to an unconditioned well drilling permit issued by the Department is a business decision made by it alone.

The well operator's decision to drill before the integration hearing in no way affects the exclusive right of an uncontrolled owner in the spacing unit to elect the status at which it will participate in the exploration proposed for the spacing unit. Nor may the Department change or modify the election of an uncontrolled owner. As ECL 23-0901(3)(c)(1)(i) provides, prior to the integration hearing, uncontrolled owners are provided with an election form "granting the uncontrolled owner the right to elect to be integrated into the spacing unit as an integrated participating owner, an integrated non-participating owner or an integrated royalty owner."

In only one circumstance may Department staff impose an elective status upon an uncontrolled owner: when, in accordance with ECL 23-0901(3)(c)(2), the uncontrolled owner has failed to indicate any election and is thereby integrated into the spacing unit as a royalty owner. Thus, the timely election of an IPO or an NPO is exclusive to the uncontrolled owner and cannot be changed by Department staff.

Two points are apparent from the new law: (1) but for the exception indicated in ECL 23-0501(2)(b), the well operator may drill before the integration hearing, and (2) the status at which the uncontrolled owner elects to participate in the spacing unit is exclusive to it alone.

While the balance of risk may be allocated equally between the well operator and the uncontrolled owners prior to drilling, the well operator may remove that balance by choosing to drill before integration. But, this is a voluntary act by the well operator. Whether the well is productive or a dry hole, the well operator will have, to some degree, removed the risk otherwise inherent in exploration – the risk with which the pre-election uncontrolled owner would otherwise have been faced.

In any event, under the new law, the operator will always be made whole for its drilling costs. It will recoup those costs from all owners in the spacing unit: from IPOs through direct payment up front; from NPOs out of the well's production; and from royalty owners by earning all the proceeds of the well's production from their proportion of the spacing unit, less operating costs and royalties. Moreover, the well operator will receive a risk penalty from those uncontrolled owners who elect NPO status. Thus, the new law preserves one of the main purposes behind New York's oil and gas law since its inception: to encourage investment by venture capitalists in the exploration and production of the oil and gas reserves in the State. When they succeed in their exploratory efforts, they should be made whole for the costs they have incurred.

Nor am I persuaded that the status of these wells as transition wells is a special circumstance that warrants imposition of a risk penalty. As previously discussed, the new law applies to transition wells, and any assessment of a risk penalty in these matters is to be made pursuant to the new law. Under the new law, a risk penalty can be assessed only if an uncontrolled owner elects NPO status. As previously discussed, by drilling and establishing a producing well, the operator removes the risk, and uncontrolled owners who might have elected

NPO status (which does impose a risk penalty) can now elect IPO status (which does not impose a risk penalty).

The authority that Department staff cites for the imposition of a risk penalty on an IPO in the transition well case is the "just and reasonable" mandate of ECL 23-0901(3) and the authority to add terms to the order of integration pursuant to ECL 23-0901(3)(c)(1)(ii)(J). I do not accept staff's position that these statutory provisions justify the imposition of a risk penalty on an IPO.

The "just and reasonable" mandate is found in ECL 23-0901(3), which provides that in the absence of voluntary agreement between uncontrolled owners and the well operator, and if required to implement the policies expressed in ECL 23-0301,

> "the department shall make an order integrating all tracts or interests in the spacing unit for development and operation. Each such integration order shall be upon terms and conditions that are just and reasonable and subject to the following . . . ."

The phrase "subject to the following" leads to the statutory terms of any proposed order of integration found at ECL 23-0901(3)(c)(1)(ii)(A) through (J). As ECL 23-0901(3)(c)(1)(ii) makes clear, these terms are "applicable to integrated participating owners [IPOs] and integrated non-participating owners [NPOs]." Upon the plain reading of the statutory terms of integration, ECL 23-0901(3)(c)(1)(ii)(A) through (I), any discussion of the imposition of a risk penalty is applicable to NPOs alone, not to IPOs. This interpretation is not modified by the language of ECL 23-0901(3)(c)(1)(ii)(J), which provides that "[o]ther terms may be included in the order of integration if the Department determines such terms are reasonably required to further the policy objectives of section 23-0301 of this article." Nothing in this section suggests that, under the new law, imposition of a risk penalty on an IPO would be permissible.

Based on the foregoing, elections for mineral interests owners may be exercised only by the mineral interest owners. The "just and reasonable" mandate of ECL 23-0901(3) does not confer any authority on Department staff to vary the statutory terms of integration that would permit the imposition of a risk

penalty on an IPO.[7] Accordingly, no factual adjudication is necessary.

Therefore, no risk penalty can be imposed on WLS which, from the first, sought IPO status in Eolin 1, Little 1, Drumm 1, SRA3 1, and Usack 1. The NPO status of WLS in the Eolin 1 and Little 1 matters is vacated, and WLS's election as an IPO in each case is confirmed.

The matters are remanded to the Chief ALJ for a determination of well costs, as an IPO, due from WLS to Fortuna or Chesapeake Appalachia in each case.

Issues No. 2 and 3
Access to Well Data and the Well Site, Confidentiality of Data

Department staff's draft integration orders provide the working interest owners[8] with access to well data and the well site upon payment of well costs,[9] without any Department-imposed terms of confidentiality.[10]

As typified in the proposed Beach 1 order of integration (Issues Conference Exhibit 1A), Department staff proposes to include the following language in Paragraph I:

> "The well operator shall provide each integrated participating and non-participating owner, at the integrated owner's sole risk and cost, full and free

[7] As noted, the statute does not authorize any discretion to staff to impose a risk penalty here. Accordingly, the Chief ALJ's alternative analysis, which was premised on staff's authority to impose a risk penalty (see Drumm 1, Issues Ruling, at 32), is not legally supportable and need not be examined. Moreover, although I am not accepting staff's legal interpretation as to the scope of its discretion, I recognize that staff was engaged in a careful and conscientious effort to interpret the intent of the new law.

[8] "Working interest owners" are either IPOs or NPOs, but are not royalty interest owners.

[9] "Payment of well costs" means upon payment of their proportionate share of well costs in the case of IPOs, or after the well operator's recoupment of well costs and risk penalty from production in the case of NPOs.

[10] For the SRA3 1 well, this issue was resolved by stipulation of the parties (see Drumm 1, Issues Ruling, at 36, n 10).

access at all reasonable times to all operations on the spacing unit and to the records of operations conducted thereon or production therefrom, subject to the following provisions:

"A. An integrated participating owner's access commences upon payment of the owner's proportionate share of well costs and shall be provided on a timely basis without unnecessary delay. An integrated non-participating owner's access commences upon reimbursement to the well operator out of production of the owner's proportionate share of well costs and shall also be provided on a timely basis without unnecessary delay.

"B. Access provided by this Order shall not be exercised in a manner interfering with the well operator's conduct of an operation and shall not obligate the well operator to provide any data of an interpretive nature unless the cost of preparation of such interpretive data was charged to the account of the integrated owner.

"C. Access provided by this order is not restricted by any provisions of ECL regarding confidentiality of records submitted to the Department nor by the existence or lack of a separate confidentiality agreement among the well operator and integrated owners."

All of the parties agree that the proposed language is drawn from the terms of the joint operating agreement most commonly used in oil and gas industry practice.[11] This agreement, however, is between joint operators, which is not the case here as to working interest owners and royalty interest owners. Both WLS and the Denton owners support these provisions of the draft integration order; Fortuna opposes them.

In support of its position, Department staff relied on two ECL provisions. The first provision is ECL 23-0901(3)(c)(1)(ii)(A), one of the mandated statutory terms of integration. This section provides that an owner (i.e., an IPO or an NPO) "shall be liable for its proportionate share of all costs and expenses, including taxes, and claims of third parties related to the well, operations thereon and in conjunction

[11] This form is promulgated by the American Association of Professional Landmen (AAPL)(see AAPL Form 610-1989, "Model Form Operating Agreement").

therewith, and shall be entitled to its proportionate share of all benefits therefrom."

The second provision cited by Department staff is ECL 23-0901(3)(f), which provides the following:

> "All operations including, but not limited to, the commencement, drilling, or operation of a well or the existence of a shut-in well upon any portion of a spacing unit covered by an order of integration shall be deemed for all purposes the conduct of such operations upon each separately owned tract in the spacing unit by the owner or several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by an order of integration shall, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon."

As to the first provision, ECL 23-0901(3)(c)(1)(ii)(A), Department staff asserted that well data and reasonable site access were "benefits" inuring to the owners. As to the second provision, ECL 23-0901(3)(f), Department staff pointed out that the operations conducted in the spacing unit are deemed the operations of each owner within the spacing unit. The collection of well data, staff asserted, was among the operations conducted in the spacing unit. Accordingly, each owner in the unit was entitled to the data and reasonable access to the site.

Fortuna argued that the "benefits" referred to in the first ECL section cited and the "operations" referred to in the second ECL section cited related solely to a well's production within the spacing unit. The proposed data disclosure is not expressly provided for in the statute, Fortuna asserted. Moreover, Fortuna argued, for the Department to require operators to disclose well data to owners would require a rulemaking.

In ruling on the issue, the Chief ALJ concluded that "Article 23 is ambiguous concerning whether working interest owners are entitled to well data and well site access." To resolve this apparent ambiguity, the Chief ALJ stated that "it is appropriate to consider industry practice and the practice in other gas producing states as an aid to interpreting the legislative intent of Article 23."

I do not accept the conclusion that ECL article 23 is ambiguous and that industry practice and the practices of other

states need be consulted as an aid to determining the intent of the New York Legislature. To the contrary, the language chosen and enacted by the Legislature as ECL article 23 is unambiguous. For the reasons that follow, I conclude that the statute provides for disclosure of well data to all uncontrolled owners within a spacing unit, subject to reasonable timeframes and confidentiality requirements set forth in ECL 23-0313. Similarly, I conclude that the statute also provides for reasonable access to the well site to owners possessing working interests, but not royalty interests, within a spacing unit.

The policy of the State in the development and exploitation of its oil and gas resources is expressed in ECL 23-0301: to regulate development and production so as to (1) prevent waste, (2) maximize ultimate resource recovery, and (3) ensure that the correlative rights of all owners are fully protected.

In realizing the policy goals articulated in ECL 23-0301, a balance must be struck between the rights of landowners and leaseholders within a spacing unit and those of exploration and development investors, in particular, the spacing unit's well operator. On the one hand, leaseholders and landowners in a spacing unit have the right to know the results of an operator's exploratory efforts on their actual land, if that is where a drilling rig is located, for instance, or on their behalf if they have mineral interests elsewhere within the spacing unit. On the other hand, operators and their principals have the right to keep the results of their drilling operations reasonably confidential. Without such confidentiality, oil and gas developers would be deprived of an important competitive advantage – one of the prime reasons they would be willing to risk their capital in oil or gas exploration in this State in the first place.

In 1989, the Legislature expressly addressed the issue of confidentiality in the context of making information about wells available to the general public (ECL 23-0313). The Department requires well operators to submit various records, data, and reports. While the Department may share this information with other departments and agencies of the State on a confidential basis, it may not be disclosed to the general public for a period of six months following the period for which the information applies (ECL 23-0313[1][a]) or after the commencement of drilling (ECL 23-0313[1][d]).[12] Upon timely

[12] ECL 23-0313(1)(d) provides that "[w]ell logs, well samples, directional surveys and reports on well drilling and completion, for all wells subject to the oil, gas and solution mining law, shall be for the confidential use of the department and other departments,

application by the person furnishing the records, this six-month period may be extended for an additional six months where drilling operations have been continuous throughout that period (see ECL 23-0313[1][d][1]). Moreover, it may be exempt from disclosure for a maximum time of two years upon a application timely made and granted under Public Officers Law § 87(2) (see ECL 23-0313[1][d][2]).

The time periods in ECL 23-0313 for access to information by the general public are suitable here. Stated another way, mineral interest owners will have access to the information just as the general public would have access to it. I see no reason to establish different time periods for mineral interest owners, particularly since any lesser time periods for mineral interest owners may undermine the protections afforded the operators in ECL 23-0313.

Mineral rights owners have the right to assess the results of the exploration endeavors of the operator who is drilling and exploring on their behalf within the spacing unit in which they own or lease mineral interests. They need this information to be satisfied that the operator has dealt with them fairly and that costs being assessed against them (in the case of IPOs and NPOs) are justified. If not, they would need this information to consider any remedies available to them, such as an action for an accounting in State Supreme Court. Likewise, royalty owners need this information to verify that they are receiving their just royalty compensation.

Not all mineral interest owners, however, are entitled to access to the well site. Because IPOs and NPOs have more of a financial stake in the production of wells than do royalty owners, they have an added interest in access to the well site. In contrast, royalty owners have less of a financial stake and have a lesser interest in access to a well site. So as not to interfere with daily production of a well by enabling too many mineral interest owners to have access to a well site, and based on the different financial stakes of the mineral interest owners, I determine that only IPOs and NPOs are entitled to have access to the well site. The interest of royalty owners can be met with access to data.[13]

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agencies and offices of the state government until six months after the commencement of actual drilling operations."

[13] Of course, a property owner would always have access to the well site, no matter if the property owner is a royalty owner.

Thus, I determine that (1) mineral interests owners (both working interest owners and royalty interest owners) have a right to data from the well operator; (2) the data will be available pursuant to the time periods in ECL 23-0313; and (3) working interest owners (IPOs and NPOs) have a right to reasonable access to the well site.

CONCLUSION

Based on the above discussion and analysis, I determine that

(1) the 2005 amendments to ECL 23-0901 apply to transition wells, i.e., those wells that were permitted prior to the 2005 amendments, but for which spacing and compulsory integration orders had not been issued;

(2) ECL 23-0901 does not authorize staff to impose a risk penalty on an uncontrolled owner who opts for status as an IPO, and thus, a factual record does not need to be developed as to whether the productivity of Little 1, Eolin 1, or any other transition well was known to an IPO;

(3) the ECL provides working interest owners (IPOs and NPOs) with a right to well data and access to the well site, and further provides royalty owners with a right to well data, but not site access, subject to the time periods for confidentiality set forth in ECL 23-0313; and

(4) a factual record does not need to be developed to determine industry practices in other states regarding the sharing of well data and site access.

These matters are remanded to the Chief ALJ for further proceedings consistent with this interim decision, including the determination of well costs due and payable to well operators

by WLS as an IPO, issuance of spacing orders, and the preparation of final integration orders on appropriate wells.

For the New York State Department
of Environmental Conservation

By: _____*/s/*_____
Joseph J. Martens
Commissioner

Dated: Albany, New York
August 26, 2011