

**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,

DZYBON 1.

**RULING ON
PROCEDURAL ISSUES**

DEC Order No.
DMN 06-37

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

EOLIN 1.

DEC Order No.
DMN 06-33

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

GILLIS 1.

DEC Order No.
DMN 06-34

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

LITTLE 1.

DEC Order No.
DMN 06-13

Appearances:

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

-- The West Firm (Thomas S. West of counsel) and

Nixon Peabody LLP (Ruth E. Leistensnider of counsel),
for well operator Fortuna Energy Inc.

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

-- Christopher Denton, for James Frank (Dzybon 1)

RULING OF THE CHIEF ADMINISTRATIVE LAW JUDGE
ON PROCEDURAL ISSUES

The above referenced matters are proceedings for the compulsory integration of mineral rights interests in four natural gas well spacing units known as Dzybon 1, Eolin 1, Gillis 1 and Little 1, respectively. The four proceedings are before the Office of Hearings and Mediation Services ("OHMS") of the Department of Environmental Conservation ("Department") for administrative adjudicatory hearings 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" or "Part 624").

The Dzybon 1, Eolin 1 and Gillis 1 matters were referred by Department staff after an integration hearing held pursuant to Environmental Conservation Law ("ECL") § 23-0901(3)(b), based upon staff's determination that substantive and significant issues were raised requiring adjudication. The Little 1 matter is on remand from Supreme Court, Albany County (Donohue, J.), pursuant to a stipulation of discontinuance and order of remand entered in a CPLR article 78 proceeding challenging the final integration order issued by the Department for the Little 1 gas well spacing unit (see Matter of Western Land Servs., Inc. v Department of Env'tl. Conservation, Jan. 18, 2007, Index No. 8739-06).

The draft integration orders in Dzybon 1, Eolin 1 and Gillis 1, and the final integration order in Little 1 were all issued by Department staff pursuant to the 2005 amendments to the Oil, Gas and Solution Mining Law (see ECL article 23, as amended by L 2005, ch 386 [effective Aug. 2, 2005] ["2005 Amendments"]). The 2005 Amendments, among other things, substantially modified the procedures for integrating the interests of mineral rights owners in natural gas well spacing units established under the new law (see ECL 23-0901, as amended). Among the new procedures is an integration hearing conducted by Department staff to determine how uncontrolled owners -- mineral interest owners in a

spacing unit who have not entered into a voluntary lease or participation agreement with the well operator -- will be integrated into the Department's final integration order for the unit. If substantive and significant issues are raised at the integration hearing, the Department is directed to schedule an adjudicatory hearing (see ECL 23-0901[3][d]).

The Department continues to apply the Part 624 permit hearing proceedings to the adjudicatory hearing provided for in ECL 23-0901(3)(d) (see 6 NYCRR 624.1[a][6]; DEC Program Policy DMN-1: Public Hearing Processes for Oil and Gas Well Spacing and Compulsory Integration, Feb. 22, 2006 ["DMN-1"], at 1, 9). Due to the significant changes in the substantive law governing the integration of mineral interests in gas well units, I concluded that a ruling was necessary to clarify the manner in which Part 624 would be applied to compulsory integration proceedings, and the status of the parties involved.

Accordingly, Department staff, the well operator Fortuna Energy Inc., and the uncontrolled owners in all four proceedings were provided with the opportunity to comment on whether and how procedures under Part 624 should be modified, if at all, for gas well integration order hearings. Department staff offered its proposals first in letters dated March 1, 2007 (Dzybon, Eolin and Gillis) and April 2, 2007 (Little). Timely comments were then filed by Fortuna in letters dated March 8, 2007 (Dzybon, Eolin and Gillis) and April 9, 2007 (Little), and by Western Land Services, Inc. ("WLS") in letters dated March 7, 2007 (Dzybon, Eolin and Gillis) and April 9, 2007 (Little).

In a letter dated March 15, 2007, Department staff requested leave to reply to Fortuna's March 8 submission. I have granted staff's request and considered its March 15, 2007 reply as filed. In a letter dated March 26, 2007, Fortuna offered a surreply to staff's March 15 reply. Although Fortuna did not seek leave to file the surreply, I have accepted the surreply as filed.

In a letter dated April 17, 2007, WLS requested leave to reply to Fortuna's April 9 submission. I have granted WLS's request and accepted its April 17, 2007 reply as filed.

Other submissions considered on this ruling are March 9, 2007 comments by Chesapeake Appalachia, LLC. According to

Chesapeake, the comments were filed as an amicus party.¹ I have also received and considered submissions by Fortuna (April 19, 2007 and May 16, 2007) and James Frank (April 25, 2007 and May 21, 2007) in the Dzybon 1 well proceeding.

Discussion

Legislative Hearing

All parties filing comments recommend that the Part 624 legislative hearing be dispensed with for adjudicatory hearings on draft integration orders (see 6 NYCRR 624.4[a]). Department staff analogizes the integration hearing held pursuant to ECL 23-0901(3)(d) to the Part 624 legislative hearing and contends that the legislative hearing need not be repeated.

I disagree that the integration hearing is analogous to the Part 624 legislative hearing and, consequently, I do not consider it appropriate to diverge from the Part 624 procedure in this regard. First, the integration hearing is different from the Part 624 legislative hearing in a key regard. The integration hearing is presided over by a member of Department staff, namely a designee of the Director of the Division of Mineral Resources ("integration hearing officer"). Thus, the integration hearing is a staff level proceeding analogous to a legislative hearing conducted by Department staff pursuant to the Uniform Procedures Act (ECL art 70 ["UPA"]) and its implementing regulations (see 6 NYCRR 621.8).

A Part 624 legislative hearing, in contrast, is conducted by an administrative law judge ("ALJ") employed in OHMS. The Department's ALJs are quasi-judicial officers designated by the Commissioner. The ALJs are required, by law and regulation, to conduct hearings in a fair and impartial manner, and exercise judgment independently of Department staff (see State Administrative Procedure Act ["SAPA"] § 303; 6 NYCRR 624.2[b]; 6 NYCRR 624.8[b][2][i]). In addition, a Departmental ALJ is subject, among other things, to the rule against ex parte communications (see SAPA § 307[2]; 6 NYCRR 624.10). The process before the ALJ, including the Part 624 legislative hearing, has the procedural safeguards and formalities of a trial, including the right to present and cross-examine witnesses, and a decision

¹ In a letter dated March 15, 2007, Department staff raised objections about Chesapeake's submissions, but does not formally oppose them or seek their rejection. In the interests of completeness, I have considered Chesapeake's submissions.

limited to a formal evidentiary record. Even though the integration hearing may be conducted impartially, the integration hearing officer does not serve the same institutional role as the ALJ, nor is that officer under similar legal constraints designed to protect the trial-like administrative adjudicatory process.

In addition, OHMS is a separate and distinct office within the Department which, pursuant to the Department's Administrative Adjudication Plan, is responsible for conducting adjudicatory hearings for the Department (see 6 NYCRR 624.2[v]). The ALJs employed by OHMS report directly to the Commissioner through an Assistant Commissioner for Hearings, and not through program staff. This institutional separation of powers between OHMS and the remainder of the Department is the mechanism by which the Department complies with the Governor's Executive Order No. 131 (see 9 NYCRR 4.131[III][B][2], continued by Executive Order No. 5 [Jan. 1, 2007]). The Part 624 legislative hearing, as well as the issues conference and adjudicatory hearing, are integral parts of the Department's administrative adjudicatory process that are the responsibility of the ALJs and ultimately the Commissioner, not Department staff.

Second, one purpose of the Part 624 legislative hearing is to receive unsworn statements by the parties and the public concerning a proposed Departmental action (see 6 NYCRR 624.4[a][1]). Several issues are presented by proposed draft integration orders upon which the public may wish to offer comment. For example, the Department is required to make a public policy determination before issuing an integration order, including whether the rights of the general public are fully protected, upon which the public might wish to offer comment (see ECL 23-0901[2]; ECL 23-0301). The public might also wish to offer comments if a draft environmental impact statement has been prepared under the State Environmental Quality Review Act (see ECL art 8 ["SEQRA"]; 6 NYCRR 624.4[a][3]). Public comments, if offered, may also be used by the ALJ to inquire further of the parties during the issues conference (see 6 NYCRR 624.4[a][4]). While the public may wish to comment on several aspects of a draft integration order, such public comment is not taken at an integration hearing. Moreover, even mineral rights owners not otherwise willing or able to participate in the adjudicatory phase of a Part 624 proceeding may wish to offer comments on the draft integration order for the ALJ's consideration.

Department staff is correct that Part 624 legislative hearings have been dispensed with where a Part 621 legislative hearing was conducted. However, in those cases, which are very limited, the same ALJ presided over both the Part 621 legislative

hearing and the subsequent Part 624 proceeding. Moreover, the discretion to dispense with the Part 624 legislative hearing has been cautiously exercised. However, OHMS has not dispensed with the Part 624 legislative hearing when Department staff conducted the Part 621 legislative hearing.

Although I conclude that the Part 624 legislative hearing should be conducted in these proceedings, I believe such hearings can be conducted efficiently and without delay. As is OHMS's practice with minor projects under the UPA, the legislative hearing can be scheduled the same day as, and immediately prior to, the issues conference. If no parties or members of the public wish to offer comments, the legislative hearing may be closed, and the issues conference immediately convened.

This is also not to say that, after some experience with adjudicatory hearings on draft integration orders, the Commissioner may decide, as a matter of policy, that the Part 624 legislative hearings are not necessary. For the time being, however, I conclude that the Part 624 regulations should be followed in this regard.

Issues Conference -- Parties

Both Department staff and Fortuna appear to agree that an issues conference is necessary (see 6 NYCRR 624.4[b]). WLS, in contrast, argues that the integration hearing is the equivalent of a Part 624 issues conference and, therefore, a separate issues conference is not required. WLS contends that the proceeding should commence with the adjudicatory phase with staff, the well operator, and all integrated participating owners ("IPOs") and non-participating owners ("NPOs") involved as mandatory parties in the adjudication.

I agree with staff and Fortuna that the issues conference should be conducted. As noted above, the integration hearing is more functionally equivalent to a Part 621 legislative hearing conducted by staff, not a Part 624 issues conference conducted by an ALJ. As with a legislative hearing under Part 621, Department staff uses the integration hearing, among other things, to determine whether to refer the matter for Part 624 adjudicatory hearings. The Part 624 issues conference, in contrast, is a proceeding before an ALJ where the ALJ, with the assistance of the parties, focuses and narrows the issues, determines whether factual issues are presented requiring adjudication, and potentially resolves legal questions not dependent upon litigated facts, among other things (see 6 NYCRR

624.4[b][2])). The issues conference serves an important pre-adjudicatory hearing function that requires the presiding ALJ's involvement. Through the administrative appeals process, the issues conference also involves the Commissioner, who further refines the issues, and decides legal and policy questions in interim decisions. Whether such a pre-hearing process is referred to as an issues conference or not, it is a necessary step to assure efficiency in the process.

Which parties are automatic parties to the issues conference is the subject of some dispute among the parties filing comments. As just noted, WLS is of the view that staff, the well operator, IPOs and NPOs are all automatic parties. Department staff and Fortuna also agree that staff and the well operator are automatic parties (see 6 NYCRR 624.5[a]).

With respect to uncontrolled owners, Department staff would treat as automatic parties those owners who filed a compulsory integration form with the Department and raised objections at the integration hearing that staff determined to be substantive and significant. Staff would require all others seeking to participate in the adjudicatory hearing, including non-objecting IPOs, NPOs and royalty owners, to file the petition for party status normally required of intervenors in Part 624 proceedings (see 6 NYCRR 624.5[b]).

Fortuna agrees with staff, but would add as mandatory parties those parties who wish to pursue objections raised at the integration hearing that Department staff determined not to be substantive and significant.²

I conclude that all uncontrolled owners in a spacing unit are interested parties and, therefore, are mandatory parties under Part 624. Thus, I include as mandatory parties all parties identified by WLS, but also royalty owners. The 2005 amendments make clear that all mineral rights owners, including the well operator and all uncontrolled owners, are the subjects of the Department's integration order. In essence, compulsory integration proceedings under the 2005 amendments are multi-

² Fortuna further contends that a party raising an objection at an integration hearing is entitled to demand and receive an adjudicatory hearing, notwithstanding Department staff's determination that the objection raised is not substantive and significant. Whether such a party is entitled to a hearing without a hearing referral from Department staff is not before me in this proceeding and will not be decided here.

applicant proceedings. Those mineral rights owners participating in an integration proceeding will be the subject of the Department's final integration order, and their property rights are determined by that order. Such mineral rights owners are analogous to a property owner seeking a Departmental approval under the UPA and, thus, have the status of applicants under Part 624.

Intervenors in Part 624 proceedings, on the other hand, are not property owners seeking Departmental approvals. Instead, they are third parties to the permit or other approval who have been afforded the statutory right, under ECL article 70, to participate in the adjudicatory process (see ECL 70-0119). The analog to intervenors in a compulsory integration hearing would not be the well operator or uncontrolled owners, but third parties to the proceeding, such as local municipalities or other members of the public who do not have mineral rights in the subject spacing unit.

Although I conclude that the well operator and all uncontrolled owners in a spacing unit are mandatory parties to the Part 624 proceeding and, therefore, should not be required to file a petition for party status, I nonetheless agree that efficiency requires such parties to file a notice of appearance in advance of the issues conference. Such a statement of appearance should identify the party, whether the party is represented or appearing in his or her own behalf, what issues the party seeks to address (whether in support of or in opposition to the draft integration order), and the nature of the factual proof, if any, the party intends to present.

Third parties to the integration proceeding, if any, who wish to participate in Part 624 proceedings would still be required to file petitions for party status.

Requiring the filing of notices of appearance and petitions for party status, if any, prior to the issues conference will allow the parties to evaluate and be prepared to discuss the adjudicability of the issues raised. If there is general agreement concerning the issues for adjudication, the issues conference can be concluded, and the adjudicatory hearing may be convened immediately thereafter. Thus, as is often the case with minor projects under the UPA, the legislative hearing, issues conference, and adjudicatory proceeding may be held on the same day, if circumstances warrant.

Issues Conference -- Issues Raised

The parties make various arguments concerning which issues should be considered automatic issues for the adjudicatory phase of the proceeding, and which issues should be evaluated for their adjudicability and ruled upon during the issues conference stage. The parties also argue that the adjudicability of those issues that are not automatic issues should be evaluated under the "substantive and significant" standard.

A determination concerning the adjudicability of issues, including whether they are timely and properly raised, cannot be made until the issues conferences in each of these proceedings. At that point, the issues will be presented and defined, and their merits can be appropriately reviewed.³ I reserve on the question whether adjudicatory proceedings might have some effect on the statutory election period. Answering the question might depend on the changes, if any, made to the draft integration order occasioned by the adjudicatory proceedings, and should not be answered in the abstract at this time.

With respect to the issues raised by the mandatory parties, as described above, the adjudicability of such issues will be evaluated applying the standards applicable to disputes between Department staff and applicants (see 6 NYCRR 624.4[c][1][i], [ii]; see also DMN-1, at 9 [a mineral rights owner will be given the status of an applicant in other Departmental permit proceedings]). Application of the Part 624 standards to mineral rights owners for purposes of defining the issues for adjudication recognizes that mineral rights owners are property rights holders whose right to participate in administrative adjudicatory proceedings and develop a record on their issues flows from SAPA and principles of due process (see Matter of 628 Land Assocs., Interim Decision of the Commissioner, Sept. 12, 1994, at 2).

The substantive and significant test will be applied to issues raised by third parties to the proceeding, if any (see

³ I recognize that the Little 1 proceeding is before me on remand after the filing of a CPLR article 78 petition and that this procedural posture may have the effect of limiting the issues for adjudication. Nevertheless, I reserve decision on the issues raised by the parties in Little 1 until the issues conference, for the same reasons I reserve decision in the remaining proceedings.

My reservation also includes the title issue raised by the parties in the Dzybon 1 proceeding.

6 NYCRR 624.4[c][1][iii]). Such issues would not have been reviewed by the Department during the integration hearing portion of the proceeding and, thus, would have to meet the substantive and significant test before being joined for adjudication (see ECL 23-0901[3][d]).

Interim Appeals

Citing the legislative preference for the expeditious resolution of compulsory integration proceedings, Fortuna urges that interlocutory appeals as of right from any ALJ issues ruling should be eliminated, and that all appeals or motions for leave to appeal should await the conclusion of the hearing process before the ALJ. Department staff objects to Fortuna's suggestion on the ground that it might limit due process.

I agree with Department staff that, at this time, such a major revision to the Part 624 procedures is not warranted. The modification of interlocutory administrative appeal rights should await further experience applying Part 624 to proceedings to review draft integration orders under the 2005 amendments, and subsequent regulatory amendment, or other Commissioner directive (see 6 NYCRR 624.6[g]). The parties should note, however, that all ALJ rulings are appealable as of right after the conclusion of the adjudicatory process before the ALJ (see 6 NYCRR 624.8[d][1]). Although issues rulings may be appealed on an interlocutory basis, the regulations do not require that such appeals must be taken at that time (see 6 NYCRR 624.8[d][2]). Moreover, the ALJ has the discretion to convene the adjudicatory hearing pending interlocutory appeals (see 6 NYCRR 624.8[d][7]).⁴ Thus, any delay occasioned by interlocutory appeals can be avoided by application of these regulatory mechanisms.

Hearing Logistics

Department staff and Fortuna expressed a general preference for holding adjudicatory proceedings in Albany, whereas WLS expressed a preference for a location near the wells. Given my determination to conduct the legislative hearing and the reasons in support, I conclude that the legislative hearing and

⁴ The parties should also note, however, that at least one Departmental decision indicates that if the parties adjudicate an issue joined by the ALJ, they waive the right to argue on appeal that the ALJ erred in joining the issue (see Matter of Consolidated Edison Co. of New York, Inc., Interim Decision of the Commissioner, June 4, 2001, at 6-7).

issues conference should be conducted in close proximity to the subject wells. Once the parties are known, and there is agreement among the parties, any remaining hearings may be held in a location reasonably convenient for all participants.

With respect to hearing costs, decision is reserved pending oral argument on the issue.

Ruling

Part 624 will be applied to the adjudicatory proceedings conducted in these matters, subject to the clarifications provided in this ruling.

I will convene a conference call to schedule the legislative hearings, issues conferences and adjudicatory hearings, and to begin drafting the hearing notices.

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

Dated: June 6, 2007
Albany, New York