

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

RULING ON ISSUES
AND PARTY STATUS

Project No. DMN-02-03

June 17, 2004

SUMMARY

Staff of the Department of Environmental Conservation (“DEC” or “Department”) has proposed issuance of an order which would establish field-wide spacing and integration rules for the Terry Hill South natural gas field (the “Field”). The Field is situated on portions of acreage located in the Towns of Catlin and Veteran, in Chemung County, and the Towns of Dix and Montour, in Schuyler County.

This ruling finds that there are no adjudicable issues raised in the joint petition for party status submitted by Buck Mountain Associates, Rural Energy Development Corporation, Western Land Services, Inc., Florence Teed, Rae Lynn Ames, and Terry and Linda Zahurahneec (collectively referred to hereinafter as the “Buck Mountain Intervenors”). Accordingly, the requests for party status are denied. Department Staff should prepare and complete a Commissioner’s Decision and Order establishing units and releasing royalties for the Field.

BACKGROUND

The Department is responsible for establishing spacing units for oil and natural gas pools and fields, pursuant to Environmental Conservation Law (“ECL”) Section 23-0501, in order to carry out the policy provisions of ECL Section 23-0301, which states that

[i]t is hereby declared to be in the public interest to regulate the development, production and utilization of natural resources of oil and gas in this state in such a manner as will prevent waste; to authorize and to provide for the operation and development of oil and gas properties in such a manner that a greater ultimate recovery of oil and gas may be had, and that the correlative rights of all owners and the rights of all persons including landowners and the general public may be fully protected . . .

An order establishing field-wide spacing units in the Terry Hill Field will serve to configure production units for each of the existing wells and will include procedures for establishing spacing units for future wells. All ownership interests identified for existing production units

and proposed spacing units will be integrated so that the proceeds attributable to development within each unit can be disbursed.

Fairman Drilling Company (“Fairman”), R.D. #1, Helvetia Road, P.O. Box 288, DuBois, Pennsylvania 15801-0288, began development of the Ordovician Trenton-Black River formations in the Field in March of 2000. Fairman conducted an exploration and drilling program and successfully drilled six wells in the Field. The six wells are referred to as the Broz Unit #1, Clauss #1-A, Kienzel #1-A,¹ Kimball #1, Lant #1, and Gublo #1. Permits to drill were issued for the existing wells, and are required prior to commencement of drilling operations pursuant to Section 552.1 of Title 6 of the Official Compilation of Codes, Rules and Regulations of the State of New York (“6 NYCRR”). Fairman continued to drill, complete and produce wells to develop the existing Field and to identify similar producing reservoirs in adjacent areas.² As of October 30, 2002, Fairman conveyed its interests to Fortuna Energy Inc. (“Fortuna”), 1519 Olean-Portville Road, Olean, New York 14760.

Department Staff entered into a stipulation, dated October 9, 2002 (the “Stipulation”) with Fairman, which is binding upon Fortuna as successor to Fairman. The Stipulation contains proposed well spacing provisions and unit boundaries, and provides for compulsory integration of interests within the spacing units. According to Department Staff, the Stipulation’s provisions are based upon an analysis of available geologic, engineering and seismic data from wells within the Terry Hill South Field and from similar reservoirs in the vicinity. It is Department Staff’s position that this Stipulation, which Department Staff characterizes as a joint proposal to the Commissioner from the operator of the Field and Department Staff for inclusion in a Commissioner’s order, resolves issues pertaining to field wide spacing rules and establishes procedures for future wells.

Fortuna is currently conducting an exploration and development program on portions of leasehold acreage in the Field, and has proposed eight production units. Five wells have been successfully drilled. Some production units contain a small number of unleased parcels where the right to develop has not been conveyed to Fortuna. Department Staff has reviewed the data and information provided by Fortuna and the scientific support for it and concur with the proposal.

The Department is lead agency for review of this action under the State Environmental Quality Review Act (“SEQRA,” ECL Article 8 and 6 NYCRR Part 617). Department Staff reviewed the proposal to establish field-wide spacing rules and the integration of interests within units for the Terry Hill South Field and concluded that the establishment of the field-wide spacing and integration rules within the units will have no significant adverse impact on the environment. A Notice of Determination of Non-Significance Negative Declaration was prepared on July 23, 2002.

¹ Spelled “Kienzle” in the maps attached to Exhibit 15.

² Three proposed wells are included in the Field: the Hinman #1, Colson #1, and Lant #2.

PROCEEDINGS

After entering into the Stipulation, Department Staff requested that a hearing be convened. By notice dated November 6, 2002, a hearing was scheduled on the proposed establishment of field-wide spacing and integration rules for the Field. Pursuant to 6 NYCRR Part 553, Department Staff is proposing that the Commissioner issue an order establishing these spacing and integration rules. The notice was published in the November 6, 2002 issue of the Department's *Environmental Notice Bulletin* and in the November 5, 2002 edition of the *Elmira Star-Gazette*. The notice was also mailed, in November 2002, to local governmental officials, landowners, and to those persons who had contacted the Department regarding the proposal.

The hearing began with a legislative (public comment) hearing on the evening of December 3, 2002, at the Holiday Inn in Painted Post, New York, before Administrative Law Judge ("ALJ") Maria E. Villa. The hearing continued at the same location on the following day, with an issues conference for discussion of what issues, if any, required adjudication and what parties would participate in an adjudicatory hearing regarding the proposal. The hearing was held pursuant to the procedures set forth in 6 NYCRR Part 624 (Permit Hearing Procedures).

Legislative Hearing

Approximately 70 persons attended the legislative hearing, six of whom made statements for the record. Harv Rasmussen, Fortuna's Senior Landman, and John Heyer, counsel for Fortuna, made presentations on behalf of the company. Mr. Rasmussen provided an overview of Fortuna's development efforts in the Field, and stated that the spacing units as proposed were appropriate and would protect the rights of all interested landowners.

On behalf of Department Staff, Arlene Lotters, Esq., of the Division of Legal Affairs, stated that the standard gas well spacing is inadequate for this field in order to meet the goals of ECL Article 23. She described the statutory and regulatory framework, and said that it is the position of Department Staff that the October 9, 2002 Stipulation satisfies the requirements of the ECL relative to preventing waste of the resource, providing for greater ultimate recovery and protecting the correlative rights of all owners of the resource. Thomas E. Noll, Mineral Resources Specialist, of the Department's Division of Mineral Resources, described the field and its discovery, and discussed the provisions of the Stipulation, noting that royalty payments attributable to leased and unleased owners would be escrowed in an interest bearing account until a final order issues.

The only other persons who offered comments at the legislative hearing were Christopher Denton, Esq., Allan Lipman, Esq., and Dr. Michael Joy, who holds a Ph. D. in geology and is an attorney with Mr. Lipman's firm. These three attorneys jointly represent the Buck Mountain Intervenor. Mr. Denton expressed concern about the hearing process, contending that the Department's practices in well-spacing cases violated due process and the State Administrative Procedure Act ("SAPA"). Mr. Denton argued that any person who owned property in the spacing unit should be entitled to party status, and stated that the rights of non-leasing owners were not protected by the process. According to Mr. Denton, the Department exceeded its

authority and improperly construed the statute with respect to the amounts to be paid to unleased landowners.

Mr. Lipman praised the Department's efforts to encourage development of the resource, but contended that in its zeal to bring in out-of-state operators to invest in the Field, the Department impermissibly favored these operators over the owners of the real property where the wells are located. Mr. Lipman argued that the 1/8 royalty to be paid to non-leasing landowners was unfair, and did not protect those landowners' correlative rights as mandated by the statute. According to Mr. Lipman, the situation at hand is not unique to New York State, and non-leasing landowners in other jurisdictions are treated more equitably. Michael Joy, Ph. D., a geologist, stated that he was employed by Mr. Lipman's firm, and that he had passed the bar examination and was awaiting admission as an attorney. Dr. Joy described his background in geology, and his studies of the Trenton/Black River formation at issue in this proceeding.

Dr. Joy contended that the statute, as interpreted by Department Staff, undermined a landowner's bargaining power. He took issue with the use of the word "pooling," although he did not specify who had referred to the proposal in this manner, and argued that, in fact, "unitization" was a more accurate descriptor. "Unitization," according to Dr. Joy, occurs when mineral or leasehold interests covering all or part of the common sources of supply are consolidated to maximize recovery and profit. Dr. Joy took the position that this was not taking place with respect to the Field, and argued further that the well spacing proposed was unfair to unleased landowners. He asserted that much of the information necessary to properly evaluate the unit configuration was not made public, and had been withheld under claims of trade secret protection. According to Dr. Joy, the maps provided on the Department's website are insufficient to support the configuration proposed. Dr. Joy criticized the geologic information provided with respect to the Field in the exhibits to the Stipulation, saying that it was speculative and outdated. Dr. Joy stated that because the information was withheld from public review, there had been no opportunity to independently evaluate the proposal.

Mr. Heyer, Fortuna's counsel, was the last speaker. He pointed out that the statutory interpretations advanced by the Buck Mountain Intervenors had been considered and rejected in prior proceedings. According to Mr. Heyer, the unit configuration is based upon geology, and the company is entitled to have the information it has developed at its expense kept confidential, and to share that information only with the Department. Mr. Heyer pointed out that the intervenors had not taken the risk of developing the wells, as Fortuna had, and that the Department's interpretation of the statute takes into account the interests of all participants. According to Mr. Heyer, the Buck Mountain Intervenors' remedy was to seek amendment of the governing legislation.

During February and March of 2003, the ALJ received correspondence, consisting mostly of form letters, from nearly fifty persons requesting that the royalty payments to landowners be expedited. These letters stated that the Field has been active for some time, and expressed concern over the delays occasioned by the opposition to the agreement reached by Fortuna and Department Staff.

Issues Conference

Petitions for party status in the adjudicatory hearing were received at the address specified in the notice of hearing and by the due date for such petitions from three entities: Columbia Natural Resources, Inc. (“CNR”); Pennsylvania General Energy Corp. (“PGE”); and a joint petition on behalf of the Buck Mountain Intervenors.

CNR and PGE’s petitions were essentially identical, and stated that the petitioners had an environmental interest in the oil and gas leasehold interests and attendant correlative rights in the Terry Hill South Field and in areas immediately proximate to the Field. CNR and PGE opposed the proposed field-wide spacing and integration rules, arguing that they had not been afforded the opportunity to voluntarily participate in the Field drilling operations by the Applicant, although they owned acreage within the field. In addition, CNR and PGE contended that the size and shape of certain well units in the Field might not be supportable, based upon the seismic information contained in Exhibit E to the Stipulation. At the commencement of the issues conference, counsel for CNR and PGE submitted motions to withdraw those petitions for party status. Over the Buck Mountain Intervenors’ objection, the ALJ granted the motions, which were not opposed by Department Staff and Fortuna.

The Buck Mountain Intervenors’ petition raised seven issues, objecting to the proposed unit spacing, and arguing that the proposal violated the statute and landowners’ correlative rights, as well as constitutional principles. These petitioners also voiced concerns about the procedures employed by the Department, such as the Stipulation, assertions of trade secrets with respect to documents provided by Fortuna, and the standard for adjudication. The Buck Mountain Intervenors contended further that both the New York State Attorney General and the New York State Public Service Commission should be invited to participate in the process. During and subsequent to the issues conference, the Buck Mountain Intervenors identified an additional nine issues, which are discussed at the conclusion of this ruling.

At the issues conference, Fortuna was represented by John H. Heyer, Esq., Olean, New York. Department Staff was represented by Arlene J. Lotters, Esq., and Franz T. Litz, Esq., DEC Division of Legal Affairs, Albany, New York. CNR and PGE were represented jointly by Christopher B. Wallace, Esq., Utica, New York. As noted above, the Buck Mountain Intervenors were represented jointly by Allan Lipman, Esq. and Michael Joy, Ph. D., of Lipman & Biltkoff, LLP, Buffalo, New York, and by Christopher Denton, Esq., Elmira, New York.

Both Department Staff and Fortuna opposed the Buck Mountain Intervenors’ request for party status in written submissions dated December 2, 2002, provided at the outset of the issues conference. Fortuna’s submission, marked for identification as Issues Conference Exhibit 7, pointed out that neither Rural Energy Development Corporation nor Western Land Services had parcels of real property located within the proposed unit, and thus, had not demonstrated an adequate interest in this proceeding. Fortuna also argued that the Buck Mountain Intervenors’ offers of proof with respect to the issues advanced were inadequate and speculative, noting that Buck Mountain Associates had been denied party status in prior proceedings and that the arguments advanced by that petitioner had been rejected in earlier decisions of the

Commissioner. Accordingly, Fortuna reasoned that no substantive and significant issues were raised in this proceeding. Fortuna contended further that the Buck Mountain Intervenors' proposed issues were legal and constitutional matters not appropriate for adjudication in this forum. Finally, Fortuna maintained that the petitioners had no authority to petition on behalf of other entities, such as the New York State Attorney General or the New York State Public Service Commission.

Department Staff's written submission, marked for identification as Exhibit 8, contended that a number of the proposed issues were legal rather than factual in nature, were more appropriate for briefing, and in any case, need not be adjudicated. With respect to factual issues proposed by the Buck Mountain Intervenors, Department Staff asserted that the petitioners had failed to meet their burden to demonstrate that the issues proposed were both substantive and significant. Department Staff pointed out that two of the Buck Mountain Intervenors, Western Land Services and Rural Energy Development Corporation, had not alleged that they hold interests in the units which are the subject of this proceeding. In light of this, Department Staff maintained that these petitioners lacked the requisite environmental interest to obtain party status. See Section 624.5(b)(1)(ii).

Department Staff noted further that certain of the legal issues were the subject of two petitions for declaratory rulings pending before the Department's General Counsel.³ In addition, Department Staff contended that the petition reflected a basic misunderstanding as to the role of the Stipulation, which Department Staff pointed out was not binding on any party who was not a signatory to that document until such time as the Stipulation was to be adopted by the Commissioner and incorporated into an order.

By letter dated December 12, 2002, Department Staff requested a ruling which would allow Department Staff to prepare and complete a Commissioner's Decision and Order establishing units and releasing royalties for five units,⁴ which Department Staff asserted were not affected by the issues proposed for adjudication, and establishing future spacing and integration rules for the Terry Hill South Field. Department Staff represented that the royalties, which total approximately \$1 million, had been held in escrow for the benefit of the mineral rights owners in the Broz-Kimball and Clauss units since August 2001 and October 2001, respectively, and for payment of royalties if and when production commences in the Hinman, Lant #2, and Gublo units. Fortuna joined in Department Staff's request. The Buck Mountain Intervenors opposed the motion in a response dated December 19, 2002, arguing that it would be premature to grant the motion given the factual issues in dispute and concerns raised by these petitioners about lack of notice to affected landowners.

³ Both petitions were filed on behalf of Western Land Services, Inc.. The first is dated July 9, 2002, and the second is dated September 17, 2002.

⁴ The five units are referred to in the December 12, 2002 letter as the Clauss, Hinman, Broz-Kimball, Lant #2, and Gublo units. The remaining units are referred to as the Lant #1, Kienzel, and Colson units.

On May 15, 2003, Department Staff filed a motion, requesting that the issues ruling be stayed pending a determination by the Department's General Counsel on the two petitions for declaratory rulings. The Buck Mountain Intervenors replied to the motion on May 20, 2003, objecting to the requested stay unless Department Staff's request to distribute escrowed royalties was also held in abeyance. By ruling dated June 5, 2003, the ALJ granted the motion. On June 9, 2003, Fortuna filed a response, dated June 6, 2003, asking that the escrowed royalties be released.

On August 7, 2003, Department Staff filed a request to extend the stay. Fortuna filed an objection dated August 12, 2003, reiterating its request that the royalties held in escrow be released. By letter dated August 25, 2003, the ALJ requested that Department Staff provide a projected date of issuance of the declaratory rulings, and Department Staff responded by letter dated September 10, 2003, indicating that the rulings were expected shortly. The Buck Mountain Intervenors filed an objection to the requested extension on August 15, 2003, and Western Land Services objected by letter dated September 16, 2003, unless Department Staff provided a specific date by which the declaratory rulings would issue. By ruling dated September 19, 2003, the ALJ extended the stay to November 3, 2003.

By letter dated January 13, 2004, the Buck Mountain Intervenors wrote to request that the issues ruling continue to be held in abeyance pending receipt of the declaratory rulings, and enclosed a copy of a letter sent on the same date to the Department's General Counsel with respect to those rulings. Department Staff filed a letter on January 14, 2004, requesting an extension of the stay without reference to a specific date. By the ALJ's memorandum of that same date, an extension was granted to January 30, 2004.

On January 29, 2004, the General Counsel issued two declaratory rulings (Matter of Western Land Services, Inc., Declaratory Ruling DEC #23-13 (Jan. 29, 2004); Matter of Western Land Services, Inc., Declaratory Ruling DEC # 23-14 (Jan. 29, 2004)). These two declaratory rulings are referred to hereinafter as "DR 23-13" and "DR 23-14" respectively, and are discussed at greater length below in connection with specific proposed issues.

DISCUSSION AND RULING

Well Spacing and Integration

The Department is responsible for establishing spacing units for oil and natural gas pools and fields, pursuant to ECL Section 23-0501(2), which provides, in relevant part, that "[w]henver the department finds after notice and hearing that the spacing of wells in any field is necessary to carry out the policy provision of section 23-0301, it shall promptly establish spacing units for each pool in the field" A "pool" is defined in Section 23-0101(14) as "an underground reservoir containing a common accumulation of oil or gas or both; each zone of a structure which is completely separated from any other zone in the same structure is a pool." Section 23-0101(6) defines a "field" as "the general area underlaid by one or more pools."

Pursuant to Section 23-0501(3), spacing units are required to be approximately uniform in size and shape throughout the entire pool, “except that where circumstances reasonably require,” the Department may grant variances from this requirement so long as the allowable production from the wells is adjusted so that the owners of each spacing unit receive “their just and equitable shares of the production from the pool.” If a spacing unit contains two or more separately owned tracts, or where there are separately owned interests in all or part of a spacing unit, these multiple interests are subject to voluntary or compulsory integration. See DR 23-14, p. 4. Section 23-0701 of the ECL provides for voluntary integration and unitization for the development and operation of a spacing unit. Thus, in some instances, the oil or gas produced from a spacing unit or operating unit is allocated to the separately owned tracts in the unit according to an agreement among the interested parties. See Matter of Pennsylvania General Energy, Inc. (Wilson Hollow Field), p. 2 (Ruling, May 3, 2001) (hereinafter “Wilson Hollow”).

If voluntary integration does not occur, the Department is required pursuant to Section 23-0901(3) to make an order “integrating all tracts or interests in the spacing unit for development and operation.” Section 23-0901(2) of the ECL (the “compulsory integration” provision) states, in relevant part, that

The department shall not make any order requiring the integration of interests in any spacing unit or requiring the development or operation of any field, pool or part thereof as a unit unless it finds, after detailed study and analysis, notice and hearing,^[5] that the integration of interests in spacing units, under conditions then existing in this state, or in the field or pool to be affected, is necessary to carry out the policy provisions of section 23-0301.

Thus, if the parties do not reach a voluntary agreement, the Department is required to determine the value of each tract to be developed, and to allocate the production attributable to that tract in proportion to the value of all of the tracts in the units. Wilson Hollow, p. 3. Absent specific evidence that one tract’s value is higher than another, the allocation is based upon each unit’s surface acreage within the unit and is expressed as the “participation factor.” Id.

The statute goes on to provide, at Section 23-0901(3), that

[i]f one or more of the owners shall drill, equip and operate, or operate, or pay the expenses of drilling, equipping and operating, or operating, a well for the benefit of another person as provided for in an order of integration, then such owner or owners shall be entitled to the share of production from the spacing unit accruing

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Section 23-0901(2) provides that a hearing with respect to compulsory integration pursuant to that subsection may be held in conjunction with a Section 23-0501(2) well spacing hearing. See DR 23-14, p. 4.

to the interest of such other person, exclusive of a royalty not to exceed one-eighth of the production, until the market value of such other person's share of the production, exclusive of such royalty, equals twice such other person's share of the reasonable actual cost of drilling, equipping and operating, or operating the well, including a reasonable charge for supervision and interest.

An "owner" is defined in Section 23-0101(11) as "the person who has the right to drill into and produce from a pool or a salt deposit and to appropriate the oil, gas or salt he produces either for himself or others, or for himself and others." A "person" is broadly defined to include, among other things, natural persons, business organizations such as partnerships or corporations, and government departments or agencies. Section 23-0101(12).

The ownership interest is typically either a working interest, a royalty interest or both, with a customary royalty amount of 1/8 of the value of the oil or gas produced. Wilson Hollow, p. 2. A royalty interest landowner receives this 1/8 interest in the oil and gas itself or the value thereof free and clear, at no cost to himself. Id. As set forth above, under the statute, the royalty paid must be equal to the lowest royalty fraction established in any lease within the unit, but in any event, must not be lower than 1/8. Id. A working interest owner, usually an operator, is entitled to the remaining 7/8 of the value of the oil or gas. Id.

As outlined in DR 23-13, Department Staff reviews an application from a potential operator to drill in light of the requirements set forth in 6 NYCRR Parts 551, 552, and 553. DR 23-13, p. 2. If the application satisfies those requirements, a permit is issued, and if the operator develops one or more producing wells, Department Staff determines the necessity of establishing spacing units. Id. "To arrive at proposed unit spacing, qualified Department Staff review test data, including subsurface imaging data such as seismic data. The data are generally gathered by the operator of the proposed units, at the operator's expense, and are considered proprietary and confidential business information by the operator." Id. Before a hearing is held with respect to the proposal, Department Staff enter into a stipulation with the operator, which includes, "among other things, the agreed upon size and boundaries for each well spacing unit, as well as an agreed upon procedure for determining the location, size and configuration of spacing units for any additional wells that may be drilled in the field." Id. The matter is then referred for hearing.

Related Proceedings

Subsequent to the issues conference, the participants were given the opportunity to brief several of the issues raised in the Buck Mountain Intervenor's petition. As noted above, a number of those proposed issues have been addressed by the two Declaratory Rulings. In addition, certain issues have been considered in other proceedings. On December 31, 2003, the Chemung County Supreme Court issued a Decision and Judgment (the "Decision") in a

proceeding brought pursuant to Article 78 of the Civil Practice Law and Rules (“CPLR”) as well as CPLR 3001 in Matter of Cafilisch and Roper v. Crotty, Index No. 2003-1579 (Mulvey, J.).

In that action, petitioners/plaintiffs sought to challenge the Commissioner’s Decision in Matter of Quackenbush Hill Field, 2002 WL 319700347, *2, (Dec. 30, 2002), which reaffirmed the Interim Decision⁶ and determined that petitioners/plaintiffs, in their capacity as landowner and/or lessee of certain oil and gas leases, were not entitled to a 7/8 interest in the production revenue allocated to a parcel in which they have an interest, but instead are entitled to receive only a 1/8 royalty payment of the parcel’s production revenue. Petitioners/plaintiffs also sought a declaratory judgment directing that a drilling unit’s designated operator be entitled to the share of production attributable to the parcel until the market value of the lessee’s share of production equals twice the lessee’s share of the costs of the well, and thereafter, entitlement by the lessee as co-owner to the entire working interest of all production from the well attributable to the parcel. Decision, p. 2.

The court in Matter of Cafilisch and Roper dismissed the petition/complaint in its entirety, finding that the petitioners/plaintiffs failed to demonstrate that the Department violated the hearing procedures of Part 624, or failed to comply with the statutory requirements applicable to compulsory integration pursuant to Section 23-0901. Decision, p. 4. The court also found that petitioner Roper did not exhaust his administrative remedies because he did not appeal the ruling denying him party status. Id. The court went on to conclude that the Commissioner’s decision in Matter of Quackenbush with respect to the petitioners/plaintiffs’ entitlement to a 7/8 interest was “consistent with the applicable statutory law and was not arbitrary and capricious or unreasonable.” Decision, p. 5. Noting that the Court of Appeals has upheld the constitutionality of the State’s compulsory integration statutes (see Matter of Sylvania Corp. v. Kilborne, 28 N.Y.2d 427, 432-33 (1971)), the court found that “the Commissioner’s interpretation and application of the provisions of ECL 23-0901(3) in this instance is supported by statutory construction, results in a just and reasonable allocation of production revenues, . . . and is consistent with prior rulings of the Commissioner.” Id. The court dismissed the declaratory judgment action, stating that such an action is not the proper avenue to challenge an administrative determination. Decision, p. 7. By letter dated February 5, 2004, counsel for the Buck Mountain Intervenors advised that they had filed a Notice of Appeal and Notice of Motion for Leave to Renew with respect to the Decision.

Finally, a prior issues ruling presently on appeal to the Commissioner addressed issues substantially similar or identical to those proposed by the Buck Mountain Intervenors. See Matter of County Line Field, 2004 WL 390200 (Ruling, Feb. 20, 2004). Some of the intervenors in Matter of County Line Field are represented by Mr. Lipman and Mr. Joy, who appeared as counsel on behalf of the intervenors in this proceeding.

Party Status

⁶ Matter of Quackenbush Hill Field, 2002 WL 31485966 (Interim Decision, Oct. 28, 2002). The Interim Decision affirmed the ALJ’s ruling on issues and party status (Matter of Quackenbush Hill Field, 2002 WL 229808 (Ruling, Feb. 13, 2002)).

Department Staff and Fortuna are mandatory full parties pursuant to Section 624.5(a). With respect to other parties, 6 NYCRR Section 624.5(d) provides that full party status will be granted based on: “(i) a finding that the petitioner has filed an acceptable petition pursuant to paragraphs (b)(1) and (2) of this section [the filing and contents of petitions]; (ii) a finding that the petitioner has raised a substantive and significant issue or that the petitioner can make a meaningful contribution to the record regarding a substantive and significant issue raised by another party; and (iii) a demonstration of adequate environmental interest.” The burden is on the prospective intervenor to demonstrate that the issues proposed are substantive and significant.

As discussed below, none of the proposed intervenors raised substantive and significant issues. Accordingly, none of the Buck Mountain Intervenors have been granted party status.

Standards for Adjudication

Section 624.4(c) of 6 NYCRR specifies the standards for adjudicable issues in a Department permit hearing. An issue is adjudicable if it relates to a dispute between Department Staff and an applicant over a substantive term or condition of the draft permit (Section 624.4(c)(1)(i)). When Department Staff has determined that a permit application, conditioned by a draft permit, will meet all statutory and regulatory requirements, the potential party proposing an issue has the burden of persuasion to demonstrate that the proposed issue is substantive and significant (Section 624.4(c)(4)).

An issue is substantive if there is sufficient doubt about the applicant's ability to meet statutory or regulatory criteria such that a reasonable person would inquire further (Section 624.4(c)(2)). An issue is significant if it has the potential to result in the denial of a permit, a major modification to the proposed project or the imposition of significant permit conditions in addition to those proposed in the draft permit (Section 624.4(c)(3)).

In order to establish that adjudicable issues exist, “an intervenor must demonstrate to the satisfaction of the Administrative Law Judge that the applicant’s presentation of facts in support of its application do not meet the requirements of the statute or regulations. The offer of proof can take the form of proposed testimony, usually that of an expert, or the identification of some defect or omission in the application. Where the proposed testimony is competent and runs counter to the applicant’s assertions an issue is raised. Where the intervenor proposes to demonstrate a defect in the application through cross-examination of the applicant’s witnesses, an intervenor must make a credible showing that such a defect is present and likely to affect permit issuance in a substantial way. In all such instances a conclusory statement without a factual foundation is not sufficient to raise issues.” (Matter of Halfmoon Water Improvement Area, 1982 WL 25856 (Decision, Apr. 2, 1982).

The Buck Mountain Intervenors sought full party status, and proposed a number of issues for adjudication in their petition (Exhibit 3). In addition, as part of their petition, the Buck Mountain Intervenors argued that the “substantive and significant” standard articulated in 6 NYCRR Section 624.4 is not applicable to this proceeding, and would, in fact, deprive petitioners of their right to a hearing. The Buck Mountain Intervenors asserted that to deny them

party status “and thereby eliminate an adjudicatory hearing simply because the issue advanced does not raise ‘sufficient doubt about the applicant’s (i.e. Fortuna’s) ability to operate the unit’ and ‘does not have the potential to remove the operator’ or impose ‘significant permit conditions’” would abridge petitioners’ constitutional rights, violate the State Administrative Procedure Act (“SAPA”), and deny them equal protection under the law. Exhibit 3, ¶¶ 3-13.

Department Staff countered that Part 624 does, in fact, apply, asserting that Department Staff’s process with respect to this hearing affords the most expansive public notice and opportunity for public participation available under the Department’s hearing regulations. Department Staff noted that neither Section 23-0501 nor Section 23-0901 specify the type of hearing that must be held, and asserted that Department Staff “may interpret the statute in any reasonable manner to effectuate the goal and purpose of the hearing requirement.” Staff’s Post-Issues Conference Brief (hereinafter “DEC Brief”), p. 5. Citing to Section 624.1(a)(6), Department Staff argued that the “substantive and significant” standard applies, not only to permit applications under Part 621, but also to any similar request to hold an adjudicatory hearing “which arises out of permits, licenses or entitlements that are not subject to ECL article 70 or [6 NYCRR] Part 621.”

Fortuna contended that a joint hearing held pursuant to Section 23-0501 and 23-0901 was not required to be conducted on the record, and thus was not an adjudicatory proceeding subject to the State Administrative Procedure Act. See SAPA Section 301. According to Fortuna, this is a rulemaking proceeding, and does not implicate SAPA, which defines an adjudicatory proceeding as “any activity which is not a rule making proceeding.” SAPA Section 102(3). Fortuna argued further that there is no constitutional requirement that an adjudicatory hearing be held in this case, particularly where, as here, petitioners failed to demonstrate that any substantive and significant issues exist.

In Matter of County Line Field, the ALJ’s issues ruling dealt with this question, and concluded that the procedures outlined in Part 624 are applicable to hearings on well spacing and compulsory integration. 2004 WL 390200, *20. The ruling discussed the history of the Part 624 regulations, and determined that “the ‘substantive and significant’ standard for identifying issues applies in the present case.” Id. This reasoning is equally applicable here.

Moreover, this question has been addressed by DR 23-13, which concluded that “the established process for determining well spacing and compulsory integration is lawful and consistent with Article 23 of the ECL and applicable regulations of the Department.” DR 23-13, p. 1. According to the Declaratory Ruling, while neither ECL Section 23-0501 nor Section 23-0901(2) specify the type of hearing necessary to satisfy the statutorily-mandated hearing requirement, the hearing process followed in this and similar proceedings, including the use of the uniform hearing procedures set forth in 6 NYCRR Part 624, is appropriate. DR 23-13, p. 3. These procedures include the application of the “substantive and significant” standard in determining which, if any, issues will be advanced to adjudication. The conclusion reached in the declaratory ruling with respect to this point is persuasive.

Proposed Issues

In their petition, the Buck Mountain Intervenors raised seven issues for adjudication, each of which is discussed in greater detail below. In addition, the Buck Mountain Intervenors proposed that the Stipulation be modified and, as modified, be incorporated into the Commissioner's order in this proceeding. The petitioners submitted the proposed modified stipulation as part of the petition, as well as a Model Operating Agreement and attached exhibits. See Exh. 3, at Exh. F. The petition also requested that the New York State Attorney General and the New York State Public Service Commission be invited to participate, "to protect the correlative rights of landowners," and "to recognize the indivisible nature of the stream of gas flowing from a well to a regional transmission line," respectively. Exh. 3, pp. 35-38. In addition, at the issues conference the Buck Mountain Intervenors provided an additional submission (Exhibit 10) proposing another issue. This proposed issue was incorporated into a subsequent submission dated January 9, 2003 that raised further issues, and is discussed below under the heading "Additional Proposed Issues."

Issue No. 1

Whether each of the petitioners is entitled to a share of the working interest where each such petitioner's controlling acreage is not of sufficient size to satisfy drilling permit requirements?

The Buck Mountain Intervenors contended that, under their interpretation of the statute, they should not be deprived of a share of the working interest of production (i.e., a 7/8ths working interest), merely because the acreage under their control is too small to develop under the Department's well spacing requirements. The petitioners argued that they should receive 100% of the production value of the natural gas attributable to their interests in the proposed units, and asserted that the past practice of the Department in other fields deprived landowners of their rights to share in the working interest of the units. In their post-issues conference brief, the Buck Mountain Intervenors maintained that the landowner of an unleased tract should be entitled to the 7/8ths working interest, citing to the legislative history of ECL Section 23-0901, and arguing that while the minimum well spacing requirements were intended to prevent overdrilling and waste of the resource, those requirements were never intended to deprive a landowner of the right to share in the working interest of a well.

Department Staff countered that the petitioners were afforded the same opportunity to develop the Field as Fortuna, and could have pooled their acreage with their neighbors to create sufficient holdings to meet the well-spacing requirements, or, in the alternative, applied for a variance, pursuant to 6 NYCRR Section 553.4, to obtain a drilling permit. According to Department Staff, the Buck Mountain Intervenors could have negotiated an agreement with Fortuna to share development costs as a co-operator. Department Staff pointed out that the petitioners failed to adduce any evidence that they made any effort to develop a well in the Field.

Department Staff went on to argue that the terms of the Stipulation, which would allow unleased non-operator owners a royalty fraction of not less than 1/8, are just and reasonable and have been accepted by the vast majority of the proposed intervenors' neighbors. Department

Staff observed that Rural Energy Development Corporation and Western Land Services did not have any interests in any of the proposed units, and argued that, therefore, only Buck Mountain Associates and the individual petitioners were entitled to raise this issue. With respect to Buck Mountain Associates (present in two units, including the undrilled Colson unit), Department Staff contended that this petitioner could attempt to negotiate a voluntary integration agreement. If no agreement is reached, Department Staff pointed out that both parties could propose terms to be included in the order which would allow Buck Mountain Associates to receive gas or its equivalent, attributable to its acreage, after the penalty has been recovered.

Fortuna argued that because the Buck Mountain Intervenors do not have sufficient acreage within a spacing unit to obtain a drilling permit, they are not “owners” entitled to a working interest. According to Fortuna, the petitioners’ argument relies upon a selective and limited reading of only a portion of the statute, and if all of the statute’s language is taken into account, it is clear that ECL Section 23-0901 “does not mandate apportionment of production among all the tracts in the drilling unit, regardless of size or location, but only among all those tracts owned by one or more persons who fall within the statutory definition of the term ‘owner.’” Fortuna’s Reply Brief, p. 8. Fortuna argued that the Buck Mountain Intervenors’ proposal would undermine the statutory intent by discouraging landowners from entering into leases with operators. As a result, less gas would ultimately be recovered, because operators would delay drilling, or forego drilling altogether.

Fortuna pointed out that in New York State, “[g]as is produced under the law of capture so that in a competitive field it belongs to the producer who first gets it out of the ground.” Application of Republic Light, Heat & Power Co., 265 A.D. 74, 79 (3rd Dept. 1942). Fortuna acknowledged that the unitization statute has altered this concept somewhat, but pointed out that the legislation did not eviscerate the law of capture. According to Fortuna, to the extent, if any, that unitization may abridge the limited rights of lessees and landowners, the courts have considered and rejected constitutional challenges to the statute raised by such entities. Sylvania Corp. v. Kilborne, 28 N.Y.2d 427, 432-33 (1971). Fortuna urged adherence to prior decisions of the Commissioner, which Fortuna asserted were consistent with Fortuna’s interpretation of the statute.

Ruling:

This issue was one of the matters addressed by DR 23-14, which pointed out that “[u]nder the rule of capture, a property owner does not have ownership of the subsurface oil and gas until captured, but the owner does have the right to search for, develop and produce the oil or gas.” DR 23-14, p. 10. According to the declaratory ruling, this “correlative rights” theory “is reflected in the statutory definition of the term ‘owner’ as set forth under ECL § 23-0101(11).” *Id.* The declaratory ruling goes on to state that landowner may exercise the right to explore for subsurface resources by drilling, or, if the acreage owned is too small to allow for well development under the Department’s well spacing requirements, an owner may pool acreage with neighboring landowners, apply for a variance from the requirements to obtain a drilling permit, or negotiate an agreement to share costs with a drilling operator. *Id.*, pp. 10-11. The

declaratory ruling points out that, absent this statutory overlay, under the rule of capture, a landowner could drill numerous wells on a small parcel, which could result in waste of the resource and would not protect correlative rights. Id.

The declaratory ruling is dispositive of this issue. As a result, no substantive and significant issue has been raised requiring adjudication.

Issue No. 2

Whether the petitioners, who are not parties to the Stipulation entered into between the Department and Fortuna's predecessor in interest, are bound by the Stipulation?

At the issues conference, the Buck Mountain Intervenors argued that it was improper for Fortuna and Department Staff to enter into the Stipulation, because, according to the petitioners, this practice denies interested parties the right to a full evidentiary hearing. Department Staff and Fortuna pointed out that the Stipulation is not binding on any other party, including the Commissioner or the ALJ. Issues Conference Transcript (hereinafter "Tr.") p. 55, 57. Department Staff characterized the Stipulation as "merely a joint proposal from Department Staff and the well field operator concerning well spacing and compulsory integration," and pointed out that the petitioners were free to raise issues concerning the Stipulation and propose an order on different terms. Exh. 8, p. 5; DEC Brief, p. 2.

Ruling:

No substantive and significant issue requiring adjudication is raised. As DR 23-13 points out, Section 624.13(d) provides that only a stipulation "executed by all parties" is sufficient to remove an issue from consideration at a hearing. DR 23-13, p.6. The Stipulation is not binding upon the Buck Mountain Intervenors. Absent adoption by the Commissioner and incorporation into an order, the Stipulation binds only Department Staff (not the Department or the Commissioner) and Fortuna. The declaratory ruling notes that "Department Staff is free to enter into such stipulations with well developers or with potential parties to an adjudicatory hearing," pointing out that these agreements are "a well established and appropriate part of administrative practice" before the Commissioner and the ALJs. DR 23-13, p. 5. Moreover, in Matter of County Line Field, the proposed intervenors presented this same issue, which the ALJ did not advance to adjudication. 2004 WL 390200, *13.

Issue No. 3

Whether the petitioners must be an "Operator" within the definition of the stipulation entered into between the Department and Fortuna's predecessor in interest in order to receive a working interest?

The Buck Mountain Intervenors argued that they did not have to fall within the Stipulation's definition of an "operator" to be entitled to a working interest in a well. The Stipulation defines an "operator" to mean "a person, natural or artificial, engaged in the business

of drilling, producing and/or operating wells for oil and/or natural gas.” Stipulation, ¶ 1(B). In their post-issues conference brief, the proposed intervenors reiterated their arguments with respect to the Stipulation, and argued further that if the legislature had intended to limit the term “owners” to mean only “operators,” it would have done so in enacting the statute. The Buck Mountain Intervenors argued that the Commissioner’s interpretation deprived owners who are not operators of the equal protection of the law, in violation of the State and federal constitutions. According to the petitioners, there is no requirement that an owner be an operator, and that this reading of the statute precludes everyone other than the operator from sharing in the working interest of the production from the well.

Fortuna countered that, to be entitled to a working interest, an owner or lessee of real property within a spacing unit must be either an “owner” or an “operator.” An “operator” is defined in the regulations as “any person who is in charge of the development of a lease or the operation of a producing well.” 6 NYCRR Section 550.3[ab]. According to Fortuna, in order to be an owner or operator, a landowner must have received, or be entitled to receive, a permit to drill, which, Fortuna pointed out, is not the case with respect to any of the petitioners. Fortuna argued further that there are no other statutory owners who have the right to drill within the proposed drilling units, and thus, no owner has been deprived of equal protection of the law. To the extent that petitioners contended that Fortuna and Department Staff had no authority to limit the scope of the statute to defined “operators,” Fortuna countered that it was in fact the legislature’s determination to preclude everyone other than owners of mineral rights within a unit who also possess the right to drill from sharing in the working interest of production, and that this intent was enunciated in the statute.

Department Staff reiterated its earlier arguments with respect to the scope of the Stipulation, and pointed out that consistent with prior Commissioner’s orders, “the Stipulation proposes that unleased owners in the Field be integrated as royalty interests because they have not incurred risk nor invested resources toward developing wells in the Field.” DEC Brief, p. 9. According to Department Staff, the definition of “operator” in the Stipulation, and the provisions proposing that any order specify the basis upon which each operator will share all reasonable costs of drilling and producing, are likewise consistent with prior orders. Finally, Department Staff noted that the Stipulation does not, in fact, dictate who would be an operator for the Field, or for any particular unit. Rather, Department Staff pointed out that the Commissioner’s order will determine who will have status as an “operator.”

Ruling:

As was the case with Issue No. 2, which dealt with petitioners’ objections to the Stipulation itself, this proposed issue does not raise a substantive and significant issue requiring adjudication. The Buck Mountain Intervenors’ arguments with respect to the scope of the term “operator” in the Stipulation essentially restate their objections based upon their interpretation of the statutory language, which are at variance with the position taken by Department Staff and Fortuna. As noted above, the statute defines an “owner” as the person who has the right to drill and produce from a pool, and an “operator” is defined under the regulations as any person in

charge of developing a lease or operating a producing well. Section 23-0101(11) and 6 NYCRR Section 550.3[ab].

Both the declaratory ruling and the Decision in Matter of Caflisch confirm that a landowner and/or lessee is not entitled to a 7/8th working interest in the production revenue of a parcel, but rather, will receive only a 1/8th royalty payment. Decision, p. 2; DR 23-14, p. 14 (“In other words, the well operator is entitled to the non-consenting interest owners’ share of production, except for a maximum one-eighth royalty, until the market value of production equals 200% of the non-consenting interest owners’ proportionate share of the costs of drilling, equipping and operating the well.”) The declaratory ruling points out that the statutory definition of “owner” “does not include any qualifying language regarding size or location of tracts as a prerequisite to a ‘right to drill.’” DR 23-14, p. 10. Under the circumstances, the petitioners have not raised a substantive and significant issue.

Issue No. 4

Whether the 100% penalty provision as set forth in ECL Section 23-0901(3) is applicable where the petitioner has not been given the opportunity to participate in well costs?

The Buck Mountain Intervenors observed that many states, including New York, have adopted the “risk penalty” approach with respect to compulsory integration. See Section 23-0901(3). Under this arrangement, a non-drilling landowner, or non-operator, is afforded the opportunity to advance cash or its equivalent to share in the drilling costs before drilling begins. If the non-operator does not do so, the non-operator is considered as a “carried interest” subject to a risk penalty. The operator, who assumes the risk of drilling, may retain from production of a successful well the non-operator’s proportionate share of costs of drilling and completing the well, and an additional sum to compensate the operator for the risk assumed. Petitioners’ Brief, pp. 40-41 (citing B. Kramer & P. Martin, The Law of Pooling and Unitization, § 12.02 (Bender, 3rd Ed. [1989])). According to petitioners, other risk penalty states employ this concept without transferring any interest in mineral rights as among owners. The Buck Mountain Intervenors maintained that a legislative enactment that would require an owner to forfeit this property right under these circumstances would raise significant constitutional issues. As a result, these petitioners took the position that “the voluntary integration options set forth in ECL § 23-0701 must be given to a party before the State can implement the compulsory terms of ECL § 23-0901.” Petitioners’ Brief, p. 43.

Fortuna argued that there is no prerequisite in the statute requiring that owners within a spacing unit must first have negotiated or attempted to achieve voluntary integration, pointing out that the statute provides only that there must be an “absence of voluntary integration.” Applicant’s Brief, p. 23. Fortuna took the position that the 100% risk penalty provision applies even if a landowner has not been given the opportunity to participate in well costs, and countered the petitioners’ taking arguments by observing that the integration statute allows for voluntary integration, which provides an opportunity for a landowner to participate in well costs before drilling. According to Fortuna, there is no constitutional bar to the imposition of the risk penalty simply because the parties failed to agree on terms for voluntary integration.

Department Staff made similar arguments, noting that the statutory risk-penalty provision does not require negotiation, and observing that the Stipulation favors voluntary integration by proposing that the operator initiate any such negotiations. Department Staff also pointed out that this question was the subject of the pending declaratory rulings.

Ruling:

This question was considered by the General Counsel in DR 23-14. The declaratory ruling concluded that elimination of the 100% of cost penalty “is not possible because the 100% risk penalty charge is mandatory pursuant to statute.” DR 23-14, p. 14.

In addition, this issue was raised by Western Land Services in Matter of County Line Field, and rejected in the ALJ’s issues ruling of February 20, 2004. See 2004 WL 390200, * 14. Petitioners in that case relied upon essentially the same arguments as those under consideration here. No substantive and significant issue requiring adjudication has been advanced.

Issue No. 5

Whether the proposed unit configuration and size is proper?

Department Staff argued that the petitioners’ offers of proof on this issue were insufficient. According to Department Staff, the Buck Mountain Intervenors did not specify which units were improperly drawn or in what manner the proposed lines were inaccurate, and therefore failed to meet their burden of demonstrating that this is a substantive and significant issue. In addition, Department Staff asserted that neither Rural Energy nor Western Land Services had any acreage position within the Field, and challenged those petitioners’ standing to raise this issue. Tr. p. 71-72. The petitioners argued that the Field might, in fact, extend to include their acreage, if the boundaries of the Field had not been drawn as they were. Tr. pp. 136-37.

Fortuna pointed out that it had submitted voluminous data to Department Staff, and noted that the petitioners had not provided any data to support their contentions. Tr. p. 73. Fortuna cited to Section 23-0501(4), noting that the statute provides that spacing units are to be established by specifying a size and shape which shall be such as will, in the opinion of the Department, result in efficient economic development. Id. Based upon this language, Fortuna took the position that it was appropriate to rely upon the Department’s opinion in this regard. Id.

Mr. Lipman asserted that the confidential information provided to Department Staff should be made available to the proposed intervenors for their review. Tr. p. 97. The ALJ inquired whether the intervenors had made a request pursuant to the State Freedom of Information Law (“FOIL”), Public Officers Law sections 84-90, for access to that information. Id. Mr. Lipman responded that he had done so, and that he had been told that the documents were being withheld as trade secrets and were confidential. Tr. pp. 97-98. Kathleen Sanford, Chief of the Permits Section for the Bureau, discussed the FOIL requests that had been received,

and stated that the denials of access had not been appealed. Tr. pp. 109-111. Department Staff took the position that the proposed intervenors had not invested time or resources in obtaining the information independently, stating that some seismic analysis could have been performed “at modest cost.” Tr. p. 108.

Dr. Joy spoke on behalf of the Buck Mountain Intervenors. According to Dr. Joy, his researches in geology focused on the structural development of the Trenton and Black River formations and the overlying Utica shale. Tr. p. 76. Dr. Joy provided a copy of the map which was Exhibit D to the Stipulation, on which he had marked in color what he believed to be precise locations of the seismic lines shown on Exhibit E to the Stipulation. Tr. p. 77. Dr. Joy noted that there might be some slight inaccuracies, because Exhibit D shows seismic shotpoints, not the actual seismic lines, and he had to “connect the dots.” Id.

After describing his colored markings on the map, marked as Exhibit 18, Dr. Joy stated that based upon the science available, it would be impossible to use well data or geophysical data collected from a well to precisely determine a unit size where a well has not actually been drilled. Tr. p. 78. Dr. Joy pointed out that this was the procedure Fortuna followed with respect to the as yet undrilled Colson # 1 unit and the Lant # 2 well. Id. Thus, according to Dr. Joy, Fortuna’s proposed unit size, which was based upon geophysical, reservoir engineering and seismic data collected at the well site, was fundamentally flawed. Id.

Dr. Joy criticized the data provided by Department Staff and Fortuna, stating that there was no indication that the information had been reviewed at the Department level by a geophysicist. Tr. pp. 86-87. Dr. Joy indicated that he had not had a chance to review the seismic data. Tr. p. 87. On this point, Department Staff provided comments by John K. Dahl, a geophysicist who is the director for the Bureau of Oil and Gas. Tr. p. 89. Mr. Dahl stated that he had reviewed the data over an eleven and a half year period. Tr. pp. 89-90. He noted that Dr. Joy’s colored maps left out a seismic line presented on Exhibit E, which, according to Mr. Dahl, showed the features that Dr. Joy questioned. Tr. p. 90. While Dr. Joy later stated that he had added in a missing seismic line and it did not change his conclusions, he acknowledged that he did have “difficulty locating precise locations of seismic lines.” Tr. p. 112.

Dr. Joy asserted that the seismic coverage was insufficient to configure these units, making reference to the Gublo # 1 unit, and stating that, in his opinion, based upon the seismic information provided by Fortuna, the unit could not be correctly configured. Tr. pp. 79-80. Dr. Joy raised similar criticisms with respect to the Lant # 1 well, noting that the unit boundary curved beyond the limits of the seismic lines. Tr. p. 80. According to Dr. Joy, a number of the well placements are “askew,” located, for example, closer to the eastern boundary of the unit than to the western boundary. Tr. p. 82. Dr. Joy questioned other assumptions based upon Fortuna’s map, such as the representation that the Kienzel #1-A and the Lant # 2 well share a common source of supply. Tr. p. 83.

Fortuna’s geologist, Robert Bonnar, stated that he had been working on the Trenton formation since about 1987. Tr. p. 105. Mr. Bonnar noted that Fortuna’s staff included geologists, a geophysicist, and an engineer, all of whom had between fifteen to thirty years’

experience in the industry. *Id.* Mr. Bonnar stated that he and his team looked over Fairman's data very carefully before purchase, and that they reached a virtually identical interpretation. Tr. pp. 105-06.

Ms. Sanford noted that several meetings had taken place where the seismic data was reviewed, and that the maps attached to the Stipulation accurately reflected corrections that were made based upon that review, and the discussions had with Fairman. Tr. pp. 91-92. Ms. Sanford said that she was trained in interpreting seismic data, and that she has both a bachelor's and master's degree in geology. Tr. p. 91. Ms. Lotters noted that Department Staff conducted a "separate and independent review and confirmation of data," and that Department Staff's goal was to ensure that all of the owners of the resource are fully protected, consistent with the Department's statutory mandate. Tr. pp. 92-93.

Mr. Dahl explained that the configuration of the Lant well resulted because it follows the trend in the other features in the Field. Tr. p. 90. Mr. Dahl stated that every individual shotpoint had been verified and that Department Staff was in agreement with the units as proposed. Tr. p. 91. Dr. Joy took issue with Mr. Dahl's statements regarding trends in the field, stating that the information presented "would not necessarily support" these trends. Tr. p. 113. Dr. Joy went on to say that he did not know how much information might be needed to draw the correct configurations with respect to the Lant # 2 unit, but that the information presented was not sufficient. Tr. pp. 113-14. Mr. Bonnar responded that in his professional judgment, the seismic information presented was sufficient to define the trends, going on to note that "[t]he proof is in the pudding. The company funded a million or a million and a half dollars for wells, for East and Fairman to drill the wells based on the seismic and they were successful." Tr. pp. 115-16.

Fortuna pointed out that the Department has broad discretion in determining the size and shape of spacing units, and argued that petitioners failed to show that the Department abused its discretion, or acted arbitrarily and capriciously, in determining the proposed configuration. With respect to Dr. Joy's contention that unit spacing is done differently in other states (Tr. p. 86), Fortuna countered that petitioners are required to do more than show that alternative methods of configuring and sizing the units exist, for example, in other jurisdictions, and that the petitioners failed to meet their burden in that regard. Department Staff objected to this issue as well, contending that Dr. Joy's assertions were conjecture, and arguing that Dr. Joy was not qualified to offer an expert opinion with respect to the use of seismic data to determine the boundaries of a gas pool.

Ruling:

This issue will not be adjudicated. The offers of proof by the Buck Mountain Intervenors are not sufficient to cast doubt on the configuration and sizing of the proposed units, such that further inquiry is warranted. Dr. Joy acknowledged that he could not say whether the size and configuration of the proposed units were correct or incorrect. Tr. p. 85. The Buck Mountain Intervenors asserted that both PGE's and CNR's withdrawn petitions for party status contended that the seismic information might not be supportable, but this was disputed by counsel for those companies, who stated that technical staff for PGE and CNR had since reviewed the geologic

information and were satisfied with the accuracy of the unit shapes and sizes for the Field. Tr. pp. 94-95.

Some of Dr. Joy's statements were qualified. For example, Dr. Joy discussed the boundaries of the County Line and Terry Hill Fields, and went on to state that "although I'm not entirely versed in it, I believe spacing requirements for those two fields would be different." Tr. pp. 84-85. Such statements are not sufficient to raise a substantive and significant issue. Dr. Joy discussed Rural Energy Development Corporation's holdings, arguing that they would be affected by the proposed units, but then went on to note that "I can't say that they are proposed incorrectly . . . You also can't say that they are proposed correctly," contending that there was insufficient data to support the proposal. Tr. p. 85. With respect to this proposed intervenor, Department Staff pointed out that even if it were demonstrated that Rural Energy is located in what should be an extension to the Field, the Stipulation provides, at Section IV.F.4, that for any extension well, Fortuna must offer other operators in that unit the opportunity to participate in the well.

Other statements were speculative. Dr. Joy argued that there was only one seismic line that constrained the lateral extent of any of the units, and concluded that the statement in Exhibit C to the Stipulation, p. 12 of 18, which reads that "[i]n the case of the Terry Hill South Field, seismic analysis can provide information about reservoir width and lateral extent of each pool" was not accurate. Tr. p. 83. Dr. Joy noted further that the PGS Lederer well, which is located in another field, is "approximately 10,000 feet" from the Lant # 1 unit. Tr. p. 84. Dr. Joy went on to state that there is a 9,000 foot spacing requirement, and concluded that "there is no evidence here to determine whether or not we are in the PGE Field or the Terry Hill South Field." *Id.* Dr. Joy's conclusions in this regard are not persuasive.

While petitioners argued that they did not have access to the information necessary to undertake a proper analysis of the proposed configuration, there was no indication at the issues conference or in any subsequent submission that the denial of access under FOIL was appealed. Under the circumstances, the petitioners' offer of proof is not sufficient to overcome the weight of Department Staff and Fortuna's arguments to the contrary.

Issue No. 6

Whether the rights of all petitioners within the units are fully protected to assure that they will receive their rightful share of production from the unit?

At the issues conference, Department Staff observed that this issue was the subject of the pending declaratory rulings. Tr. p. 119. Department Staff went on to point out that previous decisions of the Commissioner had addressed this question. Tr. pp. 119-20. Fortuna noted that those decisions were discussed as part of Fortuna's written submission. Tr. p. 120.

The Buck Mountain Intervenors objected to Department Staff's position, pointing out that Department Staff's reliance on prior precedent was inconsistent with Department Staff's assertion that information with respect to other well fields was not germane to this proceeding.

Tr. p. 121. Counsel for the intervenors took issue with the delays associated with Western Land Services, Inc.'s request for a declaratory ruling, and asked Fortuna and Department Staff to take a position with respect to the operating agreement proposed by the petitioners. Tr. pp. 128-29.

In post-issues conference briefing, Fortuna asserted that none of the petitioners are "owners" within the meaning of ECL Section 23-0101(11), because they do not have control of sufficient acreage to obtain a drilling permit that would afford them the right to drill and produce. Fortuna contended that the proposed integration order would fully protect the petitioners' rights by affording them a one-eighth royalty interest. Department Staff's brief reiterated that the terms of the proposal are fair and consistent with prior Commissioner's decisions, and urged deference to the Department's interpretations of the statutory provisions. Department Staff noted that appropriate notice had been provided, and the requisite hearing held, and observed that the owners of 99.07% of the acreage at issue had either accepted voluntary agreements (leases) or the compulsory integration terms of the Stipulation. According to Department Staff, petitioners' claim that they should be entitled to a 100% share is an unreasonable interpretation of the statute. The Buck Mountain Intervenors countered that they had raised substantive and significant issues which must be advanced to hearing.

Ruling:

This issue appears to be an abstract of the petition as a whole. The Buck Mountain Intervenors have not raised a substantive and significant issue for adjudication. The declaratory ruling concluded that "[t]o date, the Commissioner's Orders incorporating stipulations have fairly allocated natural gas production in compulsorily integrated units, met the policy mandates of ECL § 23-0301, and satisfied the 'just and reasonable' standard of ECL § 23-0901(3)." DR 23-14, p. 17. Moreover, the court's Decision in Matter of Caflisch rejected similar arguments by other petitioners on this point, stating that neither petitioner qualified as an "owner" with the right to drill. Decision, p. 5. The Decision determined that the Commissioner's interpretation of the statute was not "irrational or unreasonable since the rights of a non-operator lessee or owner of unleased land, under the circumstances presented, have been protected by a finding that they are entitled to a 1/8 royalty interest." Decision, p. 6.

Issue No. 7

Whether the well costs incurred or to be incurred by Fortuna are appropriate?

The Buck Mountain Intervenors contended that prior to the adjudicatory hearing, Fortuna is obliged to supply the landowners with information with respect to the costs of drilling and other expenses for which Fortuna seeks reimbursement. According to the petitioners, this would afford the landowners the opportunity to challenge costs or items of expenditure. The Buck Mountain Intervenors argued further that the reasonable charges for well maintenance and supervision would also be appropriate subjects for a hearing, and pointed out that Fortuna had not agreed to the petitioners' proposed model operating agreement and attached exhibits. As a result, the petitioners argued, a dispute (and therefore, an adjudicable issue) existed regarding the method of determining cost allocation and production proceeds.

Fortuna pointed out that the Buck Mountain Intervenors had made no offer of proof, and failed to carry their burden of demonstrating that this issue should be adjudicated. Fortuna went on to argue that the discovery sought by petitioners with respect to Fortuna's costs could not take place at this stage of the proceedings, inasmuch as the Buck Mountain Intervenors had failed to carry their initial burden of demonstrating that this issue is substantive and significant. Department Staff contended that it was premature to involve the Department in disputes regarding Fortuna's costs, and that in any event no actual dispute existed.

Ruling:

The identical issue was raised by Western Land Services in Matter of County Line Field, and rejected in the ALJ's issues ruling of February 20, 2004 (see 2004 WL 390200, * 15-16). Petitioners in that case relied upon essentially the same arguments as those under consideration here. In Matter of County Line Field, the ALJ noted that the petitioner had, "at most, made a legal argument that a model agreement, that would include provisions about expenses for development and operation of gas wells, should be included in the Stipulation," and went on to conclude that no factual issue had been raised that could affect the well spacing and integration rules proposed. Id., * 16.

There is no substantive and significant issue for adjudication with respect to the propriety of the well costs incurred or to be incurred by Fortuna.

Additional Proposed Issues

By letter dated January 9, 2003, counsel for the Buck Mountain Intervenors sought to raise additional issues for briefing and consideration in this proceeding, as follows:

8. *Whether the proposed unit configuration and size are proper within the Terry Hill South Field?*
9. *Whether the Stipulation should be modified as set forth in Attachment No. 1 to the Petition?*
10. *With respect to the size and configuration of the units, whether Fortuna and the Department can rely on any information which is not part of the record?*
11. *Whether, in the absence of a voluntary agreement, all the natural gas produced in a spacing unit subject to a compulsory integration order is co-owned by the owners of the tracts within the spacing unit or whether Fortuna is first allowed to take and market all the gas attributed to the tracts it controls for its sole account and leave the remaining gas for further disposition, if any, by the owners of the other tracts within the spacing unit at some later time?*

12. *Whether Fortuna has an obligation to transport and/or market the gas for the other working interest owners?*
13. *Whether Fortuna should be required to offer to all owners a working interest participation in all drilling units in the Terry Hill South Field?*
14. *Whether the working interest of all drilling units in the Terry Hill South Field should be held in escrow pending a final order in this proceeding?*
15. *Whether the New York State Attorney General should be invited to become a party to this proceeding to protect the correlative rights of landowners?*
16. *Whether the New York State Public Service Commission should be invited to become a party to this proceeding to recognize the indivisible nature of the stream of gas flowing from a well to a regional transmission line?*
17. *Whether any of the foregoing is dependent on whether a well is drilled before or after the date of a final order establishing spacing units under ECL 23-0501?*

In connection with additional proposed issues Nos. 8 through 11 and 13, the Buck Mountain Intervenors made reference to certain sections of their petition, but did not provide any commentary in connection with additional proposed issues 12, 14, 15, 16 and 17. Fortuna objected to the additional proposed issues as irrelevant, by letter dated January 10, 2003, noting further that the Buck Mountain Intervenors had not provided any evidence as to those issues.

By memorandum dated January 17, 2003, the ALJ reserved as to whether briefing of additional proposed issues 8, 9, 10, 11 and 13 would be allowed, and determined that the remaining issues either had already been addressed as part of the issues conference, or, in the case of additional proposed issues Nos. 12 and 17, were irrelevant to this matter. In their post-issues conference brief, the Buck Mountain Intervenors requested that the ALJ reconsider the rulings with respect to all of these proposed additional issues.

Petitioners' January 9, 2003 letter did not provide offers of proof with respect to any of the additional proposed issues that would demonstrate that these issues were substantive and significant. In light of this, as well as for the reasons set forth below, these issues are not advanced to adjudication.

Additional issue No. 8 is the same as Issue No. 5 in the Buck Mountain Intervenors' petition, and has been considered above. Thus, there is no need for a ruling on this additional proposed issue.

Additional issue No. 9 asks that the Stipulation be modified consistent with proposed language proffered by the Buck Mountain Intervenors at the issues conference. As noted in Matter of County Line Field, where similar arguments were made, this issue "is essentially a question of whether [petitioner's] position on several other proposed issues should prevail at the

end of the hearing process.” 2004 WL 390200, * 19. As was determined by the ALJ in that proceeding, no separate issue for adjudication is raised.

In raising additional issue No. 10, the January 9, 2003 letter refers to “discussion at page 10 *et seq.* of the Petition.” This is the only offer of proof with respect to this issue. At the issues conference, and in the petition, the Buck Mountain Intervenors argued that because the data relied upon by Department Staff to determine unit size and configuration was not part of the record, Department Staff’s procedures violated Article 23 of the ECL and the State Administrative Procedure Act. This issue was considered in the issues ruling in Matter of County Line Field, where the ALJ stated that “[t]his proposed issue is actually an argument about the burden of proof and the burden of going forward” with respect to a preceding issue, and concluded that no additional issue for adjudication was raised. 2004 WL 390200, * 13. The reasoning of County Line Field is persuasive, as this issue has already been considered in the context of petitioners’ arguments concerning Issue No. 5, and will not be revisited here.

Additional issue No. 11 was the subject of a supplemental submission by the Buck Mountain Intervenors at the issues conference (Exh. 10). The Buck Mountain Intervenors argued that in the absence of a voluntary agreement, the entire stream of gas produced from a spacing unit subject to compulsory integration is co-owned by all the owners of tracts within the spacing unit. According to the Buck Mountain Intervenors, the designated operator has a duty to transport the gas at the expense of all owners to a transmission line for marketing. The Buck Mountain Intervenors contended that if Fortuna marketed all the gas first produced for its own account, this would constitute an impermissible conversion of property. Moreover, the petitioners argued that if Fortuna was allowed to remove all of its gas and then abandon the well, there would be less ultimate recovery and a likelihood of waste of the resource.

The Buck Mountain Intervenors’ arguments are based upon an August 8, 2002 letter from John K. Dahl, Director of the Department’s Bureau of Oil and Gas Regulation, to Timothy L. Jackson, Vice President of Rural Energy Corporation. (Exh. 11). The identical letter was proffered by the intervenors in Matter of County Line Field in an attempt to raise this issue in that proceeding. As the ALJ noted, the letter relates to the Wilson Hollow Field, and the petitioners were objecting to a provision that was not part of the proposal for the County Line Field. 2004 WL 390200, *15. The ALJ rejected this issue. Id. As was the case in that proceeding, the objections raised here by the Buck Mountain Intervenors are not borne out by either the language of the Stipulation or the letter itself, and this issue will not be advanced to adjudication. The text of the Stipulation does not include this proposal, and the August 8, 2002 letter deals with a different field. In any event, the issue as stated by the Buck Mountain Intervenors is presented as only one of five possible scenarios, and there is no indication that the letter is applicable to this Field.

Additional issue No. 12 was included as part of Western Land Services’ supplemental petition for a declaratory ruling. The declaratory ruling concluded that the assertion that an operator has a responsibility to transport and market gas for the benefit of all owners was meritless, and noted that the language of ECL 23-0901(3) does not provide a basis for the Department to order a well operator to market and use its gas gathering pipeline to transport gas

owned by others, absent a voluntary agreement to do so. See DR 23-14, p.14. This issue was also considered in the Matter of County Line Field issues ruling, and rejected by the ALJ, who noted that the intervenor in that action had not made an offer of proof or cited any legal requirement in support of its position. See 2004 WL 390200, * 16. This issue will not be advanced to adjudication in this proceeding.

Additional issue No. 13 is listed in the “Wherefore” clause on page 38 of the petition for party status, but the petitioners did not make any offer of proof with respect to this proposed issue at the issues conference. Moreover, this additional issue appears to be a restatement of Issue No. 3, discussed above. This issue will not be adjudicated.

Additional issue No. 14 was considered in the County Line Field ruling, where the ALJ determined that this issue was more in the nature of a motion requesting that some action be taken prior to the final decision and order. The ALJ denied the motion, relying upon a more substantial record than the Buck Mountain Intervenors have provided in this case. 2004 WL 390200, * 17. Here, no offer of proof was made. Thus, there is no issue for adjudication.

With respect to additional issues 15 and 16, the ALJ concluded that the Buck Mountain Intervenors had not cited to any authority mandating or encouraging participation by the Attorney General’s office or the Public Service Commission (“PSC”), and that the arguments advanced with respect to any basis for that participation were not persuasive. The Buck Mountain Intervenors renewed those arguments in their post-issues conference brief, contending that the PSC should be invited to join “where it appears that the ALJ believes that the Department has no authority to require Fortuna to transport the gas from the wellhead to the transmission line,” and to provide for “a meaningful comprehensive operation plan for the drilling unit that will protect the correlative rights of the owners.” Intervenors’ Brief, p. 6-7. The rationale advanced for participation by the Attorney General was the Buck Mountain Intervenors’ assertion that the mineral rights within the units are owned by the Village of Millport, and the State of New York. Intervenors’ Brief, p. 7. These contentions do not amount to an offer of proof sufficient to advance these issues to adjudication.

The Buck Mountain Intervenors did not make an offer of proof with respect to additional issue No. 17, other than to state in their brief that this issue is irrelevant “only if Fortuna and the Department Staff agree that no distinction should be made for purposes of ECL § 23-0901(3) between wells drilled prior to a spacing order and wells drilled thereafter.” Petitioners’ Brief, p. 6. This is not sufficient to raise an issue for adjudication.

By letter dated April 2, 2003, Vincent C. Stalis, of Buck Mountain Associates, provided further arguments with respect to certain of the additional proposed issues, stating that the additional information was part of the County Line Field hearing, and should be considered because that information was not reasonably available at the time of the issues conference in this proceeding (see Section 624.4(b) (“At the ALJ’s discretion, the issues conference may be reconvened at any time to consider issues based on new information upon a showing that such information was not reasonably available at the time of the issues conference.”)). Buck Mountain’s counsel, Mr. Lipman, was not a signatory to the letter, although he was copied on

that correspondence. By correspondence dated April 4, 2003, Department Staff objected to the letter as an unauthorized attempt to brief the additional issues. Fortuna joined in Department Staff's objection by letter dated April 8, 2003.

Mr. Stalis's letter makes certain assertions, but does not indicate what qualifications Mr. Stalis may have to draw conclusions with respect to the facts contained in the letter. In addition, the information provided is contradicted by other information in the record. In his letter, Mr. Stalis referred to Exhibits "E" and "C" to the Stipulation, and asserted that the seismic line at the western end of the Gublo #1 unit (00-CAT-25) is not located on the road bed, which, according to Mr. Stalis, is where readings to determine the location of the line would be taken by seismic, or vibrator trucks. Exhibit E is a map showing the location of seismic lines in the Field. Exhibit C, at page 17 of 18, states that the western boundary of the Gublo #1 unit is located "approximately 5,045 feet west of the Gublo well where the anomaly appears to end on seismic line 00-CAT-25." Mr. Stalis's letter stated that "[t]his would lead to the conclusion that some landowners are excluded from the Gublo #1 unit as all lands should be included in the unit up to the seismic line 00-cat-25 at the road bed." This statement overlooks the fact that there are a number of seismic lines and shotpoints on Exhibit E that do not follow roadways, suggesting that the seismic trucks themselves may not always stay on paved roads, but instead could travel across lots.

Moreover, some of the statements in the letter are speculative. The letter points out that in the Terry Hill Field matter, seismic information in the vicinity of New York State Route 14 was not included, while such information appeared in the County Line Field documentation. Based upon this omission, Mr. Stalis stated that "[i]t appears that the Wilson Hollow Field and Terry Hill Field could in fact connect together. It also can be argued that the Colson unit also does connect into the Wilson Hollow Field because no seismic information is submitted." Such statements, without more, are not enough to warrant reconvening the issues conference in this matter.

Finally, Mr. Stalis cited to Matter of Stagecoach Field, 1993 WL 393510 (Decision and Order, Sept. 24, 1993), noting that provisions in that order "are different from the proposed Terry Hill Field stipulation," and making certain arguments with respect to the determination in that matter. Mr. Stalis's letter does not indicate how, if at all, the facts in the Stagecoach Field case are similar to those under consideration here, only that this information is part of the record in the County Line Field case. In the County Line Field case, where this argument was also advanced, the issues ruling indicated that Department Staff pointed out that the Stagecoach Field (which is located in Broome and Tioga counties) is not geologically similar to the County Line Field. 2004 WL 390200, *23. The ruling went on to state that "[t]he Decision and Order in Stagecoach Field do not govern the procedures to be followed or the contents of an order concerning the County Line Field, in view of the Decisions and Orders issued by the Commissioner since Stagecoach Field, and the other reasons cited by DEC Staff." *Id.* This same reasoning applies to Mr. Stalis's submission in this case. Accordingly, the submission is rejected, both because of its substance, and because this additional briefing was not authorized.

By letter dated February 17, 2004, counsel for the Buck Mountain Intervenors submitted argument with respect to the declaratory rulings and the Decision in Matter of Caflisch, asserting that “declaratory ruling DEC #23-14 confirms our position that unleased mineral owners or non-operator lessees are entitled to eight-eighths of spacing unit production after the operator has received 200% of the actual costs of drilling, equipping and operating the well.” Department Staff objected to the letter as an unauthorized submission in correspondence dated February 19, 2004. Finally, by letter dated February 18, 2004, Mr. Denton stated that he represents the bankruptcy trustee for Mr. Zahurahneq, and made similar arguments with respect to the bankruptcy trustee’s royalty entitlements. Counsel for Fortuna responded to that letter in correspondence dated March 12, 2004, objecting to Mr. Denton’s interpretation of the declaratory rulings and the Decision in Matter of Caflisch.

The arguments raised by the proposed intervenors and Mr. Denton in the correspondence overlooks the fact that the declaratory ruling’s treatment of this issue indicates that the entitlement to an eight-eighths interest is “not an automatic entitlement as compulsory integration orders must be ‘just and reasonable’ based upon field-specific factors.” DR 23-14, pp. 6-7. Accordingly, these arguments will not be considered.

APPEALS

As provided in 6 NYCRR Section 624.8(d)(2), during the course of a hearing, a ruling by the administrative law judge to include or exclude any issue for adjudication, a ruling on the merits of any legal issue made as part of an issues ruling, or a ruling affecting party status may be appealed as of right to the Commissioner on an expedited basis. While such appeals are to be filed with the Commissioner in writing within five days of the disputed ruling as required by Section 624.6(e)(1), this time frame may be modified by the ALJ, in accordance with Section 624.6(g), to avoid prejudice to any party.

Accordingly, any appeals in this matter must be received at the office of Commissioner Erin M. Crotty, 625 Broadway, Albany, New York 12233, no later than the close of business on Friday, July 9, 2004. Moreover, responses to the initial appeals will be allowed and such responses must be received as above no later than the close of business on Friday, July 30, 2004.

The appeals and any responses sent to the Commissioner’s Office must include an original and two copies. In addition, one copy of all appeal and response papers must be sent to the ALJ and to all other persons on listed below, at the same time and in the same manner as to the Commissioner. Service of any appeal or response thereto by facsimile transmission (FAX), or by electronic mail, is not permitted and any such service will not be accepted.

Appeals and any responses thereto should address the ALJ’s rulings directly, rather than merely restate a party’s contentions and should include appropriate citations to the record and any exhibits introduced therein.

/s/

Maria E. Villa
Administrative Law Judge

Albany, New York
June 17, 2004

TO: Service List