**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** "Jack Dahl" <jkdahl@gw.dec.state.ny.us>
**Date:** 3/18/2008 9:46:03 AM
**Subject:** RE: 3/26 meeting

Scott Rotruck is the Director of Government Affairs for Chesapeake Appalachia. He is not a lawyer. The Chesapeake attendees are as follows: Eddy Grey, Jim Wilson, Marty Byrd, Kathy Watson, Diane Larch, Tim Smith and Scott Rotruck. Yvonne Marciano and I will attend the behalf of The West Firm. In an effort to meet your goal of providing the Department with written comments, we will have the capability at our pre-meeting, prior to when you join us, to make redline changes to the proposed legislation. Assuming that we come to some sort of industry consensus, we will share those proposed changes with you when you join us. We will also have the capacity to make further changes to the working draft if there are any additional changes that result from the participation of your group in this meeting.

Thomas S. West

The West Firm, PLLC

677 Broadway - 8th Floor

Albany, NY 12207

Direct Phone: 518-641-0501

Direct Fax: 518-615-1501

E-Mail: twest@westfirmlaw.com

Website: www.westfirmlaw.com



-----Original Message-----
From: Jack Dahl [mailto:jkdahl@gw.dec.state.ny.us]
Sent: Tuesday, March 18, 2008 9:19 AM
To: West, Thomas
Subject: RE: 3/26 meeting

Thank you. What is Scott's title? Is he technical or an esquire?

jkd

>>> "West, Thomas" <twest@westfirmlaw.com> 3/18/2008 8:58 AM >>>

Thanks Jack. As of today, we have the following confirmations: Eddy Grey, Scott Rotruck and two technical representatives will attend on behalf of Chesapeake; Jim O'Driscoll, Mark Scheuerman, Jim McCulley and Kathy Lederhouse will attend on behalf of Fortuna; Bill Fustos and Bob Long will attend on behalf of East Resources, and Brad Gill and John Holko will attend on behalf of IOGA New York. Potentially, IOGA New York's lobbyist, Jim Carr, will also attend. Once I have a final tally I will let you know.

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This transmittal is subject to our standard e-mail legend.

-----Original Message-----

From: Jack Dahl [mailto:jkdahl@gw.dec.state.ny.us]

Sent: Tuesday, March 18, 2008 8:35 AM

To: West, Thomas

Subject: 3/26 meeting

The 26th @ 1:30 - 3:00 is good for us. DMN staff attending the meeting are Brad, Kathy, Jen and me. Please send me the list of attendees representing East, Chesapeake, Fortuna, IOGA and the West Firm.

thanx

jkd

**CC:** "Marciano, Yvonne E." <yem@westfirmlaw.com>

**From:** "Marciano, Yvonne E." <yem@westfirmlaw.com>
**To:** <jkdahl@gw.dec.state.ny.us>
**Date:** 3/27/2008 9:19:18 AM
**Subject:** 3.26.06 Statewide Spacing Meeting

Jack,

Per your request I am attaching the following from yesterday's meeting:

1. Proposed statewide spacing legislation; and

2. Chesapeake's chart on statewide spacing unit sizes and setbacks.

Please let me know if you need anything else.

Regards,

Yvonne

<http://www.westfirmlaw.com/attorney-profiles/yvonne-e-marciano.cfm>

**CC:** "West, Thomas" <twest@westfirmlaw.com>

| CURRENT REGS | | | PROPOSED NY-DEC PROGRAM #205 BILL | | | CHESAPEAKE PROPOSED SPACING | | | |
|---|---|---|---|---|---|---|---|---|---|
| Pool | Unit Size | Setback | DEC #205 PB Horizontal Unit Acre Calculation | DEC #205 PB Unit Size (3,000' Horiz) | DEC #205 Prog Bill Setback | Vert. Unit Size | (Single) Horiz. Unit Size | (Multi) Horiz. Unit Size | Setback |
| Medina (Tight Sand) | 40 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 131 ac.** | **460'** | 40 ac. | **160 ac.** | **160 ac.** | **330'** |
| Onondaga Reef/Oriskany | 160 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 251 ac.** | 660' | 160 ac. | **320 ac.** | **320 ac.** | **330'** |
| Fault Bounded Resevoirs (TBR- Hydrothermal Dolomite) [4,000'-8,000'] | 320 ac. | 660' | N/A | 320 ac. | 660' / 1,000' | 320 ac. | 320 ac. | 320 ac. | 660' |
| Fault Bounded Resevoirs (TBR- Hydrothermal Dolomite) [ >-8,000'] | 640 ac. | 660' | N/A | 640 ac. | 660' / 1,500' | 640 ac. | 640 ac. | 640 ac. | 660' |
| Other Pools (Inc. shales) [<4,000'] | 80 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 171 ac.** | **460'** | 80 ac. | **160 ac.** | **640 ac.** | **330'** |
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Black text: Existing Unit Size / Setback Distances
Blue text: Proposed changes per NY-DEC Program Bill
**Red text: Proposed CHK Unit Size / Setback Distances**

**From:** Jack Dahl
**To:** Thomas West
**Date:** 3/27/2008 8:13 AM
**Subject:** RE: 3/26 meeting

Please send us an electronic version of your proposed bill language and the spreadsheet with unit sizes.
thank you
jkd

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DEC #6-08

AN ACT to amend the environmental conservation law, in relation to provisions in the oil, gas and solution mining law regarding statewide spacing for oil and gas wells

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Subparagraph 1 of paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to read as follows:

(1) "statewide spacing" means spacing units for gas or oil wells that are within ten percent of the following sizes, as applicable, unless another percentage is specifically stated:

(i) for Medina [polls] gas pools and shale gas pools at any depth, 40 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than [660] 460 feet from any unit boundary;

(ii) for Onondaga reef or Oriskany gas pools at any depth, 160 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560 with the wellbore within the target formation no less

than 660 feet from any unit boundary;

(iii) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is between 4,000 and 8,000 feet deep, 320 acres with the proposed productive section of the wellbore within the target formation no less than one-half mile from any other well in another unit in the same pool and no less than [1000] 1,000 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(iv) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is below [8000] 8,000 feet, within five percent of 640 acres with the proposed productive section of the wellbore within the target formation no less than one mile from any other well in another unit in the same pool and no less than [1500] 1,500 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(v) for all other gas pools where the majority of the pool is above the depth of 4,000 feet, 80 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than [660] 460 feet from any unit boundary;

(vi) for all other gas pools where the majority of the pool is 4,000 to 6,000 feet deep, 160 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than 660 feet from any unit boundary;

(vii) for all other gas pools where the majority of the pool is 6,000 to 8,000 feet deep, 320 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 2,000 and dividing the product by 43,560, with the wellbore within the target formation no less than [1000] 1,000 feet from any unit boundary; [and]

(viii) for all other gas pools where the majority of the pool is below 8,000 feet, within five percent of 640 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 3,000 and dividing the product by 43,560 with the wellbore within the target formation no less than [1500] 1,500 feet from any unit boundary;

(ix) for oil pools in the Bass Island, Trenton, Black River, Onondaga reef or other oil-bearing reef at any depth, 40 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within

the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than 460 feet from any unit boundary;

(x) for all other oil pools at any depth, the wellbore within the target formation shall be no less than 165 feet from any lease boundary; and

(xi) wells completed under a well permit issued pursuant to clauses (ix) or (x) of this subparagraph may not commence production of only natural gas prior to modification of the spacing unit pursuant to applicable provisions of this title.

§2. Subdivision 6 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

6. [An order establishing] Unless it is extinguished pursuant to subdivision 7 of this section, a spacing unit established by the department shall be binding upon all persons and their heirs, successors and assigns. Upon good cause shown, an order establishing a spacing unit or a spacing unit which conforms to statewide spacing may be modified by the department without conducting a hearing if a finding has been made that no facts are in dispute after all affected persons have been provided a reasonable opportunity to comment. If necessary, upon issuance of [a modified] an order which changes unit boundaries, the well operator shall adjust the accounts for owners within

the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties based thereon shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§3. This act shall take effect immediately.

**Jack Dahl - 3.26.06 Statewide Spacing Meeting**

**From:** "Marciano, Yvonne E." <yem@westfirmlaw.com>
**To:** <jkdahl@gw.dec.state.ny.us>
**Date:** 3/27/2008 9:19 AM
**Subject:** 3.26.06 Statewide Spacing Meeting
**CC:** "West, Thomas" <twest@westfirmlaw.com>
**Attachments:** CHK Statewide Spacing Chart.xls; CHK Draft Statewide Spacing Bill Counterproposal.doc

Jack,

Per your request I am attaching the following from yesterday's meeting:

1. Proposed statewide spacing legislation; and
2. Chesapeake's chart on statewide spacing unit sizes and setbacks.

Please let me know if you need anything else.

Regards,
Yvonne

THE WEST FIRM

**Yvonne E. Marciano**
677 Broadway - 8th Floor
Albany, New York 12207
Office: 518-641-0500
Direct: 518-641-0507
Fax: 518-615-0507
yem@westfirmlaw.com
www.westfirmlaw.com

| CURRENT REGS | | | PROPOSED NY-DEC PROGRAM #205 BILL | | | CHESAPEAKE PROPOSED | | |
|---|---|---|---|---|---|---|---|---|
| **Pool** | **Unit Size** | **Setback** | **DEC #205 PB Horizontal Unit Acre Calculation** | **DEC #205 PB Unit Size (3,000' Horiz)** | **DEC #205 Prog Bill Setback** | **Vert. Unit Size** | **Horiz. Unit Size** | **Setback** |
| Medina (Tight Sand) | 40 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 131 ac.** | **460'** | 40 ac. | **160 ac.** | **330'** |
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DEC #6-08

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The People of the State of New York, represented in Senate and Assembly, do enact as follows:

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(iii) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is between 4,000 and 8,000 feet deep, 320 acres with the

proposed productive section of the wellbore within the target formation no less than one-half mile from any other well in another unit in the same pool and no less than ~~1000~~ 1,000 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(iv) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is below ~~8000~~ 8,000 feet, within five percent of 640 acres with the proposed productive section of the wellbore within the target formation no less than one mile from any other well in another unit in the same pool and no less than ~~1500~~ 1,500 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(v) for all other gas pools where the majority of the pool is above the depth of 4,000 feet, 80 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(vi) for all other gas pools where the majority of the pool is 4,000 to 6,000 feet deep, 160 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

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with the wellbore within the target formation no less than ~~1000~~330feet from any unit boundary; [and]

(viii) for all other gas pools where the majority of the pool is below 8,000 feet, ~~within five percent of~~ 640 acres for a vertical well with the wellbore within the target formation no less than ~~1500~~330 feet from any unit boundary;

(ix) for all other gas pools at any depth, 640 acres for a unit that includes at least one horizontal well with the wellbore within the target formation no less than 330 feet from any unit boundary and a proposed spacing pattern for horizontal and/or vertical infill wells that may be modified based upon site specific information developed from the original wellbore;

(x) for oil pools in the Bass Island, Trenton, Black River, Onondaga reef or other oil-bearing reef at any depth, 40 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than 460 feet from any unit boundary;

(xi) for all other oil pools at any depth, the wellbore within the target formation shall be no less than 165 feet from any lease boundary; and

(xii) wells completed under a well permit issued pursuant to clauses (x) or (xi) of this subparagraph may not commence

production of only natural gas prior to modification of the spacing unit pursuant to applicable provisions of this title.

§2. Paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to add new subdivisions (4) and (5) as follows:

(4) "Vertical well" means any wellbore that is not a horizontal well.

(5) "Horizontal well" means a wellbore drilled laterally at an angle of at least 80 degrees to the vertical.

§3. Subdivision 6 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

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the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties based thereon shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§4. This act shall take effect immediately.

**Jack Dahl - Statewide Spacing**

**From:** "Marciano, Yvonne E." <yem@westfirmlaw.com>
**To:** bjfield@gw.dec.state.ny.us
**Date:** 4/10/2008 3:35 PM
**Subject:** Statewide Spacing
**CC:** twest@westfirmlaw.com; kfsanfor@gw.dec.state.ny.us; jkdahl@gw.dec.state....
**Attachments:** Statewide Spacing Bill Proposal (changes re_oil).doc

Brad,

During our meeting last month on the Department's statewide spacing, we discussed the intent of the subdivision xi (or xii in our proposed version) with respect to oil wells. Attached is proposed language to reflect this discussion which is highlighted in track changes and embedded in the draft proposal we circulated during our meeting.

Thanks,
Yvonne

THE WEST FIRM

**Yvonne E. Marciano**
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the well operator shall adjust the accounts for owners within the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties based thereon shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§4. This act shall take effect immediately.

**From:** "West, Thomas S." <Twest@llgm.com>
**To:** "Alison Crocker" <ahcrocke@gw.dec.state.ny.us>
**Date:** 5/13/05 2:18:28 PM
**Subject:** RE: I recieved the information about Virginia's program

I figured as much. Since it is likely that Lipman and Joy will attack the constitutionality of whatever we propose, we are going to address our specific proposal in the memorandum.

In reviewing the Virginia information, you will see that they have a zero royalty during the risk penalty payout period where the oil and gas rights have not been leased. If the oil and gas rights have been leased, the risk penalty is exclusive of the royalty payable, but the risk penalty is higher. We, of course, do not favor rewarding leases to third parties, but note that Virginia serves as precedent for a zero royalty during a risk penalty payout period.

Thomas S. West, Esq.
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twest@llgm.com

-----Original Message-----
From: Alison Crocker [mailto:ahcrocke@gw.dec.state.ny.us]
Sent: Friday, May 13, 2005 1:37 PM
To: West, Thomas S.
Cc: Arlene Lotters; Bradley Field; Maureen Coleman
Subject: I recieved the information about Virginia's program

Please ignore the note in my previous email. It arrived safely.



**CC:** "Arlene Lotters" <ajlotter@gw.dec.state.ny.us>, "Bradley Field" <bjfield@gw.dec.state.ny.us>, "Maureen Coleman" <mxcolema@gw.dec.state.ny.us>

CNR KFS copy

# LeBoeuf, Lamb, Greene & MacRae LLP


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November 23, 2005

**VIA FEDERAL EXPRESS AND ELECTRONIC MAIL**

Mr. John Dahl
Director of the Bureau of Oil and Gas Regulation
NYSDEC Mineral Resources
625 Broadway
Albany, New York 12233-6500

Re: CNR Comments on Draft Program Policy DMN-05-01

Dear Mr. Dahl:

Please accept these comments on behalf of Columbia Natural Resources LLC regarding the Draft Program Policy DMN-05-01.

## Overview

In general, the Department has done an excellent job of developing policy documents to implement the new legislation (Chapter 386 of the laws of 2005) in a manner that seeks to streamline the procedures associated with the creation of spacing units and compulsory integration. However, there are some procedural issues that warrant further clarification before this policy document becomes final

## Specific Comments

Under Section I on DMN-05-1, the document provides an overall summary of the program policy. Included within that summary is a discussion of the applicability of the policy. The discussion indicates that the policy applies to well permits issued on or after August 2, 2005, which is consistent with the legislation. It also addresses the exemptions provided in the law for pre-1981 oil fields and pre-1995 gas fields, which is also consistent with the legislation. However, the discussion of the exemptions includes the proviso: "which are not being extended."

23-0501(1)

The quoted language does not appear in the law and may be an issue for new wells that are drilled in exempted fields.

Also notable is the last sentence of the summary, which states: "the procedures herein may be implemented, to the extent applicable, for other pending and future proceedings related to spacing and integration." It is unclear what purpose this language serves since the effective date of the legislation is specified in the legislation.

Section II of DMN-05-1 outlines the new policy as it applies to both the establishment of spacing units and the compulsory integration process. The policy confirms that adjudicatory hearings pursuant to 6 NYCRR Part 624 are no longer automatic, which is consistent with the intent of the new legislation.

Regarding spacing units, the policy states that no spacing order or spacing hearing is necessary for units that conform to statewide spacing. The Department will issue the well permit after the required notice of intent has been published. The well permit will confirm the unit established for that well. This is also consistent with the new legislation.

In contrast to conforming units, non-conforming units provide an opportunity, though not a guaranty, for public hearing. Under the policy, any person objecting to a non-conforming unit must file an objection with DMN staff. If DMN staff determines that there is a substantive and significant issue, the matter is referred to an adjudicatory hearing. Section V of the policy confirms that objectors may get two opportunities to raise substantive and significant issues – one before DMN staff and another with an administrative law judge ("ALJ"). If this policy is interpreted to give objectors two opportunities to raise a substantive and significant issue, it is inconsistent with the new legislation. In pertinent part, the new legislation provides as follows:

> The department shall determine whether substantive and significant issues have been raised. If the department receives no comments or if the comments do not raise a substantive and significant issue, the department shall issue the permit and the final spacing order. If the department determines that substantive and significant issues have been raised in a timely manner, the department shall schedule an adjudicatory hearing. ECL Section 23-0503 (3)(d).

Since this language does not contemplate two opportunities for objectors to raise substantive and significant issues, the draft policy appears to be inconsistent with the legislative mandate.

Moreover, the policy language makes reference to the continued applicability of 6 NYCRR Part 624 if the matter is referred to the Office of Hearings and Mediation Services ("OHMS") for an adjudicatory hearing. It is unclear, however, whether an ALJ determination

that an issue is not substantive and significant will be appealable to the Commissioner. This is another issue that should be clarified. In the absence of language specifically limiting appeals, time-consuming appeals will still be available to the parties. A better approach would be to make the staff determination regarding whether an issue is substantive and significant final, with no administrative appeal rights. That way, if staff determines that the issue is substantive and significant, the matter progresses to hearing before an administrative law judge. If not, the spacing unit is final and the objector's procedural recourse is an Article 78 proceeding. As a practical matter, if staff determines that an issue is substantive and significant, in most instances, the well operator will negotiate with the objector and reconfigure the unit in a manner that avoids the dispute.

Likewise, this section of the policy implies that both the proponent of the non-conforming unit and the objecting owners will carry their ultimate burden of proof on their respective issues, citing 6 NYCRR Part 624.9, but later states that the objecting owners carry the burden of proof. These burden issues can be very confusing and should be clarified in the policy document.

On a positive side, the policy indicates that both the operators and the objectors must share the cost of any adjudicatory hearing. However, this is a departure from existing practice and the regulatory requirements of 6 NYCRR Section 624.11. This departure from existing practice and the regulations demonstrates that the Department is willing to modify the Part 624 requirements, where appropriate. Whether modifications to the Part 624 rules are legal without a formal rulemaking is an overarching issue that must be considered. The best way to avoid this overarching issue is to clarify what happens to matters before they are referred to OHMS. Any attempt to change what is required in Part 624 may be challenged by objectors.

Section III of DMN-05-1 goes into greater detail regarding implementation of the policy. Under the discussion of statewide spacing beginning on the bottom of page 3 and continuing on to page 4, reference is made to the burden of proof. Specifically it states: "Challenges may lead to an adjudicatory hearing, where the challenging owner bears responsibilities and burden of proof of an applicant in other Department permit proceedings." As noted above, it seems that the Department is attempting to place the entire burden of proof upon the party bringing the challenge to the non-conforming spacing unit. However, the language in this section of the policy document is inconsistent with earlier statements in the draft policy and the regulations cited in the document. Clarification is warranted.

Section IV of DMN-05-1 identifies the responsibilities of various units within the Department. The Bureau of Oil and Gas Regulation in the DMN is responsible for implementing the policy and maintaining and interpreting the policy document, with appropriate assistance from the Division of Legal Affairs. The OHMS is responsible for conducting adjudicatory hearings, including issues conferences, on spacing units and integration orders that are referred by DMN in accordance with this policy. Once again, the reference to issues conferences creates confusion and a process beyond what is contemplated by the new legislation. If DMN decides that an issue is substantive and significant, why have an issues conference? This is another

example of where the interface between that which is decided by DMN and that which is referred to the OHMS becomes somewhat confused. Clarification is necessary. Also, it is important that the Department publish a formal Organization and Delegation Memorandum to confirm the division of responsibilities.

Section V of DMN-05-1 provides more details concerning the procedures. Under the discussion of procedures for spacing hearings for non-conforming units on page 5, there are several issues worth noting. First, the policy specifies that upon a determination by the Department that the unit meets the policy objectives of the statute, the Department will publish a notice of intent in the Environmental Notice Bulletin. This is a sound practice. However, the policy goes on to state that the well operator is required to publish in the newspaper of general circulation in the area where the unit is proposed and mail individual notices to all owners within the unit. Since newspaper notice provides notice to all owners within and outside of the proposed unit and persons outside of the unit are more likely to challenge the unit configuration, CNR questions the need for individual notice to unit owners within the proposed spacing unit and respectfully requests that the individual notice requirement be eliminated. Notice in the Environmental Notice Bulletin and notice by publication will satisfy any due process concerns.

Second, there is no requirement that an objecting party provide notice to owners who may be affected by the alternative spacing unit being proposed. Although the statute does not specifically require any such notice, the absence of such a notice may be problematic given case law in New York State which identifies those parties as necessary parties to court proceedings regarding unit boundaries. See Matter of Spence v. Cahill, 300 App. Div. 2d 992 (4th Dept. 2002). However, the issue of how much notice is required is certainly open to debate. One possible solution is to include language in the original notice given by publication that places persons in or near the unit on notice that: "A change in the unit boundary as a result of the hearing process may affect your participation rights."

Under the discussion of substantive and significant issues at the top of page 6, the policy document indicates that DMN staff will determine if a substantive and significant issue "may" exist. In the next paragraph, it makes reference to DMN having determined that a substantive and significant issue "has" been raised. This is confusing. Also, the document goes on to state that if no substantive and significant issue has been raised, as determined by DMN staff, the owner may request an issues conference before the ALJ assuming that certain criteria have been met. This gives objectors two opportunities to establish a substantive and significant issue, which, as noted above, is inconsistent with the new legislation. Once again, this is an example of where the interface between DMN and OHMS must be delineated carefully and it should be delineated in a manner that does not give objectors two opportunities to raise an issue for adjudication..

Further down on the same page (4th full paragraph), the document indicates that, if the objecting owner requests an issues conference within ten business days of receiving DMN's determination, the DMN will then expeditiously refer the matter for proceedings pursuant to 6 NYCRR Part 624. This is potentially confusing, because it is not clear whether all of Part 624

applies, or just parts of it. Of particular significance are the provisions of Part 624 that give persons an opportunity to appeal adverse determinations concerning issues that are not substantive and significant. In practice, this has been very time consuming and has very rarely led to a refinement or narrowing of the issues, as contemplated by the issues conference process. More appropriately, the determination by DMN should be final, with no administrative appeal rights.

In the second to last paragraph on page 6, the document once again speaks to burden of proof and provides that all owners objecting will carry the ultimate burden of proof on their issues. This is an admirable goal, but is potentially inconsistent with the regulatory requirements and other parts of the policy document.

Page 7 addresses the procedures for compulsory integration hearings. The hearing process and the attachments appear to be consistent with the new legislation and a move towards the Virginia system, with the laudable goal of having final integration orders issued to at the hearing. Regarding compulsory integration, the policy outlines an approach whereby regular integration hearings are to be scheduled at the Department offices in Albany. Matters will be scheduled sufficiently far in advance to allow the 30-day notice required by the statute. The policy contemplates that orders will be signed and finalized at the hearing unless i) DMN determines in response to objection that a substantive and significant issue may exist which requires adjudication, or ii) revisions to the draft order are required before it can be accurately finalized.

One issue that raises concern is the last bullet on page 8 regarding title and acreage disputes. Clearly title and acreage disputes should not be subject to adjudication. However, if the operator has based acreage upon a tax map and an owner objects to the acreage so stated, there is no reason to postpone the issuance of an order or adjourn the matter to the next hearing date. Since the owner has been on notice of the acreage reflected on the tax rolls, the well operator and the remaining owners in the unit should not be burdened by delays in the process solely because the owner decides to raise an issue concerning the accuracy of the acreage stated on the tax map in the context of a compulsory integration hearing. The way the policy is currently drafted, owners could object to acreage and cause an adjournment of the integration hearing, which will put pressure on the operator to proceed with drilling and bring us back to the problems of the old legislation where owners were accorded a free look at the viability of the well prior to making an election. Accordingly, we respectfully request that you delete all language that appears after the first sentence in the last bullet.

Aside from the issue concerning acreage disputes, however, the proposed compulsory integration procedures are consistent with the new legislation, including the legislative mandate that the Department take action "as expeditiously as possible," and a positive step forward for New York State.

Regarding the proposed Compulsory Integration Order, we note that there is no language in the Order specifying how notice should be given to the well operator. Accordingly,

language should be added in providing that all legal notices to the well operator shall be given by mailing such notices to the well operator at an address stated in the Order. In addition, the Order should include language requiring the owner to cooperate with the well operator by executing any tax forms or other forms required by law to process payments to the owner in accordance with the election made by the owner.

Finally, regarding the election form, the form requires the well operator to serve the election form upon owners by certified mail. However, there is no requirement that the owner serve his or her election upon the well operator by certified mail. In order to avoid disputes concerning whether an election was timely mailed, owner should be required to mail their elections to well operators by certified mail.

**Conclusion**

In conclusion, the Department has done an excellent job of creating procedures to implement the new legislation. CNR's main concern relates to the interface between those procedures that will be handled by the DMN and those that will be handled by the OHMS. Likewise, confusion exists regarding which parts of Part 624 will be applicable to hearings before the OHMS and an overarching issue exists concerning whether this type of policy document can modify the requirements of Part 624 without going through the formal rulemaking process. Finally, compulsory integration hearing should not be delayed based upon acreage disputes if the well operator has based acreage upon the acreage stated in the tax rolls and both the Compulsory Integration Order and the Election Form should be revised, as suggested above.

Sincerely yours,

Thomas S. West

TSW:cd (93032.4)

cc: Columbia Natural Resources LLC

**From:** "West, Thomas S." <Twest@llgm.com>
**To:** "Alison Crocker" <ahcrocke@gw.dec.state.ny.us>
**CC:** "Arlene Lotters" <ajlotter@gw.dec.state.ny.us>, "Bradley Field" <bjfield...
**Date:** 5/13/05 2:18 PM
**Subject:** RE: I recieved the information about Virginia's program

I figured as much. Since it is likely that Lipman and Joy will attack the constitutionality of whatever we propose, we are going to address our specific proposal in the memorandum.

In reviewing the Virginia information, you will see that they have a zero royalty during the risk penalty payout period where the oil and gas rights have not been leased. If the oil and gas rights have been leased, the risk penalty is exclusive of the royalty payable, but the risk penalty is higher. We, of course, do not favor rewarding leases to third parties, but note that Virginia serves as precedent for a zero royalty during a risk penalty payout period.

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General Fax Number: (518) 626-9010
twest@llgm.com

-----Original Message-----
From: Alison Crocker [mailto:ahcrocke@gw.dec.state.ny.us]
Sent: Friday, May 13, 2005 1:37 PM
To: West, Thomas S.
Cc: Arlene Lotters; Bradley Field; Maureen Coleman
Subject: I recieved the information about Virginia's program

Please ignore the note in my previous email. It arrived safely.

## Jennifer Maglienti - RE: Whitesville Field-East Resources

**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** jlhairie@gw.dec.state.ny.us
**Date:** 4/17/2008 3:10 PM
**Subject:** RE: Whitesville Field-East Resources
**CC:** rlong@eastresourcesinc.com

Thanks Jennifer. Of course we understand that Judge McClymonds will establish the procedures for the hearing process. However, given the limited precedent for this kind of hearing, I expect that he will look to staff for guidance.

On the substance, East Resources would like to come forward with a proposal that has a high likelihood of acceptance by staff in order to make the hearing process productive. You may find it interesting to note that when we were meeting with Assemblyman Parment this week on behalf of Chesapeake he went out of his way to indicate Senator Young's concern about oil production in general and some pending issues concerning East Resources specifically. I am not sure what contact has been made with Senator Young by East Resources or whether individual landowners have contacted her, but I can report to you what was reported to us by Assemblyman Parment concerning her level of interest in this matter. We are only looking for an opportunity to discuss with staff the substance of what might be acceptable to staff. As an aside, I do not see any reason why staff cannot provide guidance to East Resources concerning positions that might be acceptable as to staff. As you are aware, it is commonplace for staff to work with applicants in other contexts to produce defensible application documents, including application documents that include variance requests. As such, I do not see anything out of the ordinary associated with this request for a meeting or conference call to discuss substantive issues.

We look forward to hearing from you and staff concerning the opportunity for a call to discuss the substance of the gas to oil ratio issue. As always, thank you for your time and attention to these issues.

Thomas S. West
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Direct Fax: 518-615-1501
E-Mail: twest@westfirmlaw.com
Website: www.westfirmlaw.com



-----Original Message-----
From: Jennifer Hairie [mailto:jlhairie@gw.dec.state.ny.us]
Sent: Thursday, April 17, 2008 2:54 PM
To: West, Thomas
Subject: Re: Whitesville Field-East Resources

As I've mentioned before, Judge McClymonds, not staff, will determine what procedures will be used for the hearing. In fact, ALJ McClymonds has already scheduled a conference call to discuss the case.

So I don't see what there is to discuss. As to your request to discuss the gas/oil ratio, I'll forward your request to staff and get back to you. But regardless of whether the Department decides to meet with you and East, you should not expect to know the Department's position in advance of the hearing.

>>> "West, Thomas" <twest@westfirmlaw.com> 4/17/08 9:38 AM >>>

Jennifer, as a follow-up to our recent telephone conversations and the recent assignment of this matter to the Office of Hearings and Mediation Services, please consider this e-mail as a request for a meeting or conference call to discuss staff's position concerning the procedures going into this hearing and the substance of the gas to oil ratio issue. As we understand the procedures concerning the oil and gas ratio issue, East Resources will have the burden of demonstrating the merits of its proposal. Department Staff will then testify concerning East Resources' proposal. Since we would like to put forth a proposal that will be received by staff positively, we would appreciate the opportunity to discuss the substance of this issue with staff with a view towards submitting a draft report to staff prior to the hearing for review and comment. We see no reason why East Resources should not be allowed to work closely with staff to come up with a position that is acceptable to staff and will allow the efficient development of the resources.

Please call to discuss.

## Jennifer Maglienti - RE: East Resources-Whitesville Field

**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** jlhairie@gw.dec.state.ny.us
**Date:** 5/22/2008 9:59 AM
**Subject:** RE: East Resources-Whitesville Field
**CC:** yem@westfirmlaw.com

Thanks Jennifer. We are in agreement that it is important for the public to know about the substantial lease holdings of East Resources in this area, but believe that disclosure of that information could be accomplished by other means without identifying the specific locations of the East leases. For example, East could compile the total acreage that it has under control within the field and the relationship of the property under control to the entire property within the field in terms of percentage. This would accomplish the same purpose without having to disclose the specific areas under lease and not under lease. Let us know if this works for the Department. If so, we can figure out the best way to put that information in the public domain.

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Website: www.westfirmlaw.com



**From:** Jennifer Hairie [mailto:jlhairie@gw.dec.state.ny.us]
**Sent:** Thursday, May 22, 2008 7:48 AM
**To:** West, Thomas
**Cc:** Marciano, Yvonne E.
**Subject:** Re: East Resources-Whitesville Field

Tom - we can agree that the earlier version of the maps can be excluded, but the final map with the color coding should be left in. This is a pretty unusual application and I think it's important to show why East has the ability to seek a field wide variance. That would naturally be tied to East's lease position.

Also, Kathy Sanford has left two voicemail messages for Jared Hall. We need an electronic copy of the spacing unit map to post on our website but she hasn't heard back yet. Can you please check on this with East? Thanks.

Jennifer.

>>> "West, Thomas" <twest@westfirmlaw.com> 5/20/08 5:21 PM >>>
Jennifer, in connection with the preparation of the documents for the public repositories, we were wondering if we could eliminate the two maps that preceded the final spacing map and eliminate from the final spacing map the color coding that shows acreage under lease to East Resources? We see no reason why preliminary maps are needed in the public domain and believe that the preliminary maps may serve to confuse the public. Likewise, we do not see any need for anyone to know which property is under lease to East Resources in the context of the spacing process.

If you are in agreement, we will prepare the documents for distribution to the public repositories and notify Judge McClymonds of our agreement concerning this subject matter.

THE WEST FIRM

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## Jennifer Maglienti - RE: East Resources-Whitesville Field

**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** jlhairie@gw.dec.state.ny.us
**Date:** 5/22/2008 10:21 AM
**Subject:** RE: East Resources-Whitesville Field
**CC:** yem@westfirmlaw.com

PS: We will work on getting you an electronic version of the spacing map ASAP. Since it is the spacing map that includes the lease information, we will get Kathy the electronic version of the map as soon as the issue concerning the lease holdings is resolved.

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**From:** Jennifer Hairie [mailto:jlhairie@gw.dec.state.ny.us]
**Sent:** Thursday, May 22, 2008 7:48 AM
**To:** West, Thomas
**Cc:** Marciano, Yvonne E.
**Subject:** Re: East Resources-Whitesville Field

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Jennifer.

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**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** "Michael P. Joy" <mjoy@lbfirm.com>
**CC:** "Jennifer Hairie" <jlhairie@gw.dec.state.ny.us>
**Date:** 3/12/07 1:44 PM
**Subject:** RE: Program Policy - Hearing Procedures

Michael, thanks for your e-mail. Just to clarify for the record, some of the operators are talking about approaching IOGA New York about working on this issue if the Department is interested in addressing the issue on a more programmatic basis. As of this writing, we are waiting to hear from the Department concerning whether they want to pursue this issue on a programmatic basis or as part of the pending proceedings.

Jennifer, I hope that this provides some context for Michael's e-mail. Please call me if you have any questions.

Thomas S. West, Esq.
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Direct: (518) 641-0501
Fax: (518) 615-1501
twest@westfirmlaw.com



---

From: Michael P. Joy [mailto:mjoy@lbfirm.com]
Sent: Monday, March 12, 2007 12:30 PM
To: West, Thomas
Cc: Jennifer Hairie
Subject: Program Policy - Hearing Procedures

Tom - you recently mentioned an IOGA workshop to develop an 'industry sponsored' amendment to DEC Program Policy DMN-1 regarding procedural issues.

John Wilson will not commit resources to that effort at this time.

Although Western has not always agreed with the determinations of "substantive and significant' issues, appeal rights do exist and the process is hardly broken.

More significantly, Western has reviewed the number of issues currently pending adjudication. In its opinion the issues Western is aware of could be solved by negotiation. Fortuna does not appear willing to discuss the 'risk penalty' issue although Western has made multiple overtures to do so and Fortuna continues to advance the data/site access objections rather than negotiate a workable solution that could be presented to INPOs in advance of the hearings.

It simply makes more sense to commit resources to the resolution of the substantive issues than to procedural issues and the mechanisms to resolve the substantive issues through litigation.

Michael P. Joy, J.D., Ph.D.

333 International Drive Suite B-4

Williamsville, New York 14221

O: (716) 633-3200

F: (716) 633-0301

**Jennifer Maglienti - Revised Cost and Revenue Statements**

**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** "Jennifer Hairie" <jlhairie@gw.dec.state.ny.us>
**Date:** 11/7/2008 12:01 PM
**Subject:** Revised Cost and Revenue Statements
**CC:** "Gregory A. Mountain" <gam@westfirmlaw.com>
**Attachments:** 20081107 Revised Cost and Revenue StatementFortuna_Old Wells.pdf

Jennifer, attached please find a sample revised cost and revenue statement in furtherance of the discussion had during the Issues Conference. This sample was prepared relative to Mr. LeRose, who has now settled, but it is an example of the format that we would follow consistent with the discussion had on the record at the Issues Conference.

In addition, we would like Department Staff to consent to limiting the distribution of revised cost and revenue statements to the active parties remaining in the proceeding. We recognize that ALJ McClymonds would have to rule upon this request, but would like to represent that Staff has no problem limiting the distribution to active parties. As discussed by telephone today, we believe that it will be confusing to parties who have settled or decided not to seek party status in these proceedings to get revised statements.

Thank you for your attention to this detail.

THE WEST FIRM

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April 30th

# Soderblom 1
## Notice to Uncontrolled Owner

| | |
|---|---|
| **Owner Name** | Michael LeRose |
| **Parcel ID Number** | 47-00-1-19.122 |
| **Size of spacing unit** | 0.83934% |
| **Well API #** | 31-015-23134-00-00 |
| **On production date** | 16-Dec-04 |

| Draft Order Ref. | | Gross Well | Attributable to the above-named owner's acreage within the unit | |
|---|---|---|---|---|
| 8. a. | Amount of actual well costs incurred to March 31, 2008 as defined by ECL 23-0901(3)(a)(5), and a 100% penalty thereon | 7,718,332 | 64,783 | |
| 8. b. | Amount of actual costs incurred to March 31, 2008 as described by ECL 23-0901(3)(c )(1)(ii)(E), and a 100% penalty thereon | 1,104,833 | 9,273 | |
| 8. c. | Amount of royalties paid to March 31, 2008 pursuant to the Interim Order, attributable to the uncontrolled owner's acreage within the unit | 644,463 | 70,649 | |
| 8. d. | Amount of actual costs incurred to March 31, 2008 for subsequent operations as described by ECL 23-0901(3)(c )(1)(ii)(H) and a 100% penalty thereon | 0 | 0 | |
| 8. e. | Amount of actual costs incurred to March 31, 2008 for the Well's operation, including, but not limited to, labor, transportation, materials, equipment, third-party transportation charges and taxes assessed directly on the Well's production | 8,195,884 | 68,791 | |
| 8. f. | Estimate of the amount of plugging, abandonment and reclamation costs to be incurred by Fortuna or its successor | 594,998 | 4,994 | see separate schedule |
| 8. g. | Amount of revenue attributable to the Well received by Fortuna since the Well commenced production | 67,000,193 | 562,359 | |
| 8. h. | The difference between the amount stated by item g above and the sum of the amounts stated by items a through f. This result shows that the production proceeds have exceeded the sum of actual costs, penalties and estimated plugging, abandonment and reclamation costs. | 48,741,683 | 343,869 | |
| 8. j. | 1. Estimate of remaining recoverable reserves in the Spacing Unit from the Black River formation<br>2. Estimated time required to recover such reserves | 0.816 bcf<br>9 yrs, 9mos | 0.00685 bcf<br>9 yrs, 9mos | See Note (1) |

Note:

(1) The process of estimating oil and gas reserves is complex and involves a significant number of assumptions in evaluating available geological, geophysical, engineering and economic data; therefore, reserves estimates are inherently uncertain. In addition, there are numerous uncertainties in forecasting the amounts and timing of future production, costs, expenses and the results of exploration and development projects. Moreover, Fortuna Energy Inc.'s actual production, taxes and development and operating expenditures with respect to its reserves will likely vary from such estimates and such variances could be material.

September 19th

# Soderblom 1
# Notice to Uncontrolled Owner

| | |
|---|---|
| **Owner Name** | Michael LeRose |
| **Tax Parcel ID Number** | 47-00-1-19.122 |
| **Share of spacing unit** | 0.83934% |
| **Well API #** | 31-015-23134-00-00 |
| **On production date** | 16-Dec-04 |

| Draft Order Ref. | | Gross Well | Attributable to the above-named owner's acreage within the unit | |
|---|---|---|---|---|
| 8. a. | Amount of actual well costs incurred to March 31, 2008 as defined by ECL 23-0901(3)(a)(5), and a 100% penalty thereon | 7,718,332 | 64,783 | |
| 8. b. | Amount of actual costs incurred to March 31, 2008 as described by ECL 23-0901(3)(c )(1)(ii)(E), and a 100% penalty thereon | 1,104,833 | 9,273 | |
| 8. c. | Amount of royalties paid to March 31, 2008 pursuant to the Interim Order, attributable to the uncontrolled owner's acreage within the unit | 644,463 | 70,649 | |
| 8. d. | Amount of actual costs incurred to March 31, 2008 for subsequent operations as described by ECL 23-0901(3)(c )(1)(ii)(H) and a 100% penalty thereon | 0 | 0 | |
| 8. e. | Amount of actual costs incurred to March 31, 2008 for the Well's operation, including, but not limited to, labor, materials and equipment. | 396,485 | 3,328 | See Note (2) |
| 8. f. | Estimate of the amount of plugging, abandonment and reclamation costs to be incurred by Fortuna or its successor | 594,998 | 4,994 | see separate schedule |
| 8. g. | Amount of revenue attributable to the Well received by Fortuna since the Well commenced production | 67,000,193 | 562,359 | |
| 8. h. | The difference between the amount stated by item g above and the sum of the amounts stated by items a through f. This result shows that the production proceeds have exceeded the sum of actual costs, penalties and estimated plugging, abandonment and reclamation costs. | 56,541,082 | 409,332 | |
| 8. j. | 1. Estimate of remaining recoverable reserves in the Spacing Unit from the Black River formation<br>2. Estimated time required to recover such reserves | 0.816 bcf<br>9 yrs, 9mos | 0.00685 bcf<br>9 yrs, 9mos | See Note (1) |

Note:

(1) The process of estimating oil and gas reserves is complex and involves a significant number of assumptions in evaluating available geological, geophysical, engineering and economic data; therefore, reserves estimates are inherently uncertain. In addition, there are numerous uncertainties in forecasting the amounts and timing of future production, costs, expenses and the results of exploration and development projects. Moreover, Fortuna Energy Inc.'s actual production, taxes and development and operating expenditures with respect to its reserves will likely vary from such estimates and such variances could be material.

(2) Amount of actual costs incurred to March 31, 2008 for Well's operation does not include any marketing fees, gas transportation fees or taxes assessed directly on the Well's production.

## Jennifer Maglienti - RE: Chesapeake - Stage Unit

**From:** "West, Thomas" <twest@westfirmlaw.com>
**To:** jlhairie@gw.dec.state.ny.us
**Date:** 2/19/2009 4:01 PM
**Subject:** RE: Chesapeake - Stage Unit
**CC:** kathy.watson@chk.com

Jennifer, due to confusion over the issue concerning payments to uncontrolled owners, payments to controlled owners were not processed regarding the Stage unit. Chesapeake is taking steps to make those payments as soon as possible. To the best of our knowledge, this is the only unit where this has occurred.

Thank you for bringing this to our attention.

Thomas S. West
The West Firm, PLLC
677 Broadway - 8th Floor
Albany, NY 12207
Direct Phone: 518-641-0501
Direct Fax: 518-615-1501
E-Mail: twest@westfirmlaw.com
Website: www.westfirmlaw.com



-----Original Message-----
From: Jennifer Hairie [mailto:jlhairie@gw.dec.state.ny.us]
Sent: Tuesday, February 17, 2009 2:38 PM
To: West, Thomas
Subject: Re:

Tom - I'm re-checking the dates again. It appears Jack's morning is booked on the 26th and Bill Glynn is on vacation through the 25th. Since you said you planned to travel on the 26th, I'm looking for dates the first week of March. I'll let you know when I hear back from staff.

Also, concerning Chesapeake, DEC staff received a complaint from someone in the Stage unit. His name is Kenneth Bubacz and he told DEC staff that he has a lease with Chesapeake and has not been paid royalties even though the well is in production. He said he contacted Chesapeake and someone named Cathy advised him that the well "was held up in litigation" and that he should call DEC if he wanted more information. The permit issued to Chesapeake instructs that royalties for uncontrolled owners should be held in escrow but obviously has no impact on leased owners. Would you please check with Chesapeake and confirm: a) that Mr. Bubacz has not been paid royalties, and if not, why; and b) if Chesapeake is informing callers that DEC should be contacted with royalty issues between Chesapeake and leased owners. The Department can then decide how to address his complaint.

Thanks.

>>> "West, Thomas" <twest@westfirmlaw.com> 2/17/09 10:33 AM >>>
Jennifer, we can do the call next Thursday morning at 9 AM. Please confirm and I will send out a dial in number.

<http://www.westfirmlaw.com/attorney-profiles/thomas-s-west.cfm>

**Jennifer Maglienti - Statewide Spacing**

**From:** "Marciano, Yvonne E." <yem@westfirmlaw.com>
**To:** bjfield@gw.dec.state.ny.us
**Date:** 4/10/2008 3:35 PM
**Subject:** Statewide Spacing
**CC:** twest@westfirmlaw.com; kfsanfor@gw.dec.state.ny.us; jkdahl@gw.dec.state....
**Attachments:** Statewide Spacing Bill Proposal (changes re_oil).doc

Brad,

During our meeting last month on the Department's statewide spacing, we discussed the intent of the subdivision xi (or xii in our proposed version) with respect to oil wells. Attached is proposed language to reflect this discussion which is highlighted in track changes and embedded in the draft proposal we circulated during our meeting.

Thanks,
Yvonne

THE WEST FIRM

Yvonne E. Marciano
677 Broadway - 8th Floor
Albany, New York 12207
Office: 518-641-0500
Direct: 518-641-0507
Fax: 518-615-0507
yem@westfirmlaw.com
www.westfirmlaw.com

DEC #6-08

AN ACT to amend the environmental conservation law, in relation to provisions in the oil, gas and solution mining law regarding statewide spacing for oil and gas wells

Field Code Changed

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Subparagraph 1 of paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to read as follows:

(1) "statewide spacing" means spacing units for gas or oil wells that are within ten percent of the following sizes, as applicable, unless another percentage is specifically stated:

Field Code Changed

(i) for Medina ~~pools~~ gas pools ~~and shale pools~~ at any depth, 40 acres for a vertical well and 160 acres for a horizontal well, with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(ii) for Onondaga reef or Oriskany gas pools at any depth, 160 acres for a vertical well and 320 acres for a horizontal well, with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(iii) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is between 4,000 and 8,000 feet deep, 320 acres with the

proposed productive section of the wellbore within the target formation no less than one-half mile from any other well in another unit in the same pool and no less than ~~1000~~ 1,000 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(iv) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is below ~~8000~~ 8,000 feet, within five percent of 640 acres with the proposed productive section of the wellbore within the target formation no less than one mile from any other well in another unit in the same pool and no less than ~~1500~~ 1,500 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(v) for all other gas pools where the majority of the pool is above the depth of 4,000 feet, 80 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(vi) for all other gas pools where the majority of the pool is 4,000 to 6,000 feet deep, 160 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(vii) for all other gas pools where the majority of the pool is 6,000 to 8,000 feet deep, 320 acres for a vertical well

with the wellbore within the target formation no less than ~~1000~~330feet from any unit boundary; [and]

(viii) for all other gas pools where the majority of the pool is below 8,000 feet, ~~within five percent of~~ 640 acres for a vertical well with the wellbore within the target formation no less than ~~1500~~330 feet from any unit boundary;

(ix) for all other gas pools at any depth, 640 acres for a unit that includes at least one horizontal well with the wellbore within the target formation no less than 330 feet from any unit boundary and a proposed spacing pattern for horizontal and/or vertical infill wells that may be modified based upon site specific information developed from the original wellbore;

(x) for oil pools in the Bass Island, Trenton, Black River, Onondaga reef or other oil-bearing reef at any depth, 40 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than 460 feet from any unit boundary;

(xi) for all other oil pools at any depth, the wellbore within the target formation shall be no less than 165 feet from any lease boundary; and

(xii) wells completed under a well permit issued pursuant to clauses (x) or (xi) of this subparagraph that do not produce

any oil; may not commence production of natural gas prior to establishing a spacing unit pursuant to applicable provisions of this title.

Deleted: only

Deleted: modification

Deleted: of the

§2. Paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to add new subdivisions (4) and (5) as follows:

(4) "Vertical well" means any wellbore that is not a horizontal well.

(5) "Horizontal well" means a wellbore drilled laterally at an angle of at least 80 degrees to the vertical.

§3. Subdivision 6 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

6. ~~An order establishing~~ Unless it is extinguished pursuant to subdivision 7 of this section, a spacing unit established by the department shall be binding upon all persons and their heirs, successors and assigns. Upon good cause shown, an order establishing a spacing unit or a spacing unit which conforms to statewide spacing may be modified by the department without conducting a hearing if a finding has been made that no facts are in dispute after all affected persons have been provided a reasonable opportunity to comment. If necessary, upon issuance of ~~a modified~~ an order which changes unit boundaries,

the well operator shall adjust the accounts for owners within the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties based thereon shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§4. This act shall take effect immediately.

**Jennifer Maglienti - Statewide Spacing**

**From:** "Marciano, Yvonne E." <yem@westfirmlaw.com>
**To:** jlhairie@gw.dec.state.ny.us
**Date:** 4/15/2008 6:23 PM
**Subject:** Statewide Spacing
**CC:** twest@westfirmlaw.com; kfsanfor@gw.dec.state.ny.us; bjfield@gw.dec.state...
**Attachments:** image001.jpg; 20080327 Counterproposal of Spacing Unit BillChesapeake_Legislative.doc

Jennifer,

As a follow-up to our meeting last month as well as discussions we have had with the legislature, we have prepared revised language to address three areas. First, we clarified subparagraph xii (former subparagraph xi from the Department's bill version) to clarify natural gas production from oil wells per our discussions during our March meeting. I previously forwarded this language to the Department in a prior email. In addition, given what was perceived as two issues of possible concern (drilling a horizontal well first, as opposed to a vertical well, to secure the proposed 640 acre spacing unit and the operator's commitment to its proposed development plan), we now have proposed language for both of these issues. I am therefore circulating a revised bill with these three areas of change highlighted in track changes.

We look forward to discussing this revised language with the Department.

~Yvonne

× Yvonne E. Marciano - The West Firm

DEC #6-08

AN ACT to amend the environmental conservation law, in relation to provisions in the oil, gas and solution mining law regarding statewide spacing for oil and gas wells

Field Code Changed

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Section 1. Subparagraph 1 of paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to read as follows:

(1) "statewide spacing" means spacing units for gas or oil wells that are within ten percent of the following sizes, as applicable, unless another percentage is specifically stated:

Field Code Changed

(i) for Medina ~~pools~~ gas pools ~~and shale pools~~ at any depth, 40 acres for a vertical well and 160 acres for a horizontal well, with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(ii) for Onondaga reef or Oriskany gas pools at any depth, 160 acres for a vertical well and 320 acres for a horizontal well, with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(iii) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is between 4,000 and 8,000 feet deep, 320 acres with the

proposed productive section of the wellbore within the target formation no less than one-half mile from any other well in another unit in the same pool and no less than ~~1000~~ 1,000 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(iv) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is below ~~8000~~ 8,000 feet, within five percent of 640 acres with the proposed productive section of the wellbore within the target formation no less than one mile from any other well in another unit in the same pool and no less than ~~1500~~ 1,500 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(v) for all other gas pools where the majority of the pool is above the depth of 4,000 feet, 80 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(vi) for all other gas pools where the majority of the pool is 4,000 to 6,000 feet deep, 160 acres for a vertical well with the wellbore within the target formation no less than ~~660~~330 feet from any unit boundary;

(vii) for all other gas pools where the majority of the pool is 6,000 to 8,000 feet deep, 320 acres for a vertical well

with the wellbore within the target formation no less than ~~1000~~330feet from any unit boundary; [and]

(viii) for all other gas pools where the majority of the pool is below 8,000 feet, ~~within five percent of~~ 640 acres for a vertical well with the wellbore within the target formation no less than ~~1500~~330 feet from any unit boundary;

(ix) for all other gas pools at any depth, 640 acres for a horizontal well with the wellbore within the target formation no less than 330 feet from any unit boundary and a development plan that includes a proposed spacing pattern for horizontal and/or vertical infill wells that may be modified based upon site specific information developed from the original wellbore and written commitment by the operator concerning implementation of the development plan;

Deleted: unit that includes at least one

(x) for oil pools in the Bass Island, Trenton, Black River, Onondaga reef or other oil-bearing reef at any depth, 40 acres, plus, if applicable, the number of acres calculated by multiplying the length in feet of any horizontal wellbore within the target formation by 1,320 and dividing the product by 43,560, with the wellbore within the target formation no less than 460 feet from any unit boundary;

(xi) for all other oil pools at any depth, the wellbore within the target formation shall be no less than 165 feet from any lease boundary; and

(xii) wells completed under a well permit issued pursuant to clauses (x) or (xi) of this subparagraph that do not produce any oil may not commence production of natural gas prior to establishing a spacing unit pursuant to applicable provisions of this title.

Deleted: only

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§2. Paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to add new subdivisions (4) and (5) as follows:

(4) "Vertical well" means any wellbore that is not a horizontal well.

(5) "Horizontal well" means a wellbore drilled laterally at an angle of at least 80 degrees to the vertical.

§3. Subdivision 6 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

6. ~~An order establishing~~ Unless it is extinguished pursuant to subdivision 7 of this section, a spacing unit established by the department shall be binding upon all persons and their heirs, successors and assigns. Upon good cause shown, an order establishing a spacing unit or a spacing unit which conforms to statewide spacing may be modified by the department without conducting a hearing if a finding has been made that no facts are in dispute after all affected persons have been

provided a reasonable opportunity to comment. If necessary, upon issuance of ~~a modified~~ an order which changes unit boundaries, the well operator shall adjust the accounts for owners within the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties based thereon shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§4. This act shall take effect immediately.

**From:** "West, Thomas S." <Twest@llgm.com>
**To:** "Alison Crocker" <ahcrocke@gw.dec.state.ny.us>, <ajlotter@gw.dec.state.n...
**Date:** 3/30/2005 4:01 PM
**Subject:** Proposed Legislation PowerPoint
**Attachments:** Outline of Proposed Legislation.ppt

**CC:** "Jo Ellen Diehl Yeary " <jyeary@TrianaEnergy.com>, "Jim McCulley " <jmcc...

Thanks for the meeting. Please distribute the PowerPoint to the Department attendees.

We look forward to hearing from you and working with you regarding these issues.

Thomas S. West, Esq.
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
99 Washington Ave., Suite 2020
Albany, New York 12210-2820
Direct Electronic Fax: (518) 431-8234
General Fax Number: (518) 626-9010
twest@llgm.com

# Outline of Proposed Legislation

New York State

Unitization and

Compulsory Integration

# Goals and Objectives

- Resolve Controversy
- Simplify Process
- Foster Natural Gas Exploration and Development

# Permit Process

- Well Permit Applications with Uniform Time Limits
- Complete Application Includes All Documents Presently Required, Plus:
  - Proposed Unit Configuration
  - Affirm Control of at Least 60% of Land
  - 1320' Minimum Well Spacing
  - Control of Drilling Rights Underlying Well Bore

# Permit Process, Continued

- Department Issues Well Permit
- If Operator Controls All Land Within Unit And Complies With Statewide Spacing, No Further Process Required
- If Operator Does Not Control All Land, Operator May Drill at Risk Or Await Outcome of Compulsory Integration Process

# Permit Process, Continued

- Hearing Scheduled Within 45 Days of Permit Issuance
- Notice to All Controlled and Uncontrolled Owners at Least 30 Days Prior to Hearing

# Permit Process, Continued

- Certified Mail Notice to All Controlled and Uncontrolled Owners in Unit
  - Controlled Owners Receive Notice of Compulsory Integration Proceeding
  - Uncontrolled Owners Receive Notice of Proceeding, Plus Full Offer to Participate Conforming to Statutory Requirements
- Newspaper Notice to All Persons Not in the Proposed Unit

# Permit Process, Continued

- Status of All Controlled and Uncontrolled Owners Determined at Hearing
- All Lands Within Unit Are Integrated Whether They Are Controlled or Uncontrolled
- Order Recorded Against All Owners Within Unit
- Binding Upon Current Owners, Successors And Assigns

# Permit Process, Continued

- Uncontrolled Owners Have Two Options:
  - Agree to Participate (Sign Agreement) And Pay Proportionate Share of Full Costs Upfront at or Prior to Hearing to Receive Participant's Proportionate Share of Production (8/8ths)
  - If Silent or If Uncontrolled Owner Chooses Not to Participate And Pay, Integrated With Royalty Interest Equal to Lowest Royalty Payable by Operator, but not Less Than 1/8$^{th}$

# Permit Process, Continued

- Costs Include:
  - All Well Costs
  - Plugging, Abandonment And Reclamation Costs
  - Fixed Percentage of Well Costs to Reflect Exploration Costs
- Participants Assume Full Liability Consistent With Simplified JOA

# Permit Process, Continued

- Transportation And Marketing:
  - At Election of Participant, Operator Transports And Markets on Behalf of Participant
  - Participant Responsible for Fees for Gathering, Transporting, Conditioning And Marketing Such Gas

# Permit Process, Continued

- Terms of Participation:
  - Modified 610 Agreement
  - Disclosure of Risks
  - No Right to Seismic or Other Proprietary Data
  - No Right to Share in Decisionmaking
  - Defines Liability

# Permit Process, Continued

- Unit Contests
  - Must Meet Substantive And Significant Test
  - No Right to Operator Data
  - If They Seek Working Interest, Must Declare, Execute and Pay or Post Financial Security to Participate at Issues Conference
  - Objector Must Give Notice to All Potentially Impacted Owners

# Permit Process, Continued

- Unit Contests, Continued:
  - In Camera Review of Operator Data By ALJ/Commissioner
  - ALJ Issues Order Regarding Payments Pending Outcome of Dispute
  - Final Order Is Binding Upon The World

# Landowner Protection

- Provision in Lease That This Is a Lease, Not a Sale, Containing Terms That Are Negotiable
- 3 Day Cooling Off Period
- Lease Must Disclose Whether the Agent Is Subject to a Code of Conduct And Any Dispute Resolution Mechanism Available to the Landowner

**From:** "West, Thomas S." <Twest@llgm.com>
**To:** "Alison Crocker" <ahcrocke@gw.dec.state.ny.us>, <ajlotter@gw.dec.state.ny.us>,

**From:** "West, Thomas S." <Twest@llgm.com>
**To:** "Alison Crocker" <ahcrocke@gw.dec.state.ny.us>, <ajlotter@gw.dec.state.ny.us>, <lisa.burianek@oag.state.ny.us>
**Date:** 5/27/05 4:01PM
**Subject:** Research Memo re Constitutionality of 3-Door Approach

Alison, as promised, attached is our research memorandum concerning the constitutionality of the three-door approach. This document addresses the entirety of the system, including that aspect of the system that does not pay any royalty to the fee owner of the oil and gas interests during the risk penalty phase.

We trust that this will resolve any concerns that you may have. To the extent necessary, we will make ourselves available to discuss these issues with you.

Thomas S. West, Esq.
LeBoeuf, Lamb, Greene, & MacRae, L.L.P.
99 Washington Avenue, Suite 2020
Albany, New York 12210-2820
(518) 626-9000 Ext. 307
Direct Electronic Fax: (518) 431-8234
General Fax Number: (518) 626-9010
twest@llgm.com



**CC:** "Yeary, JoEllen" <jyeary@TrianaEnergy.com>, "Henuset, Lydia" <LHenuset@talisman-energy.com>

LeBoeuf, Lamb, Greene & MacRae
L.L.P.
A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

99 Washington Avenue
Suite 2020
Albany, NY 12210-2820

May 27, 2005

To: Columbia Natural Resources

From: LeBoeuf, Lamb, Greene & MacRae, L.L.P.

RE: Compulsory Integration Legislation
Constitutionality of a "3-Door Approach"

## INTRODUCTION

You have asked us to evaluate the constitutionality of newly proposed legislation offering a "3-door approach" to compulsory integration under Article 23 of the Environmental Conservation Law ("ECL"). Specifically, the question is whether CNR's proposal - which provides three alternative options for uncontrolled interests to protect and realize their inchoate property rights – passes muster under the substantive due process and takings clauses of the State and Federal Constitutions. Our research indicates that the proposed 3-door approach is, most certainly, constitutionally valid, and any due process or takings challenge would fail.

The first option of the 3-door approach affords uncontrolled interests a full opportunity to participate up-front with the operator, proportionally sharing in costs and production. Whether viewing the mineral interest owner's alleged property right under the common law rule of capture (which is still valid in this State to the extent not abrogated by ECL Article 23) or the existing statutory scheme (which seeks to protect correlative rights), this option alone (i.e., without any other alternatives) fully satisfies substantive due process and takings requirements. The inclusion of two other options (i.e., risk penalty with working interest and burden-free royalty interest only)

to accommodate uncontrolled interests who choose not to participate transcends what is constitutionally required, since these options are not necessary to protect any vested property right.

In other words, to the extent that the mineral interest owner has a vested property right at all (which is questionable), that right, at most, is the right to have the *opportunity* to produce, or to share in production, on a reasonable and fair basis. The first option, standing alone, fully protects this interest, i.e., by providing the up-front opportunity to participate, sharing proportionally in the costs and benefits of the well. That additional alternatives are provided for uncontrolled interests who choose to forego this option does not, and cannot, detract from the proposal's constitutionality, since these additional options are not necessary to protect correlative rights or any other vested property right.

Discussed below, in turn, are (1) the details of the proposed 3-door approach; (2) the substantive due process and "takings" standard; and (3) analysis of the proposed 3-door approach under the analytical framework for due process and takings claims.

---

## I. CNR's PROPOSED 3-DOOR APPROACH FOR COMPULSORY INTEGRATION

The 3-door approach for compulsory integration proposed by CNR is as follows:

Option 1: Participate up-front, sharing proportionally (on a surface-acreage basis) in all costs and production; or

Option 2: Integrate as a 1/8$^{th}$ royalty interest (with no working interest), without any risk

penalty, costs or liability; or

Option 3: Integrate as a full 8/8$^{ths}$ working interest after the operator has recouped 400% of the costs of drilling and operation and without any royalty payment during the risk penalty pay out period.

Failure to make a timely election results in the uncontrolled interest's receiving Option 2 (1/8$^{th}$ royalty interest without any working interest).

## II. THE SUBSTANTIVE DUE PROCESS AND TAKINGS STANDARDS

The Fifth Amendment of the United States Constitution and Article I, § 7, of the New York State Constitution provide that private property cannot be taken without due process of law or just compensation. Specifically, "[t]he Fifth Amendment ... provides in relevant part that '[n]o person shall ... be deprived of ... property, without due process of law; nor shall private property be taken for public use, without just compensation.' The [Due Process and] Takings Clause[s] of the Fifth Amendment appl[y] to State action through the Fourteenth Amendment ... Article I, § 7 of the New York State Constitution [likewise] provides that '[p]rivate property shall not be taken for public use without just compensation.'" *Gazza v. New York State Dep't of Envt'l Conservation*, 89 N.Y. 2d 603, 610, n. 2 (1997), *cert. denied*, 522 U.S. 813 (1997).

State regulation satisfies substantive due process if it is reasonably related to a legitimate governmental objective. *N.Y. Coal. of Recyc. Enterprs., Inc. v. City of N.Y.*, 158 Misc.2d 1, 11 (N.Y. Cty 1992) (*citing Village of Belle Terre v. Boraas*, 416 U.S. 1 [1974]); *see also Richmond Boro Gun Club, Inc. v. N.Y. State Rifle & Pistol Ass'n, Inc.*, 97 F.3d 681, 688 (2d Cir. 1996).

As for takings, in essence, the takings clause seeks "to prevent the government from 'forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'" *Palazzolo v. Rhode Island*, 533 U.S. 606, 617-618 (2001). The clearest sort of taking is a physical invasion – i.e., when the government encroaches upon or occupies private land for its own proposed use and "requires an owner to suffer a permanent physical invasion." In such instances, "however minor [the invasion,] [the government] must provide just compensation." *Lingle v. Chevron U.S.A., Inc.*, ___ S. Ct. ___, 2005 WL 1200710, *7 (May 23, 2005); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982); *Palazzolo*, 533 U.S. at 617.

The other type of taking occurs through governmental regulation that limits the uses to which property may be put. "'[W]hile property may be regulated to a certain extent, if a regulation goes too far it will be recognized as a taking.'" *Palazzolo*, 533 U.S. at 617 (*quoting Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 [1922]). It is only the latter type of taking that is potentially at issue here.[1]

The ultimate determination of whether governmental regulation "goes too far" and works a taking involves a multi-pronged inquiry. As a preliminary matter, a vested property interest must exist before it can be "taken." *Gazza*, 89 N.Y.2d at 613 (*citing U.S. v. Willow Riv. Co.*, 324 US 499, 502-503); s*ee also Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027 (1992) (discussing the "logically antecedent inquiry" to be made "into the nature of the owner's estate [to see if] the proscribed use interests were [ ] part of his title to begin with"). Thus, the

[1] Importantly, "[a] landowner who claims that land regulation has effected a taking of his property bears the heavy burden of overcoming the presumption of constitutionality that attaches to the regulation and of proving every element of his claim beyond a reasonable doubt." *de St. Aubin v. Flacke*, 68 N.Y.2d 66, 76 (1986); *see also Gazza*, 89 N.Y.2d at 610.

takings analysis begins with a search into the "bundle of rights" and concomitant obligations contained in a prospective plaintiff's title. *Kim v. City of N.Y.*, 90 N.Y.2d 1, 6 (1997), *cert. denied*, 522 U.S. 809 (1997). In the absence of superseding federal law, the State defines the rights and obligations that constitute property. *Lucas,* 505 U.S. at 1030; *Kim*, 90 N.Y.2d at 5-6. Accordingly, the threshold inquiry is whether, in light of the "restrictions that background principles of the state's law of property and nuisance already place upon land ownership," the plaintiff ever possessed the property interest alleged to be taken by the challenged governmental action. *Lucas*, 505 U.S. at 1027-1030; *see also Lingle*, 2005 WL 1200710, *7; *Palazzolo*, 553 U.S. at 626-630. Only if the claimed property interest "inhered in the [owner's] title itself" will the court continue with the analysis to determine if there is a compensable taking. *Lucas*, 505 U.S. at 1027-1032.[2]

If a vested property interest exists, the next part of the takings analysis focuses on whether there is a *per se* regulatory taking: namely, whether the regulation "completely deprives an owner of 'all economically beneficial us[e]' of her property. *Lingle*, 2005 WL 1200710, *7;

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[2] This does not mean, however, that the post-regulation acquisition of title is fatal to a takings claim. Rather, the takings claim is constrained only by those "'restrictions that background principles of the state's law of property and nuisance already place upon land ownership'." *Palazzolo*, 533 U.S. at 629 (*quoting Lucas*, 505 U.S. at 1029, and rejecting a rule that would make *any* State enactment a "background principle" that would bar a takings claim at the outset). While there may be circumstances in which a state enactment would be deemed to constitute a "background principle" of state law, that will not always be so, and the U.S. Supreme Court in *Palazzolo* failed to elaborate on what those circumstances would be. However, what is clear is that "a regulation that would be otherwise unconstitutional in the absence of compensation is not transformed into a background principle of a state's law by mere virtue of the passage of title." *Palazzolo*, 533 U.S. at 629-630. In this regard, the U.S. Supreme Court's articulation in *Palazzolo* narrows the broader reading of *Lucas* advanced by the New York State Court of Appeals. *Contrast Palazzolo*, 533 U.S. at 626-630 (rejecting an interpretation of *Lucas* that would render all State enactments predating acquisition of title as restrictions on title that would bar a takings claim), *with Kim*, 90 N.Y.2d at 6-9 (stating that statutory law is a part of the "background principles" of State law that limit a plaintiff's title and, hence, property interest), *Gazza*, 89 N.Y.2d at 614 (stating that a "promulgated regulation forms part of the title to property as a preexisting rule of State law," but also finding that no taking had occurred under traditional takings analysis), *Anello v. Zoning Bd. of Appeals of Vill. of Dobbs Ferry*, 89 N.Y.2d 535 (holding that because petitioner acquired her property after enactment of steep-slope ordinance, denial of variance did not deprive her of any property interest).

*see also Palazzolo*, 533 U.S. at 617; *Smith v. Town of Mendon*, 4 N.Y.3d 1, 9, 13-14 (2004); *Bonnie Briar Syndicate, Inc. v. Town of Mamaroneck*, 94 N.Y.2d 96, 108 (1999), *cert. denied*, 529 U.S. 1094 (2000); *see also Gazza*, 89 N.Y.2d at 610 (a party can establish an unconstitutional taking by showing that the property, as restricted, "has lost its economic value, or all but a bare residue of it").

If the regulation falls short of eliminating "all economically viable use" of the property, there is no "categorical taking." *Lingle*, 2005 WL 1200710, *7.[3] However, the deprivation may still qualify as a taking and, hence, be compensable under the standards set forth in *Penn Central Transp. Co. v. New York City,* 438 U.S. 104 (1978). *Lingle*, 2005 WL 1200710, *7.[4] To make this determination, the court considers "a complex of factors including the regulation's economic effect on the landowner, the extent to which the regulation interferes with reasonable investment-backed expectations, and the character of the governmental action." *Palazzolo*, 533 U.S. at 617-618 (*citing Penn Central Transp. Co.*, 438 U.S. at 124); *see also Lingle*, 2005 WL 1200710, *7; *Lucas,* 505 U.S. at 1019-1020, n.8; *Smith*, 4 N.Y.3d at 9; *Gazza,* 89 N.Y.2d at 616-618.

The court considers and weighs these factors on a case-by-case basis. *Lucas*, 505 U.S. at 1015; *Gazza*, 89 N.Y.2d at 617. Importantly as to the first factor, the "'mere diminution in the

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[3] Prior to *Lingle,* the courts, including the New York State Court of Appeals, recognized another category of *per se* takings: regulation that did not "substantially advance" a legitimate governmental interest - i.e., was not "reasonably related to the legitimate governmental purpose" that it was meant to serve. *See Smith*, 4 N.Y.3d at 9, 14; *Bonnie Briar*, 94 N.Y.2d at 108; *Manocherian v. Lenox Hill Hosp.*, 84 N.Y.2d 385, 392 (1994), *cert. denied*, 514 U.S. 1109 (1995). This prong of the takings analysis arose from language in *Agins v. City of Tiburon*, 447 U.S. 255 (1980) that seemingly mingled due process and takings considerations. *Lingle*, 2005 WL 1200710, *9. In *Lingle,* the U.S. Supreme Court "correct[ed] course," holding that the "'substantially advances' formula is not a valid takings test, ... and has no proper place in [ ] takings jurisprudence." *Id.* at * 14.

[4] There is another special category of takings – land use exactions. "Exactions" are defined as "'land-use decisions conditioning approval of development on the dedication of property to public use.'" *Smith,* 4 N.Y.3d at 10, *quoting City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702 (1999). This type of taking (not at issue here) is governed by the standards set forth in *Dolan v. City of Tigard*, 512 U.S. 374 (1994) and *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987). *Lingle*, 2005 WL 1200710, *7, 12-13.

value of property, however serious, is insufficient to demonstrate a taking'." *Gazza*, 89 N.Y.2d at 618; *see also Penn Cent. Transp. Co.,* 438 U.S. at 131 (cases "uniformly reject the proposition that diminution in property value, standing alone, can establish a 'taking'"). Moreover, balancing of the *Penn Central* factors must occur in light of the "background principles of the state's law of property and nuisance" predating plaintiff's acquisition of title, since these principles inform both the nature of plaintiff's property interest and the "reasonableness" of plaintiff's investment-backed expectations. *See Palazzolo*, 533 U.S. at 632-636; *see also Lucas,* 505 U.S. at 1027-1030; *Gazza*, 89 N.Y.2d at 618 (reasonable "[e]xpectations may also be examined in light of the level of interference with permissible uses of the land by the subject regulation," *citing Penn Centr. Transp. Co.*, 438 U.S. at 136). Finally, as to the character of the regulation, the inquiry of whether the governmental action "amounts to a physical invasion or instead merely affects property interests through 'some public program adjusting the benefits and burdens of economic life to promote the common good' -- may be relevant in discerning whether a taking has occurred." *Lingle*, 2005 WL 1200710, *7.

Under this analytical rubric, CNR's 3-door approach indisputably accords with all constitutional requirements; thus, any substantive due process or takings claim would fail.

## III. CNR'S PROPOSED 3-DOOR APPROACH IS CONSTITUTIONALLY VALID

The 3-door approach advanced by CNR fully satisfies all constitutional requirements and does not effect a taking of the mineral interest owner's property rights. First, the proposed approach advances a number of legitimate state interests, thus making it impervious to substantive due process attack. Point IIIA, *infra.*

As for the takings inquiry, at the outset, it must be recognized that under the common law

rule of capture, mineral rights owners have no vested property right to any specified amount of production. Thus, a takings claim cannot legitimately be premised on such an alleged deprivation. Point IIIB, *infra.*

Even if a vested property interest is deemed to exist, the proposal, nonetheless, does not effect a taking. Point IIIC, *infra.* If a vested property interest exists at all, at most, that interest is the *opportunity* to share equitably in production (i.e., by also sharing the costs associated with production); the first option of the 3-door approach provides that opportunity, thus defeating any takings claim. Point IIIC(1), *infra.* That additional options are provided to nonconsents who elect not to participate up-front cannot render what is already constitutional unconstitutional – i.e., since these additional options transcend what is necessary to protect the subject property interest. *Id.* Finally, by virtue of the first option, the full value of the nonconsent's property interest is realized; thus, the proposal (which allows, but does not mandate, any particular alternative options) does not at all diminish the value of the nonconsent's property interest or interfere with "reasonable" investment-backed expectations. Point IIIC(2) & (3), *infra.* Accordingly, there is no taking, and the 3-door approach passes muster under the Federal and State Constitutions.

### A. The 3-Door Approach Is Reasonably Related To Legitimate Governmental Objectives And, Thus, Satisfies Substantive Due Process Requirements

State oil and gas regulation generally, and the 3-door approach specifically, are within the state's police powers and are reasonably related to a number of legitimate governmental interests.

Significantly, oil and gas regulations (including compulsory integration provisions) have been upheld against constitutional attack and found to be reasonably related to the legislative goals of promoting development, protecting correlative rights, and preventing waste. In the

plethora of constitutional challenges that have been brought over the decades, the United States Supreme Court and the states' high courts have uniformly recognized that such regulation falls within the states' police powers and advances these legitimate governmental objectives. *E.g.*, *Ohio Oil Co. v. Indiana,* 177 U.S. 190, 210-212 (1900) (rejecting due process challenge to compulsory pooling provisions and upholding state's police power to regulate correlative rights of landowners and leaseholders in common source of supply),[5] *Patterson v. Stanolind Oil & Gas Co.*, 77 P.2d 83, 88-90 (Okla. 1938) ("[t]he cases which uphold the power of the state to prevent the depletion of a common source of supply of gas and oil by the regulation of production are numerous. The exercise of such power has also been upheld under provisions of our own state Constitution ... Thus, ... it is well established that the police power of the state extends to protecting the correlative rights of owners in a common source of oil and gas supply and this power may be lawfully exercised by regulating the drilling of wells ... and distributing the production thereof among the owners of mineral rights ..."), *appeal dismissed*, 305 U.S. 376, 379 (1939),[6] *Hunter Co., Inc. v. McHugh*, 11 So.2d 495, 502-506 (La. 1942) (rejecting constitutional challenge, relying on *Ohio Oil Co., supra*, and *Patterson, supra*), *appeal dismissed,* 320 U.S. 222, 227 (1943),[7] *Sylvania Corp. v. Kilborne*, 28 N.Y.2d 427 (1971) (stating

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[5] *Ohio Oil Co.* 177 U.S. at 210 (also stating "...[i]t follows from the essence of their right [in a common source of supply] and from the situation of the things as to which it can be exerted, that the use by one of his power to convert a part of the common fund to actual possession may result in an undue proportion being attributed to one of the possessors of the right to the detriment of the others, or by waste of one or more to the annihilation of the rights of the remainder. Hence it is that the legislative power ... can be manifested for the purpose of protecting all the collective owners, by securing a just distribution ... of their privilege to reduce to possession, and to reach the like end by preventing waste. Viewed, then, as a statute to protect or to prevent the waste of the common property of the surface owners, the law ... is a statute protecting private property and preventing it from being taken by one of the common owners without regard to the enjoyment of the others...").

[6] *Patterson,* 305 U.S. at 378 (dismissing appeal for lack of a substantial federal question, but citing approvingly the agency's findings that the integration order would permit the "greatest ultimate recovery of oil, [ ] would best conserve reservoir energy, and would protect the relative rights of the leaseholders and royalty owners in [the] common source of supply").

"[t]here can be no doubt as to the constitutionality of this legislation [referencing compulsory integration provisions of the Conservation Law, the precursor to the compulsory integration provisions of ECL Article 23];" citing numerous cases from other states and noting the legislative goals of promoting development, preventing waste and protecting correlative rights).

In accord with this precedent, the proposed 3-door approach is indisputably within the state's police powers and serves these legitimate objectives. Option 1 clearly protects correlative rights, i.e., by affording all mineral interest owners an up-front opportunity to participate and share proportionally in the benefits (and burdens) of well development. *See Bennion v. ANR Prod. Co.*, 819 P.2d 343, 348 (Utah 1991).

Waste is prevented as it has been since the initial enactment of ECL Article 23, i.e., through the statute's well spacing and permitting requirements (which would remain unchanged under the proposed amendment). *See generally* ECL § 23-0501; *see Sylvania*, 28 N.Y.2d at 433 (noting, *inter alia,* the spacing restrictions in the precursor to ECL Article 23; stating "[m]anifestly, this regulatory legislation is designed 'to prevent waste....'").

The development goal is promoted by Option 1, which requires owners to share proportionally in costs (if they want a working interest free of a risk penalty). *See Bennion,* 819 P.2d at 348-349. In lieu of that, the alternative options (i.e., [1] risk penalty and working interest [without royalty interest], and [2] royalty interest [without risk penalty, liability, or working interest]) further the development goal by providing an incentive for parties to participate in drilling and, barring that, compensating the operator for the risks associated with development.

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[7] *Hunter Co., Inc.*, 320 U.S. at 227 (dismissing appeal for want of substantial federal question, but stating "[w]e have held that a state has constitutional power to regulate production of oil and gas so as to prevent waste and to secure equitable apportionment).

*See Bennion*, 819 P.2d at 346-347 ("[a] nonconsent penalty clearly protects the participating parties by compensating them for the risk they assume in drilling the well ..."); *id.* at 349 (stating "the [risk] penalty provides an incentive for parties to participate in drilling, resulting in increased production consistent with the public policy of this state").

Accordingly, the 3-door approach indisputably satisfies substantive due process requirements.

### B. In New York State, There Is No Vested Property Right To Any Specific Amount Of Production; Therefore, A Takings Claims Premised On Such An Alleged Deprivation Is Wholly Inappropriate At The Outset

As noted, the takings analysis begins with the threshold inquiry of whether the plaintiff has a vested property interest in what he claims is being deprived by the governmental action. Quite importantly, in New York State, no landowner or mineral deed owner has a vested property right in the production underlying, or attributable to, his acreage. This renders takings claims – alleging regulatory deprivation of a specified amount of production (or the value of that production) – fatally flawed from the outset.

More specifically, under New York's common law, a mineral deed owner has no vested property right in a set amount of production from the common source of supply. This is so because, under the rule of capture, oil or gas is not "owned" until reduced to possession. *See Envirogas, Inc. v. Chu*, 114 A.D.2d 38, 41 (3d Dep't 1986), *affd,* 69 N.Y.2d 632 (1986) (*citing Wagner v. Mallory*, 169 N.Y. 501 [1902]). Thus, under the common law, merely having a mineral rights deed or lease, or being a landowner of acreage overlying the oil/gas reservoir, does not in any way accord the holder of such interest a vested right in any (let alone a specified amount of) production.

ECL Article 23 modifies the rule of capture only to the narrow extent specified by the statutory language. *Caflisch v. Crotty*, 2 Misc.3d 786 (Sup. Ct., Chemung Cty, 2003). Significantly, nothing in the statutory language accords a landowner or mineral deed holder a vested property right in any portion of production. *See generally* ECL § 23-0901(3); DEC Declaratory Ruling 23-14. Thus, under New York law (be it the common law or the existing statutory law), there is no vested property right in a specified amount of production; therefore, there can be no legitimate takings claim premised on being deprived of a specified amount of production. *See Patterson*, 77 P.2d at 89.

Notably, the Supreme Court of Oklahoma recognized as much, quite deftly articulating the inapt nature of takings claims relative to state regulation of oil and gas production where the rule of capture applies under the common law:

> "... [P]laintiff's mineral deed did not grant him the benefit, use, or possession of any definite amount of minerals nor the right to reduce any certain amount of minerals to possession, but only gave him an ownership in the oil and gas that might be captured or reduced to possession, and since the right to capture from a common source of supply may be limited or restricted by the state, it may be said that such a grant can confer no right or title in property that is not already subject to being limited, restricted, or modified by the state's said power. The extent of private contract in such matters being at all times subject to limitation by the inherent police power of the state, any muniment of title is impotent to assume or convey any property right in the common source of supply superior to or entirely independent of said sovereign power. Thus, ... the lawful exercise of the state's power to protect the correlative rights of owners in a common source of supply of oil and gas is not a proper subject for the invocation of the provisions of either the state or federal Constitution which prohibit the taking of property without just compensation or without due process of law ... As we view it, the property here involved has not been taken or confiscated; its use has merely been restricted and qualified. This does not violate the due process clause of either Constitution. And this would be true even though the plaintiff were able to prove a distinct loss to himself through

> the operation of the statutes putting said police power into force and effect." *Patterson*, 77 P.2d at 89.

Thus, whether viewed under the "background principles" of New York State's property law (i.e., the common law rule of capture) or the current statutory law (ECL Article 23), there is no right to a specified amount of production. *See Palazzolo*, 533 U.S. at 626-630; *Lucas,* 505 U.S. at 1027-1032; *Kim*, 90 N.Y.2d at 6. Therefore, a takings claim alleging such a deprivation (i.e., by virtue of the proposed 3-door approach) is simply inappropriate due to the lack of any such vested property right at the outset. Accordingly, a takings challenge to the 3-door approach should fail without proceeding any further in the analysis.

### C. Even If A Vested Property Right Were Deemed To Exist, the Proposed 3-Door Approach Does Not Work A Taking

#### 1. To the extent a vested property right exists, that right is limited to the *opportunity* to produce, or share in production, on an equitable basis; Option 1 fully protects this right, thus defeating any takings claim

To the extent that a vested property interest may be deemed to exist, at most that right is limited to the *opportunity* to produce (reduce the oil/gas to possession), or share in production, on a just and reasonable basis. *See Ohio Oil Co.,* 177 U.S. at 209-210; *Anderson v. Corporation Comm'n.*, 327 P.2d 699, 703-704 (Okla. 1957). As already discussed, under the rule of capture, a landowner or mineral deed owner does not actually own subsurface oil or gas; it is only after the resource is reduced to possession that ownership attaches. *Wagner v. Mallory*, 169 N.Y. 501, 505 (1902); *Envirogas, Inc.*, 114 A.D.2d at 41, 42 ("ownership of land does not entail ownership of gas"), *aff'd sub nom., National Fuel Gas Distribution Corp. v. Chu*, 69 N.Y.2d 632 (1986). Thus, under the common law, each landowner had "the right to drill wells on his own land and take from the pools below all the gas and oil that he may be able to reduce to possession,

including that coming from land belonging to others ... ." *Champlin Refining Co. v. Corporation Comm'n*, 286 U.S. 210, 233 (1932); *Patterson*, 77 P.2d at 87-88; *see also Wagner*, 169 N.Y. at 505. This often resulted in waste and a disparate distribution of production among landowners overlying the common source of supply.

Thus, the states (including New York) enacted oil and gas production regulations in an attempt to prevent such waste (while fostering responsible development). Thereby, they developed a qualified theory of ownership - "correlative rights" - pursuant to which each mineral interest owner would have the opportunity to produce, or share in production, on a just and equitable basis. *See Sylvania*, 28 N.Y. at 433, *quoting Wood Oil Co. v. Corporation Comm'n*, 268 P.2d 878, 884 (Okla. 1953); DEC Declaratory Ruling 23-14, at 12. This state-created, qualified theory of ownership is reflected in the statutes and/or regulations of a number of states, including New York, which define "correlative rights" as the "opportunity" of each owner in a pool to produce, or share in production, from the pool on a reasonable and fair basis. *See generally,* Kramer and Martin, The Law of Pooling and Unitization, § 5.01(4); *see also* 6 NYCRR § 550.3(ao); DEC Declaratory Ruling 23-14, at 12-13.

Importantly, however, "[h]aving correlative rights ... does *not* mean that each owner is guaranteed to recover a proportionate share of the oil or gas in the reservoir, but only that each owner shall be afforded the opportunity to produce or to share in production on a reasonable and fair basis. The point bears repeating for emphasis: The correlative right is having the *opportunity* to produce, not having a guaranteed share of production. Once the state has afforded that opportunity, it has protected the correlative rights of a party; it need not ensure a share of production to a party." Kramer and Martin, The Law of Pooling and Unitization, § 5.01(4), at 5-

16 (emphasis in original); *see also* DEC Declaratory Ruling 23-14, at 13.

Given the nature of the property interest at issue (i.e., at most, the opportunity to produce), the 3-door approach does not, and cannot, effect a taking. Option 1 quite explicitly provides all mineral interest owners with an opportunity to share proportionally in production on a just and equitable basis (i.e., by assuming a proportionate share of the costs associated with production). This option fully protects the only possible vested property interest that the mineral interest owner has, and that ends the takings inquiry. *See Anderson*, 327 P.2d at 702-703 (rejecting fee owner's claim that Commission order authorizing leasehold owner to drill a well effected a taking; finding no taking where Commission's order granted the fee owner the right to participate in production from the well by paying a proportionate share of the drilling and completion costs of the well), *appeal dismissed*, 358 U.S. 642 (1959).

Notably, the high courts of other states have repeatedly rejected takings claims, and upheld administrative orders, where the complainant mineral interest owner was accorded the opportunity to participate in production (by sharing proportionally in costs) but declined that opportunity. *See, e.g., Anderson,* 327 P.2d at 702-703 ("[t]he order complained of did not constitute a taking of property of Anderson in any manner. It granted him the right to participate in the production ... but on condition that certain requirements were met ... That he was allowed to share in the production or receive a bonus instead of that participation was a grant to him at the expense of [the operator] merely because of the recognition of correlative rights..."); *Bennion*, 819 P.2d at 348 (rejecting takings claim premised on order which awarded operator a risk penalty when complainant declined to participate and pay a share of drilling costs associated with new well; stating "Bennion confuses the concept of a vested property right with an

obligation to pay a share of drilling costs. The modification of the 1981 order and imposition of a nonconsent penalty did not divest Bennion of any property right. He still owns a mineral interest and has a right to a royalty ... Any right he has to a statutory share of production as a nonconsenting working interest owner is, however, subject to the payment of a share of costs and expenses, including a share of risk compensation which results from his election not to contribute to the drilling costs. Bennion had the right to participate -- or not participate -- in the second well on condition that certain requirements were met. That he had the option of participating in the costs of drilling or being subject to a penalty was a grant to him ... because of the statute's recognition of correlative rights ...").

Finally, that other alternatives are provided to those who choose not to participate up-front in production cannot render what is already constitutional (by virtue of Option 1) unconstitutional. Indeed, as alluded to above, the courts of other states have consistently upheld orders issued pursuant to statutes offering 2- or 3-door approaches to mineral interest owners to participate upfront, proportionally sharing in costs and production; or, in lieu of that participation, receive a royalty interest (with or without acreage bonuses), or incur a risk penalty in order to participate as a working interest owner. *See, e.g., Kohlman*, 263 N.W.2d 674, 675-676, 678-679 (S.D. 1978) (upholding compulsory order offering two options: [1] prepay a proportionate share of estimated drilling costs, or [2] incur 100% risk penalty, exclusive of a royalty not to exceed 1/8$^{th}$ of production); *Texas Oil & Gas Corp. v. Rein*, 534 P.2d 1280, 1281 (Okla. 1974) (upholding pooling order offering landowner two choices: [1] "an election to participate in the well by agreeing to pay [ ] proportionate share of the actual cost of the well"; or [2] "receive a bonus of $25 per acre plus a royalty of 1/16 of 7/8 in excess of the normal 1/8

royalty;" rejecting appellant's contention that he should have been afforded the opportunity to participate as a working interest owner by paying his proportionate share of costs out of production from the well); *Wakefield v. State of Oklahoma*, 306 P.2d 305 (Okla. 1957) (upholding compulsory pooling order offering two options: [1] up-front participation, or [2] $35 per acre lease bonus);[8] *Superior Oil Co. v. Oklahoma Corp. Comm'n*, 242 P.2d 454 (Okla. 1952) (upholding order offering 2-door approach: [1] pay costs up front within 15 days of order or post a bond for the amount, or [2] sell lease for $500 per acre); *Youngblood v. Seewald*, 299 F.2d 680, 681 (10th Cir., Okla., 1961) (upholding order providing two options: [1] "participate in the working interest in said well by paying [ ] proportionate part of the cost of drilling and completing the [s]ame, or furnishing satisfactory evidence for the payment thereof, within 15 days ...," or [2] "... be paid the sum of $50.00 per acre, or an override of 1/8$^{th}$ of 8/8$^{ths}$, as mineral compensation in lieu thereof"); *see also Bennion, supra; Anderson, supra.*

Accordingly, the proposed 3-door approach complies with all constitutional strictures, and there is no taking. *Supra; see also Columbia Natural Resources, LLC*, Order of Virginia Gas and Oil Board for Forced Pooling of Interest in a Drilling Unit Encompassing Well Number 24540 Located in Buchanan County, Virginia, Docket No. VGOB-04/08/17-1327 (eff. September 21, 2004), ¶ 9 (offering the following 3-door approach: [1] participate in well development and operation by paying a proportionate share of actual and reasonable costs; [2] accept a cash bonus of $5.00 per net mineral acre from issuance of the order and continuing annually until commencement of production and, thereafter, a 1/8$^{th}$ royalty from net proceeds

[8] *Id.* at 308 ("[t]he Corporation Commission is authorized to fix the proportionate share of the cost of drilling and completing an oil and gas well to be paid by an owner of an undivided part interest in the leasehold estate in a drilling unit and order such owner to elect to pay the same or to accept a fixed sum per acre as a bonus for a lease and to further order that, if the election is not made within a fixed time, it be presumed that he has elected to take the bonus for a lease"; citing *Anderson*, 327 P.2d 699).

[proceeds minus post-production costs]; or [3] obtain a working interest [without royalty interest] after the well operator has recouped 300% of costs for a leased interest or 200% of costs for an unleased interest).

### 2. The 3-door approach does not diminish, let alone deprive, mineral interest owners of the value of their property interests; thus, there can be no taking

The 3-door approach does not, in any respect, diminish the value of the mineral interest owner's property interest, let alone work a total deprivation of all economic value. The "property interest" at issue is solely having the opportunity to produce or share equitably in production. Option 1 provides that very opportunity, and, thus, the full value of the mineral interest owner's property interest is realized. Importantly, where the mineral interest owner makes the conscious choice to forego that opportunity (i.e., and takes no action to participate in capturing the resource), it is she who has affected the "value" of her property interest – which, under the common law, would effectively be zero.[9] That notwithstanding, the 3-door approach provides two additional options – (1) full working interest, after 400% cost recoupment to the operator; or (2) 1/8$^{th}$ burden-free royalty interest. In either event, the mineral interest owner obtains substantial remuneration above and beyond the "value" of its property interest (i.e., the opportunity to recover the resource, which opportunity the mineral interest owner chose to forego). Therefore, the 3-door proposal creates *no* diminution at all in the "value" of the mineral interest owner's property interest, and, thus, there can be no taking.

### 3. The 3-door approach accords with reasonable investment-backed expectations

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[9] Under the common law rule of capture, the mineral interest owner who does nothing and fails to reduce the resource to possession does not "own" anything. Accordingly, under the common law, such inaction effectively eliminates the monetary value of the owner's property interest - since the unrecovered oil and gas is not owned and, hence, has no value to the owner.

The proposed 3-door approach also fully accords with the mineral interest owner's reasonable investment-based expectations. Where the mineral interest owner takes no action to qualify for a permit, does not voluntarily integrate its interest, and consciously chooses to forego the opportunity to participate up front (i.e., by sharing proportionally in the costs of well development, in exchange for a proportionate share of production as a working interest owner), there can be no reasonable expectation in any part of that production. *See Anderson*, 327 P.2d at 702-703, *supra*; *Bennion*, 819 P.2d at 348, *supra*. That notwithstanding, the proposal nonetheless provides valuable alternatives to the nonconsent: a burden-free, cost-free 1/8$^{th}$ royalty interest, or a full working interest after 400% cost recoupment. These alternatives spare the mineral interest owner the colossal costs, risks and investments involved in well development but, nonetheless, provide significant remuneration. Therefore, being afforded such alternatives more than satisfies what should be the mineral interest owner's "reasonable" investment-backed expectation. *See Bennion*, 819 P.2d at 348 ("...[W]here, as in this case, the nonconsenting party is not only given a royalty from production but is also given the opportunity to participate in the drilling, the subsequent imposition of a nonconsent penalty constitutes a valid exercise of the police power"). Accordingly, there is no taking on the face of this proposal.

**4. Under the 3-door approach, there can be no instance where the fee owner has a legitimate takings claim, even if the well fails to reach pay out**

As already discussed, under the 3-door approach, all mineral interest owners (be they fee owners or lessees) have the opportunity to participate in well development and equitably share in production (i.e., by sharing proportionally in expenses). This option fully protects the only possible vested right that a mineral interest owner has. Importantly, there is no vested property

right by anyone in any specific amount of production or associated remuneration. In other words, there is no vested right to any specific amount of money associated with production (whether by virtue of a royalty interest or working interest).

With this backdrop, two specific scenarios bear mentioning. The first involves a fee owner who elects to be carried under Option 3 (working interest after 400% cost recoupment), and the well never reaches pay out. The second involves a fee owner who leases his mineral rights to a third party who elects to be carried under Option 3, and the well never reaches payout.

In the first scenario, the fee owner receives nothing: (1) the well never reaches payout, thus eliminating any remuneration associated with the working interest; and (2) there is no royalty being paid during the cost recoupment/risk penalty period. This potentiality does not, however, give rise to a legitimate takings claim. Again, the takings analysis begins with identifying a vested property right – and there is no vested property right in a specified amount of production or the monetary value associated therewith. The fee owner had the opportunity to participate equitably in production (under Option 1), and that is all that is required under the Takings Clause. Having chosen to forego that opportunity or the opportunity for the risk-fee royalty interest, the fee owner cannot raise a legitimate constitutional argument because he is not satisfied with the unpredictable results of his own election. In short, the Takings Clause is not a guarantor to the fee owner of mineral exploration or the particular alternative that he elected.

The second scenario also does not give rise to a valid takings claim. In the second scenario, the fee owner voluntarily leases to a third party, transferring his oil and gas rights. Thus, the private contract (and not the Takings Clause) governs whatever remuneration is due to the fee owner. Having contracted away his oil and gas rights to another and allowing that person

to make the election, the fee owner is subject to that election by reason of privity of contract. Accordingly, the fee owner would not have standing to assert a takings claim in the event the well failed to reach payout. The fee owner's recourse would be limited to contractual remedies, governed by the contract voluntarily executed by the parties.

In sum, in neither instance would a takings claim be successful. The 3-door approach affords all mineral interest owners the "opportunity" to equitably produce or share in production, and that is all the Takings Clause requires.

## CONCLUSION

The proposed 3-door approach fully complies with the due process and takings requirements of the State and Federal Constitutions. The proposal is plainly "reasonably related" to a host of legitimate state interests, thus satisfying substantive due process requirements. As for takings, to the extent there is any vested property interest at all on which to premise a takings claim, that right is limited to the opportunity to produce, or share in production, on an equitable basis. Option 1 provides that opportunity, thus, fully protecting the subject property interest. That ends the takings inquiry. The other alternative options provided under the proposal are not necessary to satisfy constitutional requirements; thus, they cannot detract from the proposal's constitutional propriety. From a constitutional perspective, this proposal is no different in substance from those of other states that have been repeatedly upheld as valid exercises of the police power and constitutionally firm. Accordingly, the proposal satisfies all constitutional strictures.

DRAFT
May 14, 2008
DEC #6-08

AN ACT to amend the environmental conservation law, in relation to provisions in the oil, gas and solution mining law regarding statewide spacing for oil and gas wells

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Subparagraph 1 of paragraph b of subdivision 1 of section 23-0501 of the environmental conservation law, as amended by chapter 386 of the Laws of 2005, is amended to read as follows:

(1) "statewide spacing" means spacing units for gas or oil wells that are within ten percent of the following sizes, as applicable, unless another percentage is specifically stated:

(i) for Medina [polls] gas [and shale] pools at any depth, 40 acres with the wellbore within the target formation no less than [660] 460 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 460 feet from any unit boundary;

Comment [ 1]: Industry suggests 330 to allow infill wells.

(ii) for Onondaga reef or Oriskany gas pools at any depth, 160 acres with the wellbore within the target formation no less than 660 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure

Comment [ 2]: Insert pinnacle.

written commitment from the well operator to drill infill wells pursuant to subdivision 4 of section 23-0503, with all horizontal infill wells in the unit to be drilled from a common well pad within three years of the date the first well in the unit commences drilling, up to 640 acres with the initial horizontal wellbore(s) within the target formation approximately centered in the spacing unit and no wellbore in the target formation less than 330 feet from any unit boundary;

(vii) for shale gas pools at any depth, for a horizontal well outside any previously established spacing unit and in the absence of a written commitment from the well operator to drill infill wells pursuant to subdivision 4 of section 23-0503, 40 acres with the wellbore within the target formation no less than 330 feet from any unit boundary plus the number of additional acres necessary and sufficient to ensure that the wellbore within the target formation is not less than 330 feet from any unit boundary;

(viii) for all other gas pools where the majority of the pool is above the depth of 4,000 feet, 80 acres with the wellbore within the target formation no less than [660] 460 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 460 feet from any unit boundary;

**Comment [ 6]:** What will be the acceptable number of infill wells deemed necessary for the operators to commit to as per the "written commitment" language. What is the significance of this language since it does not appear in any of the other subparagraphs except those relating to shale?

**Comment [ 7]:** A common well pad for all wells within a spacing unit may not always be possible due to site conditions, etc.

**Comment [ 8]:** Industry suggests that the Department give consideration to changing this language to "is completed" to reflect the fact that until the first well is completed and available for testing, it is difficult to determine the productive capability of the unit.

**Comment [ 9]:** Explain.

**Comment [ 10]:** What does this mean and is there any flexibility in deviating from this directive to accommodate site conditions or optimal drainage?

**Comment [ 11]:** What is the significance of this language since it does not appear in any of the other subparagraphs except those relating to shale?

**Comment [ 12]:** We suggest that consideration be given to graduating the unit size similar to wells within "all other gas pools" (i.e. < 4,000' TVD being 80ac + the additional acreage along the horizontal leg, 4,000' to 6,000' TVD being 160ac + the additional acreage along the horizontal leg, etc.) as it is well recognized throughout industry that the drainage area increases with depth.

**Comment [ 13]:** Does this mean that the entire unit boundary gets extended in the direction of the horizontal wellbore or is there a 330 envelope around the wellbore?

[(vi)] (ix) for all other gas pools where the majority of the pool is 4,000 to 6,000 feet deep, 160 acres with the wellbore within the target formation no less than 660 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 660 feet from any unit boundary;

[(vii)](x) for all other gas pools where the majority of the pool is 6,000 to 8,000 feet deep, 320 acres with the wellbore within the target formation no less than [1000] 1,000 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 1,000 feet from any unit boundary; [and]

[(viii)](xi) for all other gas pools where the majority of the pool is below 8,000 feet, within five percent of 640 acres with the wellbore within the target formation no less than [1500] 1,500 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 1,500 feet from any unit boundary;

(xii) for oil pools in the Bass Island, Trenton, Black River, Onondaga reef or other oil-bearing reef at any depth, 40 acres with the wellbore within the target formation no less than

460 feet from any unit boundary, plus, if applicable, the number of additional acres necessary and sufficient to ensure that any horizontal wellbore within the target formation is not less than 460 feet from any unit boundary;

(xiii) for all other oil pools at any depth, the wellbore within the target formation shall be no less than 165 feet from any lease boundary; and

(xiv) wells completed under a well permit issued pursuant to clauses (xii) or (xiii) of this subparagraph that do not produce any oil may not commence production of natural gas prior to modification of the spacing unit pursuant to applicable provisions of this title.

§2. Subdivision 4 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

4. The department may issue permits to drill infill wells on a reasonably uniform pattern within the spacing unit after an integration order has been issued, if required, and only if it determines that drilling infill wells is necessary to satisfy the policy objectives of section 23-0301 of this article. In a spacing unit established pursuant to clause (vi) of subparagraph 1 of paragraph b of subdivision 1 of section 23-0501, infill wells shall be deemed necessary, and the number of infill wells required to satisfy the policy objectives of section 23-0301 of

this article must be drilled within three years of the date the first well in the unit commences drilling.

§3. Subdivision 6 of section 23-0503 of the environmental conservation law, as added by chapter 386 of the laws of 2005, is amended to read as follows:

6. [An order establishing] Unless it is extinguished pursuant to subdivision 7 of this section, a spacing unit established by the department shall be binding upon all persons and their heirs, successors and assigns. Upon good cause shown, an order establishing a spacing unit or a spacing unit which conforms to statewide spacing may be modified by the department without conducting a hearing if a finding has been made that no facts are in dispute after all affected persons have been provided a reasonable opportunity to comment. In a spacing unit established pursuant to clause (vi) of subparagraph 1 of paragraph b of subdivision 1 of section 23-0501, failure to drill the required number of infill wells pursuant to subdivision 4 of this section shall constitute (a basis) for the department to initiate a modification of the spacing unit. If necessary, upon issuance of [a modified] an order which changes unit boundaries, the well operator shall adjust the accounts for owners within the original and modified units to reflect the modified boundary. Any participation by new owners and any adjustment of revenue or royalties [based thereon]

**Comment [ 14]:** Industry suggests that this language be changed to permitted (vs. drilled), within three years of the date the first well in the unit commences drilling". This would provide some latitude on rig availability, site construction issues, etc. A permit application should be considered intent to drill in a timely fashion.

**Comment [ 15]:** Industry is concerned that this language might be taken too literally and not require any Department judgment concerning modification of the unit. As an alternative, industry suggests that the language "good cause" be replaced by "a basis" and that the following language be edited at the end of the sentence: "which may be modified upon good cause shown to carry out the policy objectives of section 23-0301 of this article.

resulting from participation by new owners shall be on a prospective basis only. If the initial risk penalty phase pursuant to title 9 of this article is in effect, any new owner added to the unit may elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner as defined by title 9 of this article. Full well costs shall be assessed against new participating owners and non-participating owners and included in the risk penalty calculation. If the initial risk penalty phase has concluded, any new owner added to the spacing unit may elect to be integrated as a participating owner or an integrated royalty owner on a prospective basis only.

§4. This act shall take effect immediately.

that any horizontal wellbore within the target formation is not less than 660 feet from any unit boundary;

(iii) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is between 4,000 and 8,000 feet deep, 320 acres with the proposed productive section of the wellbore within the target formation no less than one-half mile from any other well in another unit in the same pool and no less than [1000] 1,000 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(iv) for fault-bounded Trenton and/or Black River hydrothermal dolomite gas pools where the majority of the pool is below [8000] 8,000 feet, within five percent of 640 acres with the proposed productive section of the wellbore within the target formation no less than one mile from any other well in another unit in the same pool and no less than [1500] 1,500 feet from any unit boundary that is not defined by a field-bounding fault but in no event less than 660 feet from any unit boundary;

(v) for shale gas pools at any depth, for a vertical well outside any previously established spacing unit, 40 acres with the wellbore within the target formation no less than 460 feet from any unit boundary;

(vi) for shale gas pools at any depth, for a horizontal well outside any previously established spacing unit and with a

**Comment [ 3]:** What is the significance of this language since it does not appear in any of the other subparagraphs except those relating to shale?

**Comment [ 4]:** Industry prefers a 330' setback for both vertical and horizontal shale wells, which will allow for infill wells. Larger units should be allowed for multiple vertical wells

**Comment [ 5]:** What is the significance of this language since it does not appear in any of the other subparagraphs?

| CURRENT REGS | | | PROPOSED NY-DEC PROGRAM #205 BILL | | | CHESAPEAKE PROPOSED | | |
|---|---|---|---|---|---|---|---|---|
| Pool | Unit Size | Setback | DEC #205 PB Horizontal Unit Acre Calculation | DEC #205 PB Unit Size (3,000' Horiz) | DEC #205 Prog Bill Setback | Vert. Unit Size | Horiz. Unit Size | Setback |
| Medina (Tight Sand) | 40 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 131 ac.** | **460'** | 40 ac. | **160 ac.** | **330'** |
| Onondaga Reef/Oriskany | 160 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 251 ac.** | 660' | 160 ac. | **320 ac.** | **330'** |
| Fault Bounded Resevoirs (TBR- Hydrothermal Dolomite) [4,000'-8,000'] | 320 ac. | 660' | N/A | 320 ac. | 660' / 1,000' | 320 ac. | 320 ac. | 660' |
| Fault Bounded Resevoirs (TBR- Hydrothermal Dolomite) [ >-8,000'] | 640 ac. | 660' | N/A | 640 ac. | 660' / 1,500' | 640 ac. | 640 ac. | 660' |
| Other Pools (Inc. shales) [<4,000'] | 80 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 171 ac.** | **460'** | 80 ac. | **640 ac.** | **330'** |
| Other Pools (Inc. shales) [4,000'-6,000'] | 160 ac. | 660' | **L. Horz WB x 1,320 / 43,560** | **91 ac./ 251 ac.** | 660' | 160 ac. | **640 ac.** | **330'** |
| Other Pools (Inc. shales) [6,000'-8,000'] | 320 ac. | 1000' | **L. Horz WB x 2,000 / 43,560** | **138 ac./ 457 ac.** | 1000' | 320 ac. | **640 ac.** | **330'** |
| Other Pools (Inc. shales) [ >8,000'] | 640 ac. | 1500' | **L. Horz WB x 3,000 / 43,560** | **206 ac./ 846 ac.** | 1500' | 640 ac. | 640 ac. | **330'** |

Black text: Existing Unit Size / Setback Distances
Blue text: Proposed changes per NY-DEC Program Bill
**Red text: Proposed CHK Unit Size / Setback Distances**