

STATE OF NEW YORK  
DEPARTMENT OF ENVIRONMENTAL CONSERVATION  
625 BROADWAY  
ALBANY, NEW YORK 12233-1010

In the Matter

- of -

the Proposed Field-wide Spacing and  
Integration Rules for the

**TERRY HILL SOUTH FIELD,**

Pursuant to Article 23 of the Environmental  
Conservation Law and Parts 550 through 559 of  
Title 6 of the Official Compilation of Codes,  
Rules and Regulations of the State of New  
York.

DEC Project No. DMN-02-03

FIRST INTERIM DECISION

December 21, 2004

DECISION OF THE COMMISSIONER

Staff of the Department of Environmental Conservation ("Department") commenced proceedings pursuant to 6 NYCRR part 624 proposing issuance of an order that would establish field-wide spacing and integration rules for the Terry Hill South natural gas field (the "Field"). Petitioners for party status Buck Mountain Associates ("Buck Mountain"), Rural Energy Development Corp. ("Rural Energy"), Western Land Services, Inc. ("WLS"), Florence Teed, Rae Lynn Ames, and Linda and Terry Zahurahneec,<sup>1</sup> (collectively "petitioners") appeal from (1) a June 17, 2004 ruling on issues and party status issued in these proceedings by Administrative Law Judge ("ALJ") Maria E. Villa ("Issues Ruling"), and (2) a July 2, 2004 ruling of the same ALJ denying Buck Mountain's motion for clarification and to extend the time to appeal ("Clarification Ruling").

In the Issues Ruling, the ALJ held, among other things, that petitioners failed to raise an adjudicable issue concerning the size and configuration of the gas well spacing units proposed for the Field. This First Interim Decision addresses that portion of the ALJ's ruling that concerns the gas well spacing proposed for the Field (see Environmental Conservation Law

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<sup>1</sup> By letter dated February 18, 2004, the ALJ was informed that the Zahuranecs have filed a bankruptcy petition and that bankruptcy trustee Douglas J. Lustig is pursuing, for the benefit of the bankruptcy estate, all claims of the estate for oil, gas and mineral rights.

["ECL"] § 23-0501), and the issues raised on the appeal that are relevant to such ruling. A Second Interim Decision will follow addressing the remaining issues raised on the appeal from the Issues Ruling, including the terms of the proposed compulsory integration order challenged by petitioners (see ECL 23-0901), and the appeal from the July 2, 2004 Clarification Ruling.

#### Background and Proceedings

In March 2000, Fairman Drilling Company ("Fairman") began development of the Ordovician Trenton-Black River gas-bearing formations in the Field. Fairman successfully drilled six gas wells in the Field that are referred to as the Broz Unit #1, Clauss #1-A, Gublo #1, Kienzel<sup>2</sup> #1-A, Kimball #1, and Lant #1, respectively.

Department staff entered into a stipulation dated October 9, 2002 with Fairman concerning the Field. Fairman subsequently conveyed its interests in the Field to Fortuna Energy Inc. ("Fortuna") and proceedings for issuance of a field-wide spacing and integration order pursuant to ECL 23-0501 and ECL 23-0901 continued.

The stipulation contains proposed well spacing provisions, and provides for compulsory integration of interests within the spacing units. With respect to well spacing, the

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<sup>2</sup> The Kienzel well is spelled "Kienzle" on the maps attached to the stipulation.

stipulation proposes boundaries for the Field itself and eight spacing units within the Field (see Stipulation, Exh D). Five spacing units are proposed for the six existing gas wells.<sup>3</sup> As originally proposed, the Field included three spacing units for three additional undrilled wells: Hinman #1, Colson #1, and Lant #2. A well, known as Hammond #1, has since been drilled in the Colson #1 spacing unit.<sup>4</sup> Accordingly, the Colson #1 spacing unit is now referred to as the Hammond #1 spacing unit.

Department staff referred the matter to the Department's Office of Hearings and Mediation Services for adjudicatory proceedings pursuant to the Department's permit hearing procedures (see 6 NYCRR part 624 ["Part 624"]) and ALJ Villa was assigned. Petitioners filed a joint petition for party status challenging, among other things, the size and configuration of the spacing units. As the Field and spacing units within it are presently proposed, petitioner Buck Mountain owns mineral rights on 28.5 acres in the Hammond (formerly Colson) #1 unit (representing 5.30% of the 537.8-acre unit), and

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<sup>3</sup> The Kimball #1 well and the Broz #1 well are combined into a single spacing unit known as the Broz/Kimball #1 unit. The remaining units are named after their respective wells.

<sup>4</sup> The acreage of the eight proposed spacing units are: Broz/Kimball #1 unit -- 639.7 acres; Clauss #1-A unit -- 323.1 acres; Gublo #1 unit -- 541.2 acres; Hammond #1 (formerly Colson #1) unit -- 537.8 acres; Hinman #1 unit -- 492.8 acres; Kienzel #1-A unit -- 578.0 acres; Lant #1 unit -- 620.2 acres; and Lant #2 unit -- 432.5 acres.

1.59 acres in the Lant #1 unit (representing 0.26% of the 620.2-acre unit). Individual petitioners Florence Teed, Rae Lynn Ames, and Terry and Linda Zahurahneec own various parcels of property with unleased mineral rights within the proposed Field.<sup>5</sup> Rural Energy holds an oil and gas lease in a proposed drilling unit in a field located outside the boundaries of the proposed Terry Hill South Field, to the west of the Lant #1 unit. WLS also holds oil and gas lease rights outside the proposed Field boundaries, but the joint petition does not specify the location of those leases beyond the general area thought to overlie the Trenton/Black River formation.

After conducting a Part 624 legislative hearing and issues conference, and after the submission of post-issues conference briefs, the ALJ issued the June 17, 2004 Issues Ruling. In that ruling, the ALJ rejected petitioners' challenge to the use of a stipulation by Department staff and Fortuna (see Issues Ruling, at 15-16). The ALJ also held that petitioners failed to raise an adjudicable issue concerning the size and configuration of the proposed spacing units, and rejected petitioners' contention that confidential information provided by Fortuna to Department staff for its review should have been

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<sup>5</sup> The Zahurahneecs own 7.03 acres within the 578-acre Kienzel #1-A unit (representing 1.2% of the unit); Florence Teed owns 0.97 acres in the Hammond #1 unit (representing 0.18% of the unit); and Rae Lynn Ames owns 0.75 acres in the Hammond #1 unit (representing 0.14% of the unit).

shared with petitioners (see id. at 18-22, 25).

Buck Mountain subsequently filed a motion for clarification of the Issues Ruling and to extend the time to appeal. On July 2, 2004, the ALJ denied the motion for clarification, but granted the motion to extend the time to appeal (see Clarification Ruling). Petitioners then filed an expedited appeal pursuant to 6 NYCRR 624.8(d)(2) from the Issues Ruling and the Clarification Ruling. Department staff and Fortuna filed timely responses to petitioners' appeal.

As noted above, this First Interim Decision concerns only those issues related to the proposed gas well spacing pursuant to ECL 23-0501. For the reasons that follow, I affirm the ALJ's ruling that petitioners raised no adjudicable issue relevant to the size and configuration of the spacing units proposed for the Terry Hill South Field.

#### Discussion

##### Statutory and Regulatory Background

ECL article 23 requires the Department to regulate the development, production and operation of natural gas and oil wells within the State in a manner that will maximize the recovery of gas and oil, prevent the waste of those natural resources, and protect the correlative rights of all persons, including landowners and the general public (see ECL 23-0301). Whenever the Department finds, after notice and hearing, that the

spacing of wells in a field is necessary to carry out the policy provisions of ECL 23-0301, the Department must issue an order establishing spacing units in the field that will, in the opinion of the Department, result in the efficient and economical development of the pool as a whole (see ECL 23-0501[2], [4]). Spacing units in a field are to be of "approximately uniform size and shape . . . , except that where circumstances reasonably require," the Department may grant variances from the size or shape of any spacing unit or units, provided that the allowable production from the wells is adjusted so that the owners of each spacing unit "shall receive their just and equitable share of the production from the pool" (ECL 23-0501[3]).

In general, after a well operator has developed one or more gas producing wells in a field, Department staff determines whether an order establishing the size and boundaries of the unit from which each well will draw natural gas is necessary to accomplish the purposes of ECL 23-0301 (see Matter of Western Land Services, Inc., Declaratory Ruling DEC #23-13, Jan. 29, 2004, at 2 ["DR 23-13"]). To arrive at proposed spacing units, staff reviews test data usually provided by the operator of the proposed units. Department staff enters into a stipulation with the operator that includes, among other things, the size and boundaries for each well spacing unit. Thereafter, staff initiates the public notice and hearing process required by ECL

23-0501 and refers the matter to the Department's Office of Hearings and Mediation Services for adjudicatory proceedings pursuant to Part 624. After Part 624 proceedings are concluded, the Commissioner issues a gas well spacing order based upon the record developed during adjudication.

Applicability of Part 624 Proceedings to Gas Well Spacing Orders

Petitioners object to the application of Part 624 permit hearing proceedings to establish gas well spacing orders pursuant to ECL 23-0501. Petitioners cite the proposition that a surface owner's common law right of capture is a constitutionally protected property right (see Ohio Oil Co. v Indiana, 177 US 190, 209-210 [1900]). Although petitioners agree that Part 624 procedures may be used as "guidance," they contend that those procedures should not be used to deprive them of their correlative rights to the gas under their property. Specifically, petitioners argue that application of the Part 624 "substantive and significant" standard deprives them of the opportunity "to fully ventilate issues affecting the operation of spacing units" and deprives them of their correlative rights without due process (Petitioners' App Brf, at 49). Instead, petitioners urge that the hearing required by ECL 23-0501 is an adjudicatory hearing on a record pursuant to State Administrative Procedure Act ("SAPA") § 302. Thus, petitioners contend that they are entitled to a full evidentiary hearing.

The Department's Part 624 permit hearing procedures are expressly made applicable to gas well spacing orders by regulation (see 6 NYCRR 624.1[a][6]; see also DR 23-13, at 4). The Part 624 hearing procedures, which the Department applies to a wide variety of Departmental permits and approvals, provide a mechanism to develop a factual record and a forum for the presentation of legal arguments upon which the Commissioner bases a decision on a proposed order. The Part 624 hearing procedures are designed to be fully compliant with the requirements of SAPA article 3 and are applied to Department adjudications when SAPA would require an article 3 hearing (see 6 NYCRR 624.2[a]). Thus, contrary to petitioners' contention, application of Part 624 hearing procedures to gas well spacing orders provides petitioners with the maximum opportunity to participate available under both SAPA and the Department's regulations.

Petitioners contend that Department staff's practice of entering into stipulations with well operators improperly removes issues from the hearing process, deprives petitioners of an opportunity at an evidentiary hearing to present their version of a proposal for a gas well spacing order, and contractually binds the Department to a position in favor of operators. Petitioners overstate the effect and purpose of the stipulations executed by Department staff and well operators in a gas well spacing proceeding. Only a stipulation executed by all parties to the

proceeding, including petitioners, would have the effect of removing issues from the hearing (see 6 NYCRR 624.13[d]). At this time, no such stipulation has been executed. Rather, the stipulation executed by staff and Fortuna essentially serves the function in these proceedings that a draft permit serves in a permit hearing proceeding. Petitioners remain free to challenge the terms and conditions of the order proposed by the stipulation, so long as the standards for raising an adjudicable issue under Part 624 are met (see also DR 23-13, at 6).

Requiring petitioners to satisfy the "substantive and significant" standard before advancing an issue from the issues conference stage to the evidentiary phase of adjudication does not deprive petitioners of any procedural right to a hearing. Where, as here, Department staff has reviewed the data supporting a proposed order and concluded that the proposal meets applicable statutory and regulatory requirements, Part 624 procedures place the burden upon the party proposing an issue to demonstrate that the issue proposed is "substantive and significant" (see 6 NYCRR 624.4[c][4]). The "substantive and significant" test, and the issues conference in general, are used to determine whether any factual issues exist requiring an evidentiary hearing. This is comparable to the purpose summary judgment serves in civil proceedings under the Civil Practice Law and Rules. The showing that must be made to survive summary judgment, however, is

significantly greater than that required at a Part 624 issues conference. Unlike summary judgment, a party proposing an issue need not support its issue with evidentiary proof, nor provide such proof as would entitle the party to judgment on the merits (see Matter of Hydra-Co. Generations, Inc., Interim Decision of the Commissioner, April 1, 1988, at 2). Rather, a proponent at an issues conference carries its burden with an offer of proof that raises sufficient doubt about whether applicable statutory and regulatory criteria have been met such that a reasonable person would inquire further (see id. at 2-3; see also 6 NYCRR 624.4[c][2], [3]). This threshold inquiry is less rigorous than the summary judgment standard. It follows that if summary judgment does not deprive civil litigants of due process (see, e.g., General Inv. Co. v Interborough Rapid Transit Co., 235 NY 133, 141-143 [1923]; see also Siegel, NY Prac § 278, at 438 [3d ed]), it cannot seriously be contended that requiring petitioners in gas well spacing proceedings to meet the substantive and significant test violates their due process rights (see Hydra-Co., at 3).

#### Size and Configuration of Spacing Units

Petitioners challenge the ALJ's conclusion that they failed to raise an adjudicable issue concerning the size and configuration of the spacing units proposed for the Field. I conclude, however, that the ALJ correctly applied the

"substantive and significant" standard and correctly held that petitioners' offer of proof failed to raise an adjudicable issue. According, I affirm the ruling.

As in an ordinary permit hearing proceeding, a party proposing a factual issue for adjudication in a gas well spacing proceeding may carry its burden at the issues conference in one of several ways.<sup>6</sup> First, the intervening party may offer proof, usually in the form of proposed testimony by an expert, alleging that the facts are either contrary to those in the permit application and supporting documentation -- in this case the stipulation and its supporting materials -- or that defective information was used in the application or draft permit (see Hydra-Co., at 2-3). In such a circumstance, an intervenor must also allege that if its facts are correct, relevant regulatory or statutory standards or criteria might not be met. In the alternative, an intervenor may offer proof that demonstrates an omission or defect in the application that is likely to substantially affect permit issuance (see id.).

At the issues conference stage, an intervenor need not present proof of its allegations sufficient to prevail. Nevertheless, its allegations cannot be mere unsupported

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<sup>6</sup> Department staff's assertion that to be successful, an intervenor in a gas well spacing proceeding must provide seismic and geological evidence of its own is not supported by Department precedent concerning an intervenor's showing in a Part 624 issues conference.

assertions (see id.). An intervenor's assertions cannot be conclusory or speculative, but must be supported by a sound factual or scientific foundation (see Matter of Bonded Concrete, Inc., Interim Decision of the Commissioner, June 4, 1990, at 1-2).

Once an intervenor asserts that an issue exists, an applicant may seek to rebut the assertion through reference to its application in order to assist the ALJ in ruling on the matter (see Matter of Halfmoon Water Improvement Area No. 1, Decision of the Commissioner, April 2, 1982, at 2). The ALJ will take into account the arguments, offers of proof, the application documents, and Department staff's expertise in reviewing the matter (see id.). The ALJ will advance a factual dispute to adjudication where sufficient doubt exists about an applicant's ability to meet all statutory and regulatory criteria such that a reasonable person would inquire further (see Hydra-Co., at 2-3).

Petitioners' offer of proof at the issues conference was insufficient to establish an adjudicable issue concerning the size and configuration of the Field. Petitioners presented geologist Michael P. Joy, Ph.D., who contended that the spacing units could not be configured based as proposed upon the available geophysical, reservoir engineering and seismic data. Specifically, Dr. Joy contended that the number and location of seismic lines used by Fortuna did not support the proposed

configuration even assuming the seismic data were correctly interpreted. Dr. Joy maintained that because the available data was insufficient to support the proposed configuration of the Field, the units should instead be drawn to uniform size and shape.

Petitioners' offer of proof was rebutted by John K. Dahl, a Department geophysicist with experience in gas and oil exploration who reviewed Fortuna's seismic data. He asserted that gas-bearing features may be successfully configured by observing the trends the seismic data reveals, and testing those observations against drilling results in the field. Dr. Joy's response failed to raise any question concerning the effectiveness of such trend analysis, nor did Dr. Joy proffer that an analysis exists that better comports with the evidence. Thus, as the ALJ correctly noted, petitioners' offer of proof was insufficient to raise an adjudicable issue.

On their appeal, petitioners assert that the circumstance that the Hammond #1 well was subsequently drilled in a location different from where the Colson #1 well was originally proposed is evidence that the Hammond #1 unit is improperly sized and configured. Department staff responds, however, that the Hammond #1 well is a directional well and, accordingly, its relocation at the surface does not require reconfiguring the Hammond #1 unit. Because petitioners' assertion fails to suggest

that further inquiry is reasonably required, no adjudicable issue is raised.

Petitioners also assert that they were improperly denied the opportunity to review the data that Department staff reviewed, but which Fortuna claims is confidential information subject to trade secret protection. Petitioners assert that an evidentiary hearing is required to review that data. However, petitioners failed to exhaust the pre-issues conference discovery devices available to them to review such information (see 6 NYCRR 624.7; see also DR 23-13, at 6). Although petitioners sought and obtained a determination under the Department's Freedom of Information Law regulations (see 6 NYCRR part 616) concerning the status of Fortuna's data, they did not pursue the administrative avenues available to them to challenge the adverse determination. Moreover, they did not seek the ALJ's permission for pre-issues conference discovery as provided for in Part 624 (see 6 NYCRR 624.7[a], [c]). Accordingly, petitioners' contention that they were improperly denied the opportunity to review Fortuna's data is not supported by the record.

#### Conclusion

In sum, petitioners failed to carry their issues conference burden of raising an adjudicable issue concerning the size and configuration of the Field boundaries and the spacing units proposed for the Field. Accordingly, Department staff is

hereby directed to prepare for my signature an order pursuant to ECL 23-0501 establishing Field boundaries and the proposed spacing units for the Terry Hill South Field. In addition, staff is directed to prepare an order releasing the escrowed royalties to the mineral rights owners in the Field other than petitioners.

The remainder of petitioners' appeal, including the terms of petitioners' integration into the ECL 23-0901 compulsory integration order for the Field, will be addressed in the Second Interim Decision.

For the New York State  
Department of Environmental  
Conservation

By: \_\_\_\_\_/s/\_\_\_\_\_  
Erin M. Crotty, Commissioner

Dated: December 21, 2004  
Albany, New York