

**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,

PIMPINELLA 1-B.

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

DEC Order No.
DMN 10-31

December 20, 2011

Appearances of Counsel:

- Steven C. Russo, Deputy Commissioner and General Counsel (Jennifer L. Maglienti of counsel), for staff of the Department of Environmental Conservation
- The West Firm, PLLC (Yvonne E. Hennessey and Gregory A. Mountain of counsel), for MegaEnergy Operating, Inc.
- Hinman, Howard & Kattell, LLP (Robert H. Wedlake of counsel), for Northeast Energy Development, LLC
- The Denton Law Office, PLLC (Christopher Denton of counsel), for Waits Road Gas Development, LLC

In this natural gas well compulsory integration proceeding conducted pursuant to Environmental Conservation Law (ECL) § 23-0901(3), staff of the Department of Environmental Conservation (Department) proposes to issue a compulsory integration order integrating mineral interests within the spacing unit for the Pimpinella 1-B natural gas well located in the Town of Tioga, Tioga County. The well is located in the Black River natural gas formation.

At the issues conference convened pursuant to section 624.4(b) of title 6 of the Official Compilation of Codes, Rules and Regulations of the State of New York (6 NYCRR), well operator MegaEnergy Operating, Inc., moved for summary dismissal of four elections filed by Northeast Energy Development, LLC, a mineral interest owner who is seeking to participate in the well as an integrated participating owner (IPO). MegaEnergy moved on

the ground that although Northeast filed its IPO elections at the staff level compulsory integration hearing, it did not tender its proportionate share of wells costs at that hearing.

The issue presented is whether a mineral interest owner electing to participate as an IPO must tender its share of well costs at the integration hearing even though the matter is referred for adjudication to the Department's Office of Hearings and Mediation Services (OHMS). For the reasons that follow, I conclude that a party electing IPO status must tender its share of well costs at the integration hearing, notwithstanding a referral of the matter for adjudication. I also conclude, however, that under the circumstance presented here, Northeast should be afforded the opportunity to tender its well costs within 30 days of this ruling.

I. PROCEEDINGS

A. Factual Background

On August 27, 2010, Department staff issued a well permit as defined by ECL 23-0501(1)(b)(3) to MegaEnergy to drill the Pimpinella 1-B well (API No. 31-107-23192-02-00) located in the Town of Tioga, Tioga County. The target natural gas formation for the well is the Black River formation. Because MegaEnergy proposed a spacing unit for the Black River formation that conformed to State-wide spacing, a spacing unit was established with the issuance of the well permit (see ECL 23-0503[2]).

Because uncontrolled mineral interest owners remained in the spacing unit, the Department conducted a staff-level integration hearing pursuant to ECL 23-0901(3)(c) on October 20, 2010. At the integration hearing, uncontrolled owner Northeast Energy Development, LLC, proffered five compulsory integration election forms electing IPO status for five separate tax parcels within the unit (see Compulsory Integration [CI] Hearing Exhibit DMN 7). Northeast raised several issues concerning the proposed integration order, argued that the issues were substantive and significant, and urged referral of the issues to OHMS for adjudicatory proceedings.

With respect to tax parcel ID no. 151.00-1-33,¹ Northeast tendered to MegaEnergy a check for Northeast's proportionate share of estimated well costs, and requested that the funds be held in escrow by counsel for MegaEnergy or an independent third party pending conclusion of the integration process (see CI Hearing Transcript [10-20-10], at 35-36). MegaEnergy declined to escrow the funds, indicating instead that it would deposit the funds in an interest bearing account until they were used to pay actual well costs (see id. at 37). In response to Northeast's objection, Department staff asserted that the Department lacked the authority to direct the well operator to hold funds in escrow pending completion of the integration process (see id. at 37-39).

With respect to the remaining four tax parcels, relying on its understanding of the Department's practice in other proceedings, Northeast declined to tender its proportionate share of estimated well costs for the four parcels on the ground that payment would not be required until adjudicatory proceedings were concluded on the challenged integration order (see id. at 42-43). Department staff explained that in other proceedings, well costs were withheld until the conclusion of adjudicatory proceedings based upon the parties' agreement, not by requirement of the Department (see id. at 44).

At the conclusion of the integration hearing, Department staff referred the matter to OHMS for adjudicatory proceedings (see id. at 51-52). The matter was subsequently assigned to the undersigned Administrative Law Judge (ALJ) as presiding ALJ.

B. Procedural Background

During a scheduling conference with the parties, MegaEnergy indicated that it would move for summary dismissal of Northeast's elections concerning the four tax parcels for which well costs had not been tendered at the conclusion of the compulsory integration hearing. To accommodate MegaEnergy's

¹ At the compulsory integration hearing, Northeast identified the parcel as ID no. 151.00-1-23 (see CI Hearing Trans, at 35). The remaining documentation, however, indicates that the parcel at issue is actually tax parcel ID no. 151.00-1-33.

proposal, I established a briefing schedule on the motion that coincided with the notice publication for the legislative hearing and issues conference (see Memorandum to Active Party Service List [1-10-11]). I also indicated that argument at the issues conference would be limited to oral argument on MegaEnergy's motion for summary dismissal. Depending on the outcome of the motion, the issues conference would be reconvened to consider the other issues raised by the parties.

A January 21, 2011, notice of public legislative hearing and issues conference, and deadline for the filing of notices of appearance and petitions for party status in this proceeding was published in the January 26, 2011, edition of the Department's electronic Environmental Notice Bulletin.² In addition, Northeast published the notice on January 31, 2011, in the Binghamton Press & Sun Bulletin.

The notice established February 17, 2011, as the deadline for the filing of notices of appearance or petitions for party status. Four timely notices of appearance were filed, one from Northeast (dated 2-15-11, Issues Conference Exhibit [IC Exh] 3), one from Department staff (dated 2-17-11, IC Exh 4), one from well operator MegaEnergy (dated 2-17-11, IC Exh 5), and one from uncontrolled owner Waits Road Gas Development, LLC (dated 2-16-11, IC Exh 6).³ No other notices of appearance or petitions for party status were filed.

Pursuant to my January 10, 2011, scheduling memorandum, MegaEnergy filed its motion for summary dismissal on February 8, 2011, raising the issue whether mineral interest owners electing to participate as IPOs must tender their

² With respect to review under the State Environmental Quality Review Act (ECL article 8 [SEQRA]), as indicated 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 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 this proceeding is 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]).

³ Waits Road Gas Development, LLC, is an uncontrolled owner in the unit that elected integration as a non-participating owner (NPO) (see ECL 23-0901[3][a][1]; CI Hearing Exh DMN 8).

proportionate share of well costs at the compulsory integration hearing even when the matter is referred to OHMS for adjudication (IC Exhs 7A and 7B). On February 17, 2011, responses to the motion were filed by Department staff (IC Exh 8), Northeast (IC Exh 9), and Waits Road (IC Exh 10).

As provided in the notice, a legislative hearing was convened in this proceeding on February 22, 2011, at the Department's Region 7 Office in Syracuse, New York. No persons appeared to provide oral comments on the proposed order. In addition, no written comments were filed. Accordingly, the legislative hearing was concluded.

The issues conference was convened as noticed on February 24, 2011, in the Department's Central Office in Albany, New York. Department staff appeared in person by Jennifer Maglienti, Esq., Associate Attorney; Ryan Naples, Esq., Assistant Attorney; Jack Dahl, Director, Division of Mineral Resources, Bureau of Resource Development and Reclamation; Tom Noll, Chief, Permit Section, Division of Mineral Resources; and Peter Briggs, Director, Bureau of Oil and Gas Permitting. The remaining parties appeared by conference call: Gregory Mountain, Esq., The West Firm, PLLC, for MegaEnergy; Robert Wedlake, Esq., Hinman, Howard & Kattell, LLP, for Northeast; and Christopher Denton, Esq., The Denton Law Office, PLLC, for Waits Road. The issues conference was limited to oral argument on the issues raised in MegaEnergy's motion for summary dismissal.

II. DISCUSSION

The purpose of an issues conference, among other things, is to determine whether legal issues exist that are not dependent upon the resolution of facts in substantial dispute and, if so, to hear argument on the merits of those issues (see 6 NYCRR 624.4[b][2][iv]). Another purpose is to decide any pending motions (see 6 NYCRR 624.4[b][2][v]).

MegaEnergy's motion for summary dismissal raises a procedural question about which no material facts are in substantial dispute. Accordingly, MegaEnergy's motion may be determined at the issues conference stage of this adjudicatory proceeding.

A. Positions of the Parties

Citing three separate provisions of ECL article 23, MegaEnergy argues that an uncontrolled owner electing to participate in a natural gas well as an IPO must tender its proportionate share of well costs by the conclusion of the integration hearing notwithstanding a referral of the draft integration order to OHMS for adjudicatory proceedings under Part 624. MegaEnergy contends that integration hearings and adjudicatory hearings are separate and distinct proceedings (compare ECL 23-0901[3][b] with ECL 23-0901[3][d]), that integration hearings are not continued through the adjudicatory process, and that IPOs cannot wait until adjudicatory proceedings on a draft integration order are concluded to tender their share of well costs.

The first statutory provision MegaEnergy cites is contained in the section governing the submissions a well operator is required to provide to the Department prior to or contemporaneously with the notice of integration hearing (see ECL 23-0901[3][c]). That section required a well operator to provide to the Department "the well operator's estimate of those well costs that the owners electing to participate shall be required to pay to the well operator prior to or at the integration hearing based on each owner's proportionate share of such costs" (id. [emphasis added]).

The second provision is contained in the section governing the contents of the election form to be provided to the uncontrolled owners with the notice of integration hearing (see ECL 23-0901[3][c][1][i]). That section provides that the election form shall set forth the well operator's good faith estimate of those well costs "which the owners electing to be integrated as participating owners will be responsible for paying to the well operator prior to conclusion of the integration hearing, based on each owner's proportionate share of such costs" (see id. [emphasis added]).

The third provision is contained in the section governing elections and their consequences (see ECL 23-0901[3][c][2]). That section provides that the "[f]ailure of an uncontrolled owner to elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner and to pay the amount specified in the notice by the date of the hearing, or to make any election, shall result in the owner

being integrated as an integrated royalty owner" (id. [emphasis added]).

Finally, MegaEnergy asserts that the Department lacks the authority to compel well operators to escrow costs tendered at an integration hearing pending completion of adjudicatory proceedings.⁴ MegaEnergy asserts that the elections Northeast submitted for the four tax parcels at issue must be dismissed because the elections were not accompanied by payment of well costs at the integration hearing. Thus, MegaEnergy asserts that those parcels must be integrated as integrated royalty interests only. MegaEnergy also argues that Northeast's remaining objections to the draft integration order should be summarily dismissed as moot.⁵

Northeast opposes the motion. Northeast argues that the compulsory integration process is not concluded until a final integration order is issued by the Department. Northeast asserts that when an integration order is referred to OHMS for adjudicatory hearings, the integration process is not concluded until adjudicatory proceedings are concluded and an integration order is issued by the Commissioner.⁶ Northeast asserts that under the statute, it is not required to tender its proportionate share of well costs until integration proceedings are concluded, that is, prior to the issuance of a final integration order by the Commissioner in the case of a referral for adjudicatory proceedings.

⁴ In the alternative, MegaEnergy argues that if it is determined that some portion of well costs should be escrowed as a result of a dispute over specific well costs chargeable to an IPO, only the disputed amount should be escrowed in an interest-bearing account, with the principal and interest going to the prevailing party in the dispute.

⁵ Objections raised by Northeast at the integration hearing include challenges to the acreage of several parcels listed on the ownership tabulation for the unit, and a request to add several additional terms to the integration order, among other objections (see Northeast Objections to Proposed Final Order of Integration, IC Exh NED-1).

⁶ Pursuant to Department Program Policy DMN-1: Public Hearing Processes for Oil and Gas Well Spacing and Compulsory Integration, Feb. 22, 2006 (DEC Policy DMN-1), when a draft compulsory integration order is referred to OHMS for adjudicatory proceedings, the final integration order will be signed by the Commissioner (see id., ¶ V.B, at 9). When no substantive and significant issues are raised at the integration hearing, and the matter is not referred for adjudication, the Director of the Division of Mineral Resources or a designee will sign the integration order (see id.).

Northeast asserts that its view is consistent not only with the statutory language, but with the Department's practice in prior cases. Northeast also asserts its position is consistent with the Department's guidance, which provides that a party electing to participate as an IPO must pay the well operator the estimated costs attributable to its proportionate interest in the unit "prior to the conclusion of the [integration] hearing, unless, as discussed below, there is a dispute about well costs which cannot be resolved at the hearing" (DEC Program Policy DMN-1: Public Hearing Processes for Oil and Gas Well Spacing and Compulsory Integration, Feb. 22, 2006 [DEC Policy DMN-1], ¶ V.B, at 8 [emphasis added]).

In the alternative, Northeast argues that if IPOs must pay well costs at the integration hearing, notwithstanding a referral to OHMS for adjudicatory proceedings, well operators must be compelled to escrow those funds with an independent third party until a final integration order is issued. Northeast asserts that escrow is necessary to protect uncontrolled owners' correlative rights pending conclusion of any adjudicatory proceedings, including protecting uncontrolled owners from a well operator's bankruptcy, insolvency, or other financial harm. Northeast also argues that if it is concluded that tender of well costs prior to the conclusion of an integration hearing is required notwithstanding a referral for adjudication, the rule should not be applied retroactively in this case to deprive Northeast of its elections to participate as an IPO with respect to the four subject tax parcels. Moreover, Northeast notes that it tendered well costs for its fifth parcel and, thus, its objections to the draft integration order are not rendered moot in any event.

Waits Road supports Northeast's opposition to the motion, echoing many of the same arguments and policy recommendations as Northeast.

With respect to when well costs must be tendered by a party seeking IPO status, Department staff agrees with MegaEnergy that well costs must be tendered to the well operator at the staff-level integration hearing even when the matter is referred to OHMS for adjudicatory proceedings. In support of this conclusion, staff cites ECL 23-0901(3)(c)(2), which references the "date of the [staff-level integration] hearing" as the date that parties seeking integration as IPOs are required to tender payment of well costs. Beyond this, however,

Department staff's position differs significantly from MegaEnergy's.

Department staff asserts that when a matter is referred for adjudicatory hearings, the staff-level integration hearing is not concluded. Rather, the integration hearing continues through all adjudicatory proceedings, and concludes with the issuance of the final order of integration.

Department staff further asserts that until the final integration order is issued, the rights and obligations of the well operator and uncontrolled owners remain unresolved, and neither the well operator nor the uncontrolled owners may fully receive the benefits that would derive from a final order. Accordingly, staff argues, the well operator is not entitled to use the funds tendered by a party electing IPO status at the integration hearing until the integration process is concluded. Staff notes that an IPO's share of well costs specified in the election form is determined based upon an estimate provided solely by the well operator. Staff contends that "[i]nequity would result if well operators are permitted to expend funds advanced by uncontrolled owners while an integration order is pending since uncontrolled owners have no control over the amount of well costs specified on their compulsory integration election form" (Department Staff's Reply Brief, IC Exh 8, at 4).

With respect to the escrow of well costs, however, staff argues that the Department lacks the authority to require the well operator to place funds in escrow with a third party, notwithstanding staff's position that well operators may not use those funds while an integration order is pending. Although staff views the use of escrow as the best practice, it concludes that use of escrow is voluntary with the parties.

B. Timing of Tender of Well Costs

I conclude that Department staff has the correct view of the statute, except on the issue of the Department's authority to require escrow. With respect to when parties seeking IPO status are required to tender their proportionate share of well costs, I agree that those parties must tender well costs to the well operator by the date of the staff-level integration hearing conducted pursuant to section 23-0901(3)(b), whether the matter is continued through a referral for

adjudicatory proceedings pursuant to section 23-0901(3)(d) or not. This conclusion is consistent with the plain language of section 23-0901(3)(c)(2), which requires a party electing IPO status to pay the amount specified in the notice of the integration hearing by the date of that hearing or be integrated as a royalty owner.

The requirement that a party electing IPO status to pay its proportionate share of well costs by the date of the integration hearing is also consistent with the legislative intent and policies of the 2005 amendments to article 23. As has previously been recognized in ALJ rulings and Commissioner decisions (see, e.g., Matter of Beach W 1, Interim Decision of the Commissioner, Aug. 26, 2011, at 17), one of the purposes of the 2005 amendments was to move decision making concerning participation in a well to as early a stage in the development of the well as possible, preferably before the well is drilled, and to streamline the process for integrating those interests (see Senate Sponsor Mem in Support, 2005 McKinney's Sessions Laws of NY, at 2254). Because one of the potential outcomes of the integration hearing is the issuance of an integration order in the event no substantive and significant objections are raised (see ECL 23-0901[3][e]), requiring parties electing IPO status to tender well costs at the integration hearing assures that the integration process can be completed at that time and without any further delay.

Requiring the tender of well costs at the integration hearing even when the matter is referred for adjudication also serves the legislative goals of early decision making and the efficiency of the administrative integration process. Requiring parties seeking IPO status to tender well costs at the integration hearing assures that those parties have the necessary standing in any ensuing adjudicatory proceedings to litigate the terms of integration relevant to an IPO, and avoids the potential for the adjudication of academic questions. Otherwise, a party claiming to elect IPO status could adjudicate the terms of a draft integration order, and then decline to tender its proportionate share of well costs at the conclusion of the hearing if it is dissatisfied with the outcome, resulting in unnecessary inefficiency, expense, and delay.

I also agree with Department staff that until a final order of integration is issued, the interests of well operators and uncontrolled owners are not finally resolved. Although

parties electing IPO status are required to tender their share of well costs at the integration hearing, those owners are not actually liable for those costs and expenses except pursuant to the terms of the final integration order (see ECL 23-0901[3][c][1][ii][A]). Thus, the well operator is not entitled to use those funds tendered at the integration hearing until any adjudicatory proceedings are concluded and a final order of integration is issued.

Instead, as MegaEnergy indicated it would do at the integration hearing, the operator is required to hold payments tendered at the integration hearing in an interest bearing account until a final order of integration is issued. This requirement is consistent with the 2005 amendments to ECL article 23 (see ECL 23-0901[3][c][1][ii][A]; see also ECL 23-0901[3][c][1][ii][B] [requiring a well operator to hold funds paid by an owner for plugging and abandonment costs in an interest bearing account until such funds are required and used for that purpose]), Department policy (see DEC Policy DMN-1, ¶ V.B., at 8; see also DEC Policy DMN-1, Responsiveness Summary, at 3, 12), and provisions of the draft integration order (see Draft Order No. DMN 10-31, IC Exh 2, ¶ VI.A). Accrued interest shall be applied to the participating owner's share until actual costs are incurred by the well operator. If the well operator incurs actual well costs prior to issuance of a final integration order, interest accrued after costs are incurred by the well operator will be applied to the well operator.

C. Departmental Authority to Require Escrow

With respect to whether the Department has the authority to require the well operator to escrow funds tendered at the integration hearing with an independent third party pending the completion of adjudicatory proceedings, I conclude that the Department has that authority. An agency's powers include not only those expressly conferred by statute, but also those required by necessary implication (see Matter of Mercy Hosp. v New York State Dept. of Social Servs., 79 NY2d 197, 203-204 [1992]). This is especially true where the Legislature has delegated administrative duties in broad terms, leaving the agency to determine the specific standards and procedures that are most suitable to accomplish the legislative goals (see id.).

Here, many details of the integration process are specified by the statute, including the various categories of participation afforded uncontrolled owners, the form of elections and their consequences, and the specific terms to be included in integration orders. With respect to those aspects of the integration process, the Department's implied powers are limited (see Beach W 1, Commissioner Interim Decision, at 19).

In contrast, the statutory provisions requiring integration and adjudicatory hearings as part of the administrative process are written in broad terms, leaving the Department to determine the specific standards and procedures to be followed to complete the administrative process for integrating oil and gas interests (see ECL 23-0901[3][b], [d]). The Department has specified the procedures to be followed in those hearings in part through the promulgation of DEC Policy DMN-1 and the application of Part 624.

In the context of adjudicatory proceedings on integration orders, Commissioners have long recognized the Department's authority to require the escrow of funds to protect the correlative rights of mineral owners pending completion of the integration process (see, e.g., Matter of Glodes Corners Road Field, Interim Decision of the Commissioner, Feb. 25, 2000, at 2-4 [citing integration orders issued as long ago as 1968]).⁷ This authority is premised upon the policy direction contained in ECL 23-0301 -- which declares, among other things, that the full protection of correlative rights is in the public interest -- and the structure of ECL article 23 itself (see id.). Nothing in the 2005 amendments limits the bases for the Department's authority to require escrow. To the contrary, the 2005 revisions evince the Legislature's intent to enhance the protection of correlative rights. Thus, the authority

⁷ Under the common law rule of capture, a mineral rights owner does not have ownership of subsurface oil or gas until it is captured, but does have the right to drill, explore, develop, and produce those minerals (see Matter of Western Land Servs., Declaratory Ruling DEC 23-14, at 10 [referenced in DEC Policy DMN-1, at 10 n 1]). This qualified right of ownership is referred to as "correlative rights" (see id.). The protection of correlative rights refers to affording mineral owners the opportunity to receive or be compensated for the oil or gas attributable to the owner's acreage when it is produced, regardless of how, when, or by whom it is produced, and without being required to drill unnecessary wells or to incur other unnecessary expense to recover or receive oil or gas or its equivalent (see id. at 11-12; see also 6 NYCRR 550.3[ao]).

recognized by Commissioners prior to the 2005 amendments remains.

On the other hand, the Department has also practiced a policy of non-interference in the commercial relationships among mineral interest owners, preferring instead that mineral interest owners resolve issues through voluntary agreement rather than through Departmental fiat.

Accordingly, although the Department has the authority to protect correlative rights through the use of escrow, that authority should only be exercised based upon a showing of necessity. This is especially so in the case of disputes between well operators and IPOs who may be presumed to be sophisticated parties well able to protect their own interests.

In this case, Northeast has not made a sufficient showing warranting the exercise of the Department's authority to require the escrow of well costs with an independent third party pending completion of the integration process. Northeast asserts that the escrow of funds is necessary to protect it from the potential bankruptcy or insolvency of the well operator, or to avoid other financial harms. However, no showing has been made that MegaEnergy is verging on bankruptcy or insolvency. Nor is the mere potential for a well operator's bankruptcy or insolvency a sufficiently compelling reason to require escrow. The potential insolvency of a well operator is one of the risks an IPO faces whether before or after the administrative integration process is completed. A party contemplating participation as an IPO has a variety of options available to avoid that risk, including seeking integration as an NPO or royalty interest. An IPO also has other remedies to protect its interest in the event it chooses to take the risks associated with IPO status, including referring alleged violations of a final integration order to the Department for appropriate enforcement action (see DEC Policy DMN-1, ¶ V.C, at 9).

In light of the options available to an IPO, exercise of the Department's authority to require escrow of funds with an independent third party to protect against the mere potential of a well operator's insolvency or bankruptcy would constitute an unnecessary and unwarranted intrusion into the relationship between well operators and IPOs. Accordingly, Northeast's request that the Department direct MegaEnergy to escrow funds tendered at the integration hearing with an independent third

party pending completion of the integration process is denied. Instead, the funds will be held by MegaEnergy in an interest bearing account, as directed above.

D. Dismissal of Northeast's Elections

Finally, MegaEnergy requests that because Northeast did not tender well costs at the integration hearing for four tax parcels in the spacing unit, those parcels should be integrated as royalty interests only. Northeast opposes this request, arguing that it proceeded in good faith based upon the Department's prior practice, among other things. Northeast urges that any ruling in MegaEnergy's favor should not be applied retroactively.

Based upon language in DEC Policy DMN-1 concerning when well costs are required to be paid and the deposit of those proceeds in an interest bearing account (see DEC Policy DMN-1, at V.B, at 8), and the Department's precedent concerning the escrow of funds during the pendency of administrative integration proceedings, I agree that Northeast had a good faith basis for its argument that the tender of well costs was not required until the conclusion of adjudicatory proceedings on a challenged integration order or, in the alterative, that the Department would require the escrow of funds tendered at the integration hearing pending completion of the integration process. Accordingly, it would be inequitable to integrate Northeast's interests in the four parcels as royalty interests. Instead, Northeast will be afforded 30 days from the date of this ruling to tender its proportionate share of well costs associated with the four parcels to MegaEnergy or be integrated as royalty interests.

III. Conclusion and Ruling

In sum, a party seeking integration as an IPO is required to tender its proportionate share of well costs by the conclusion of the integration hearing whether or not the matter is referred to OHMS for adjudicatory proceedings under Part 624. Although an IPO is required to tender well costs to the well operator at the integration hearing, the well operator is not entitled to use those funds until a final order of integration is issued by the Department. Instead, the well operator will

deposit funds tendered at the integration into an interest bearing account, with interest applied as directed above.

With respect to the escrow of well costs with an independent third party pending the conclusion of compulsory integration proceedings, the Department has the authority to require the escrow of funds to protect correlative rights. In this case, however, Northeast has failed to make a showing sufficient to justify the Department in exercising its authority. Accordingly, Northeast's request that MegaEnergy be required to escrow well costs with an independent third party pending conclusion of the integration process is denied.

MegaEnergy's motion to dismiss Northeast's elections for tax parcel ID nos. 150.00-2-17, 150.00-1-30, 150.00-1-31, and 140.00-1-53.2, and to integrate those tax parcels as royalty interests, is denied provided that Northeast tender its proportionate share of well costs to MegaEnergy on or before 30 days from the date of this ruling. If Northeast does not tender its well costs within 30 days, MegaEnergy's motion is granted as to those tax parcels for which well costs are not timely tendered.

Thereafter, the issues conference in this proceeding will be continued to consider issues raised by Northeast concerning tax parcel ID no. 151.00-1-33, and any or all of the four tax parcels for which well costs have been tendered.

The time for appealing from this issues ruling is suspended pending conclusion of the issues conference and the issuance of any further issues ruling (see 6 NYCRR 624.6[g]).

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

Dated: December 20, 2011
Albany, New York

TO: Attached Service List