

**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,

CHEMUNG SRA 1.

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

HAKES 1.

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

HARDY 1447-A.

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

REED 1.

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

ROOT 1514.

**RULING OF THE CHIEF
ADMINISTRATIVE LAW
JUDGE ON ISSUES AND
PARTY STATUS, AND
ORDER OF
DISPOSITION**

DEC Order No.
DMN 08-28

DEC Order No.
DMN 08-31

DEC Order No.
DMN 08-29

DEC Order No.
DMN 08-32

DEC Order No.
DMN 08-30

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

DEC Order No.
DMN 08-33

SODERBLOM 1.

Appearances of Counsel:

- Alison H. Crocker, Deputy Commissioner and General Counsel (Jennifer Hairie of counsel), for staff of the Department of Environmental Conservation
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- The Denton Law Office PLLC (Christopher Denton of counsel), for Thomas and Shirley Semler (Chemung SRA 1); Angela Burton and Thomas White (Hakes 1); Michael and Barbara Dandrea, John and Beverly Fridie, Michael and Silvie Wieczorek, the Fred Lewis Farm Mineral Rights and Revenue Trust and Lawrence Lewis Trustee, and Linnie and Lisa McKee (Soderblom 1)
- Boylan, Brown, Code, Vigdor & Wilson, LLP (Sheila M. Chalifoux of counsel), for petitioner Betty Hurley (Soderblom 1 Unit)
- Stephen Jeffrey Lawton, appearing pro se and on behalf of John Stephen Lawton (Reed 1 Unit)
- Thomas A. Dunbar, appearing pro se and on behalf of Deborah S. Dunbar (Soderblom 1 Unit)
- Michael J. LeRose, appearing pro se and on behalf of Susan C. LeRose (Soderblom 1 Unit)

**RULING OF THE CHIEF ADMINISTRATIVE LAW JUDGE ON
ISSUES AND PARTY STATUS, AND ORDER OF DISPOSITION**

Background

Staff of the Department of Environmental Conservation ("Department") proposes to issue compulsory integration orders pursuant to Environmental Conservation Law ("ECL") former § 23-0901(3) integrating mineral interests in the spacing units for six natural gas wells. The six wells are the Chemung SRA 1 well, located in Catlin, Chemung County; the Hakes 1 well, located in Corning, Steuben County; the Hardy 1447-A well, located in Catlin, Chemung County; the Reed 1 well, located in Corning, Steuben County; the Root 1514 well, located in Catlin, Chemung County; and the Soderblom 1 well, located in Big Flats, Chemung County.

All six natural gas wells were permitted, drilled and spaced prior to 2005, and are currently producing natural gas from the Ordovician Trenton-Black River formation. The Chemung SRA 1, Hardy 1447-A and Root 1514 units are new units located in the Wilson Hollow Field (see Director's Interim Spacing Order, DEC File No. DMN 01-1, Jan. 31, 2003). The Hakes 1, Reed 1, and Soderblom 1 units are new units located in the Quackenbush Hill Field (see Director's Interim Spacing Order, DEC File No. DMN 01-2, April 4, 2005 [Hakes 1 unit]; Director's Interim Spacing Order, DEC File No. DMN 01-2, Dec. 14, 2004 [Reed 1 unit]; Director's Interim Spacing Order, DEC File No. DMN 01-2, July 29, 2005 [Soderblom 1 unit]).

Because the six wells were permitted and the six spacing units established prior to the effective date of the 2005 amendments to ECL article 23 (see Laws of New York 2005, chapter 386), Department staff determined to apply the provisions and follow the practice under former section 23-0901(3) to integrate the interests of uncontrolled owners in the six units. Uncontrolled owners are mineral interest owners in a spacing unit who have not entered into a voluntary lease or participation agreement with the well operator. Accordingly, pursuant to the Commissioner's orders setting field-wide spacing and integration rules for the Wilson Hollow and Quackenbush Hill Fields (see Commissioner's Order, June 21, 2001 [Wilson Hollow Field]; id., Sept. 13, 2001 [same]; id., Jan. 23, 2002 [Quackenbush Hill

Field]; id., Dec. 30, 2002 [same]), and the stipulations with the well operators incorporated by reference therein, the well operator for the six units, Fortuna Energy Inc., was to provide to the uncontrolled owners notice of the compulsory integration proceedings and a 90-day period to raise objections to integration as royalty owners (see Stipulation, Dec. 27, 2000, ¶¶ IV.F.4, IV.F.5[b], and VII.F [Wilson Hollow Field]; Stipulation, Nov. 1, 2001, ¶¶ IV.F.4, IV.F.5[b], and VII.F [Quackenbush Hill Field]).

Fortuna allegedly provided the notice of compulsory integration to the uncontrolled owners in 2004 and 2005. Based upon objections raised by uncontrolled owners, and consistent with the Assistant Commissioner's Second Interim Decision in Matter of Terry Hill South Field (June 7, 2007), in which the various categories of participation status specified under the 2005 amendments were applied to wells integrated under the pre-2005 law, Department staff prepared draft integration orders integrating objecting uncontrolled mineral rights owners in the six units as non-participating owners ("NPO") as that term is defined under the 2005 amendments to ECL 23-0901 (see ECL 23-0901[3][a][1]). Non-objecting owners were proposed to be integrated as royalty owners, as that term is defined under the 2005 amendments (see ECL 23-0901[3][a][3]).

Consistent with the Commissioner's orders establishing the Wilson Hollow and Quackenbush Hill Fields, staff referred the six draft integration orders to the Department's Office of Hearings and Mediation Services ("OHMS") for adjudicatory proceedings pursuant to part 624 of title 6 of the Official Compilation of Codes, Rules and Regulations of the State of New York ("6 NYCRR Part 624"). The matters were assigned to Chief Administrative Law Judge ("Chief ALJ") James T. McClymonds as presiding ALJ. Because of common issues of fact and law, the proceedings are being conducted on a joint record.

Notice of Adjudicatory Proceedings

A joint notice of public legislative hearing and issues conference dated April 4, 2008 was published in the April 9, 2008 edition of the Department's electronic Environmental Notice Bulletin (see Issues Conference Exhibit ["IC Exh"] 1A). In addition, the April 4, 2008 notice was published on April 11, 2008 in the Corning Leader and the Elmira Star-Gazette (see IC Exhs 1D and 1E). The notice scheduled the legislative hearing and issues conference to commence on Monday, June 23, 2008, in Horseheads, New York. The notice also established Wednesday, May 28, 2008, as the deadline for the submission of petitions for

party status.

In addition to the ENB and newspaper notice publication, on June 7, 2008, OHMS sent each uncontrolled owner identified in the six units a copy of the notice and a draft compulsory integration order for the unit in which they hold an interest. The draft order included the terms of integration, including the owner's status as either a non-participating owner or royalty owner, as proposed by Department staff. The notice instructed the uncontrolled owners that if they objected to the proposed terms of integration, they must file a petition for party status. The notice and draft order were sent by certified mail, return receipt requested.

Signed return receipts were received by OHMS from all uncontrolled owners except Silvie and Michael Wieczorek (see IC Exh 2). The envelope sent to the Wieczoreks was returned marked "unclaimed" by the postal service, and received by OHMS on May 5, 2008. Counsel for the Wieczorek subsequently accepted service of the envelope at the June 23, 2008 issues conference.

The notice also indicated that Fortuna Energy Inc., the well operator for each of the six wells, would provide each uncontrolled owner a statement showing the costs expended and the revenues received to date for the well in the unit. These cost and revenue statements were to be postmarked by April 30, 2008, and sent by certified mail, return receipt requested. Fortuna sent the statements as directed and subsequently provided the ALJ with proof of service upon all uncontrolled owners (see IC Exh 3B).

Newly Discovered Owners

On or about April 25, 2008, Department staff and Fortuna informed the ALJ that previously unknown owners in the Soderblom 1 unit had recently been identified. The newly discovered owners are the heirs of Clara Lewis. To allow the newly discovered owners the full opportunity to participate, the ALJ directed Fortuna to provide each owner with a copy of the June 4, 2008 notice, the draft integration order, and a cost and revenue statement, among other things, by certified mail, return receipt requested. Although each owner was to be informed about the legislative hearing and issues conference scheduled for June 23, 2008, they were given the full 90 days from receipt of the notice to raise objections to the proposed terms of integration, as provided for in the November 1, 2001 stipulation incorporated by reference into and made a part of the December 30, 2002, Commissioner's Decision and Order for the Quackenbush Field.

On May 6, 2008, Fortuna provided the required notice to the newly discovered owners and subsequently provided the ALJ with proof of service (see IC Exh 4A; IC Exh 4B).

Petitions for Party Status

Timely petitions for full party status were filed by the following: Thomas and Shirley Semler (Chemung SRA 1); Angela Burton and Thomas White (Hakes 1); Rural Energy Development Corp. (Hardy 1447-A and Root 1514); John Stephen and Stephen Jeffrey Lawton (Reed 1); Western Land Services Inc., Michael and Barbara Dandrea, Thomas and Deborah Dunbar, John and Beverly Fridie, Michael and Silvie Wiczorek, Betty Hurley, Michael and Susan LeRose, the Fred Lewis Farm Mineral Rights and Revenue Trust and Lawrence Lewis Trustee, and Linnie and Lisa McKee (Soderblom 1). In addition, Fortuna filed a notice of appearance and issues statement dated May 28, 2008.

To date, no petitions for party status have been received from the following uncontrolled owners: Thomas R. Knapp, Sr. (Root 1514); Robert P. Blaszyk, Francis and Jean Dickens, Charles and Stephanie Hartsock, Joseph J. Meyers, Nichols and Irene Moffe, and James and Joann Phillips (Soderblom 1).

State Environmental Quality Review Act ("SEQRA") Status

As stated in the notice, Department staff published a Final Generic Environmental Impact Statement on the Oil, Gas and Solution Mining Regulatory Program in July 1992 ("GEIS"). On September 1, 1992, Department staff issued a SEQRA (ECL article 8) findings statement concluding that the conduct of compulsory integration hearings pursuant to ECL article 23 would have no significant impact on the environment. Department staff, on behalf of the Department as lead agency, determined that these proceedings are being carried out in conformance with the conditions and thresholds established for compulsory integration hearings in the GEIS and the findings statement. Accordingly, no further action is required under SEQRA (see 6 NYCRR 617.10[d][1]).

Legislative Hearing

The joint legislative hearing convened as scheduled at 1:00 P.M. on June 23, 2008. About 12 people attended the legislative hearing, and one person made an oral statement.

Ms. Hairie began the legislative hearing by making a brief presentation on behalf of Department staff. Ms. Hairie

explained that in drafting the proposed integration orders in these six proceedings, staff used the Second Interim Decision of the Assistant Commissioner in the Matter of Terry Hill South Field (June 7, 2007) as the starting point. She noted, however, that the draft order would be subject to revision based upon the adjudicatory proceeding.

Mr. Ashur Terwillinger from the Farm Bureau spoke next. Mr. Terwillinger asked that integration proceeding be done more quickly so that landowners may receive their money more quickly.

There being no other speakers, the legislative hearing was adjourned at 1:33 P.M.

Issues Conference

After the legislative hearing was concluded, the issues conference was convened as scheduled. Department staff and Fortuna participated in the issues conference as mandatory parties (see 6 NYCRR 624.5[a]). The following full-party status petitioners were represented at the issues conference: Thomas and Shirley Semler (Chemung SRA 1); Angela Burton and Thomas White (Hakes 1); Rural Energy Development Corp. ("REDC") (Hardy 1447-A and Root 1514); Western Land Services Inc. ("WLS"), Michael and Barbara Dandrea, John and Beverly Fridie, Michael and Silvie Wieczorek, Betty Hurley, the Fred Lewis Farm Mineral Rights and Revenue Trust and Lawrence Lewis Trustee (the "Lewis heirs"), and Linnie and Lisa McKee (Soderblom 1). Stephen Jeffrey Lawton appeared pro se and on behalf of John Stephen Lawton (Reed 1 Unit); Thomas A. Dunbar appeared pro se and on behalf of Deborah S. Dunbar (Soderblom 1 Unit); and Michael J. LeRose appeared pro se and on behalf of Susan C. LeRose (Soderblom 1 Unit).

During the issues conference, settlements were announced in the following three matters.

1. Chemung SRA 1

Counsel for the Semlers stated that a confidential settlement had been reached with Fortuna such that the Semlers were no longer uncontrolled for compulsory integration purposes (see Issues Conference Transcript [6-23-08] ["IC Trans"], at 27). Because no other uncontrolled owners remain in the Chemung SRA 1 unit, a compulsory integration order is unnecessary. Accordingly, the adjudicatory proceeding in Chemung SRA 1 may be dismissed and the matter remanded to Department staff for any further proceedings they deem necessary.

2. Hakes 1

Similarly in the Hakes 1 proceeding, counsel for Ms. Burton and Mr. White stated that a confidential settlement had been reached with Fortuna such that they were no longer uncontrolled for compulsory integration purposes (see IC Trans, at 29). During a September 3, 2008 post-issues conference call, however, it was confirmed that the settlement relates to only 50 percent of the interest claimed by Burton and White, and that a dispute remains as to their remaining claim. Thus, because uncontrolled interests may remain in the Hakes 1 unit, the adjudicatory proceeding in Hakes 1 is continued.

3. Soderblom 1

In the Soderblom 1 proceeding, counsel for WLS stated that confidential settlements had been reached with Fortuna with respect to three of six leases held by WLS and proposed to be integrated as non-participating owners ("NPOs"). However, Fortuna objected to integration as NPOs those leases WLS holds from the Shepards, the Hesses and the Mapps. Because those three leases, as well as other owners, remained uncontrolled in the Soderblom 1 unit, proceedings continued.

In addition, because uncontrolled owners remained in the Hardy 1447-A, Reed 1, and Root 1514 unit, proceedings continued as to those units as well.

The issues conference proceeded with discussions concerning the issues raised in Fortuna's issues statement and the petitions for party status. The issues conference adjourned at 6:50 P.M.

Post-Issues Conference Proceedings

On September 2, 2008, the presiding ALJ received an August 29, 2008 letter from the Hartsocks, uncontrolled owners in the Soderblom 1 unit. In the letter, the Hartsocks objected to being integrated into the Soderblom 1 unit, and requested that proceeds from the well be collected on their behalf. The ALJ contacted Ms. Hartsock to determine whether she was seeking party status in this proceeding. Ms. Hartsock indicated that she was not seeking party status but that her letter should be included in the record. Accordingly, the letter was incorporated into the legislative hearing record, and a copy of the letter was sent to all active parties in the proceeding.

DISCUSSION

Adjudicable Issues

At the issues conference, the parties stipulated that the issues raised in Fortuna's issues statement, and in the respective petitions for party status are adjudicable as either relating to a dispute between Department staff and Fortuna over a substantial term or condition of the draft compulsory integration orders, or a substantive and significant issue raised by a party status petitioner (see 6 NYCRR 624.4[c][1], [3]). A summary of the adjudicable issues identified follows.

1. Timeliness of Objections/Adequacy of Notice

Fortuna argues that those uncontrolled owners, or their successors or assigns, that failed to raise an objection during the 90-day period may not now be integrated on any basis other than as one-eighth royalty interests. Fortuna agrees that the Lawtons, the LeRoses and the Lewis heirs raised timely objections. However, Fortuna asserts that the remaining petitioners, or their predecessors in interest, failed to raise objections within 90-days of receiving notice in either 2004 or 2005 and, thus, must be integrated as royalty owners only. Accordingly, Fortuna opposes WLS's NPO status as proposed in the Soderblom 1 draft order for the Shepard, Hess and Mapp leases. In addition, Fortuna opposes the remaining petitioners' request to change from royalty interests, as proposed by staff, to NPO status, as sought in their petitions for party status.

During the adjudicatory phase of this proceeding, Fortuna proposes to establish what notice was given to the uncontrolled owners, when such notice was completed and whether timely objections were raised to compulsory integration as one-eighth royalty interests.

In response, petitioners argue that the notice required by prior Commissioner's orders for the Wilson Hollow and Quackenbush Hill Fields was rendered academic and superceded by the second interim decision in Terry Hill South Field, in which parties were allowed to elect their participation status. In addition, petitioners argue that even assuming the notice requirements from the prior orders remain in effect, the notice provided in these cases was procedurally and substantively inadequate. Specifically, petitioners argue that a notice provided by Fortuna on its letterhead cannot serve as legal notice of a Departmental proceeding. Petitioners also contend that uncontrolled owners are not bound by a predecessor-in-

interest's failure to object. In addition, petitioner Betty Hurley alleges that she did not receive the 90-day notice.

The parties have stipulated that the issues concerning the timeliness of objections and the adequacy of the notice provided are adjudicable. Factual issues to be developed during the evidentiary phase of these proceedings include, among other things, the dates of service of the 90-day notice upon the uncontrolled owners; the nature and content of the notice provided; the dates, if any, of objections were filed in response to the 90-day notice; which parties filed objections; and the nature and content of the objections filed. Legal issues to be argued after development of the factual record include whether the notice provided was procedurally and substantively sufficient, whether uncontrolled owners are bound by the actions of predecessors in interest, and the relevance, if any, of the Terry Hill South Field second interim decision.

2. Cash Balancing

Both Fortuna and petitioners raised objections to the cash balancing provisions Department staff proposes to apply to NPOs unable to receive their proportionate share of gas in kind at the wellhead (see Matter of Western Land Services, Inc., DEC Declaratory Ruling No. 23-14, Jan. 29, 2004 ["DR 23-14"], at 7, n 11). The draft integration orders provide that "[i]f production of the well results in insufficient reserves remaining to achieve balancing in kind or the well becomes depleted within the Black River Formation prior to balancing in kind, the well operator shall be required to effect a cash balancing with any integrated non-participating owner who remains underproduced at that time" (see, e.g., Draft Order No. DMN 08-33 [Soderblom 1], IC Exh 23, ¶VI.C, at 5). Department staff explained at the issues conference that paragraph VI.C applies when a well is overproduced, that is, when the well operator produces all the gas to which it is entitled from the well, based upon the estimated reserves. At that point, the well operator would effect cash balancing with the NPOs, that is, compensate the NPOs for the amount of gas that was overproduced.

Department staff also noted that except for the Reed 1 well, it appears that the remaining wells have reached the point of overproduction, based upon the estimates of reserves provided by Fortuna for each well. Accordingly, staff indicated that cash balancing for those wells could occur presently. As to the Reed 1 well, however, sufficient reserves remain to allow NPOs to take gas in kind, if they are able, such that paragraph VI.C would not take effect until sometime in the future.

In their petitions for party status, petitioners object to the cash balancing proposed in the Department's draft order. In the alternative, petitioners assert that a just and reasonable integration order should provide for cash balancing on an on-going, monthly basis, with interest for the uncontrolled owners and an up to five percent fee to the operator for transportation and marketing, until the subject well is depleted.¹ At the issues conference, petitioners indicated that at the evidentiary hearing, they would provide the factual bases supporting their argument that the Department's proposed order is not just and reasonable, and that their proposal is.

With respect to cash balancing at the time of overproduction, petitioners objected at the issues conference that the draft orders failed to make just and reasonable arrangements for compensating NPOs unable to take gas in kind after the well operator received its proportionate share of gas.

At the issues conference, Fortuna also objected to the Department's proposal to cash balance at the time of overproduction. Fortuna asserted that cash balancing at any time prior to the end of the life of the well is not just and reasonable. In the alternative, Fortuna objected that if cash balancing is to occur at the time of overproduction, the draft order should be interpreted to allow the well operator to cease production, cash balance for any gas overproduced, and either shut-in the well, or transfer the well and its surface facilities to the NPOs for a fee so that they can continue production.

Fortuna stipulated that the issues raised by petitioners are substantive and significant, requiring further adjudication. In addition, Fortuna's objections to the draft orders constitute a dispute between the applicant and the Department concerning material terms of the draft order. The issues to be adjudicated are whether the Department's proposal to cash balance at the point of overproduction is not just and reasonable, and whether proposals forward by petitioners or Fortuna are just and reasonable (see ECL former 23-0901[3]). Among the factual issues to be resolved are whether any of the wells have reached the point of overproduction. In addition, the parties will provide the factual bases supporting their arguments

¹ In their petition for party status, the LeRoses proposed a second alternative to the cash balancing proposed by the remaining petitioners. At the issues conference, however, the LeRoses withdrew their proposal, and adopted the proposal forwarded by the remaining petitioners.

that the cash balancing proposed by Department staff is not just and reasonable, and that their cash balancing proposals are.

3. Credit for Development of the Soderblom 1 Well

In their petition for party status, the Dunbars seek integration as integrated participating owners ("IPOs"), as that term is defined under the 2005 amendments to ECL article 23 (see ECL 23-0901[3][a][2]). This is based upon an incident that occurred in 2002, when the Dunbars' water well became contaminated by natural gas. The Dunbars assert that this incident provided information that led to the development of the Soderblom 1 well. Accordingly, the Dunbars contend that they should be integrated into the Soderblom 1 unit as IPOs, and be given pre-well development credit in the amount of \$10,426.

At the issues conference, Fortuna, Department staff and some of the petitioners argued that the credits the Dunbars seek are not chargeable well costs under the statute. Nevertheless, no party objected to the Dunbars presenting evidence on this issue in connection with proceedings concerning the appropriate terms of their integration. Thus, upon the agreement of the parties, the issue is joined for adjudication.

4. Objections to Gas Balancing/Motion to Shut-In Wells

In their petitions for party status, several uncontrolled owners in several units objected to the gas balancing provisions of the draft orders and moved to shut-in production from the respective wells pending a determination from the New York Public Service Commission concerning Fortuna's exemption under Public Service Law § 66-g(3) or its status as a common carrier under Public Service Law § 66-d. At the issues conference, however, the proponents of the motion withdrew the application (se IC Trans, at 161).

RULING

Based upon the stipulation of the parties, those issues raised in Fortuna's statement of issues and the parties' petitions for party status, as amplified and refined at the issues conference and not otherwise withdrawn, are joined for adjudication.

Accordingly, petitioners are afforded full party status in any subsequent proceedings.

ORDER OF DISPOSITION

Based upon the stipulation of the parties to the Chemung SRA 1 proceeding, no issues remain among the parties. Accordingly, the hearing record in the Matter of Chemung SRA 1 is hereby closed, and the matter is severed from the remaining proceedings and remanded to Department staff for those further proceeding deemed necessary.

_____/s/_____
James T. McClymonds
Chief Administrative Law Judge

Dated: September 15, 2008
Albany, New York

Attachments

TO: Asst. Commissioner Louis A. Alexander
Attached Service List

STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION

Matter of Chemung SRA 1; Hakes 1; Hardy 1447-A; Reed 1; Root
1514; and Soderblom 1 Draft Integration Orders

DEC Order Nos. DMN 08-28; DMN 08-31; 08-29; 08-32;
08-30; and 08-33

SERVICE LIST
(updated as of September 15, 2008)

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June M. Rhodes
Elmer F. Lewis
Richard L. Lewis
(the heirs of Elmer L. Lewis)

AND

Pamela Sackett (formerly Spencer)
Tammy L. Stermer
Annette Swiderski
Clifford W. Stermer (the heirs of Phyllis
Stermer, deceased daughter of Elmer L. Lewis)

Represented by Christopher Denton