IN THE CIRCUIT COURT OF MCDOWELL COUNTY, WEST VIRGINIA

BLUE EAGLE LAND, LLC, et al.

Petitioners, and

WEST VIRGINIA SURFACE OWNER'S RIGHTS ORGANIZATION,

Intervener/Petitioners,

v. Case No: 08-CAP-171

WEST VIRGINIA OIL AND GAS
CONSERVATION COMMISSION,
CHESAPEAKE APPALACHIA, LLC,
EASTERN AMERICAN ENERGY CORPORATION, and
PETROEDGE RESOURCES (WV), LLC,

Respondents.

INITIAL BRIEF OF
INTERVENER/PETITIONER
WEST VIRGINIA SURFACE OWNERS' RIGHTS ORGANIZATION

Introduction

The West Virginia Surface Owners' Rights Organization ("WVSORO") files this brief as an intervening petitioner. WVSORO is petitioning for appeal of the ruling of West Virginia's Oil and Gas Conservation Commission ("Commission") that certain gas wells drilled to the Marcellus Shale formation can be drilled as close together as 1000 feet.

Another major issue in this appeal is whether those gas wells are statutory "shallow" or statutory "deep" wells, and therefore whether the Commission has jurisdiction over the

spacing of those wells at all. The Commission held that those wells indeed are statutory deep wells subject to its jurisdiction. WVSORO agrees with the Commission that they are statutory deep wells, and so does not cover that issue in this brief. WVSORO expects to brief that issue in response to the brief of other petitioners.

WVSORO understands that this is an appeal of the four "Causes" numbered 160, 164, 165 and 166 in which hearings have been held and orders made by the Commission. WVSORO identified those causes in its proposed "Answer to Petition for Appeal and Cross-Petition for Appeal" that it filed with its Motion to Intervene. (This Court granted the motion to intervene and at the same time granted leave to WVSORO to "file appropriate pleadings". WVSORO will assume that this means that the proposed pleading filed with the Motion to Intervene is now a "filed" pleading in this case.)

The copy of the record below that was made available to WVSORO by the Commission, presumably the same as was filed with the Circuit Court, contained materials from additional "Causes" 167, 168, 169, 170 and 171. WVSORO is not sure these are technically part of this appeal or the record of this appeal because the Commission has made no ruling on them. (The Commission is waiting for the decision in the present case before doing so.) Some documentation from them was in the exhibits to the Supreme Court petition, which may or may not somehow make them part of this appeal. Whether or not these additional causes are technically part of the present case, the existence of these additional cases that are at least waiting in the wings does illustrate the significance of the present case.

As a final subject of this introduction, an initial clarification of terms is in order.

Many people call the process out of which this appeal arises “pooling and unitization,” or just “pooling” or “unitization” etc. Those terms are used, although in different word forms, in the statute. Confusingly, the statute defines a “pool” as an “underground accumulation of . . . gas . . .” (W.Va. Code §22C-9-2(9)), but then later refers to the division of costs of drilling a well as “pooling” (W.Va. Code §22C-9-7(b)).

WVSORO will refer to the process below as “well spacing and royalty sharing”, or “well spacing” for short. There is statutory authority for this in that W.Va. Code §22C-9-4(f)(1) states that the primary purpose of the Commission's actions is to "Regulate **well spacing**. [Emphasis added.]" WVSORO thinks this term is more descriptive than other terms, and that other terms for this process are confusing.

Statutory framework.

Before any oil or gas well is drilled, the person or entity that is going to be the "operator" of the well has to apply to the State for a permit. W.Va. Code §22-6-6.

When an operator applies for a permit to drill a gas well that will be a statutory "deep well", the operator has to file a supplement to the permit application (39 C.S.R. 1-4.4.a through e) and the entire application is first reviewed by the Commission (39 C.S.R. 1-4.2) before it goes through the normal permitting process that all oil or gas wells must go through.

There is a presumption that a new statutory deep well may not be drilled within 3000 feet of another statutory deep well. 39 C.S.R. 1-4.2.

If the operator wants to avoid the presumption and drill a new statutory deep well closer than 3000 feet from an existing statutory deep well, then the operator has two ways to proceed to get an exception to the presumption.[1]

First, if the operator wants to apply for an exception one well at a time, the operator applies for an exception to the 3000-foot spacing limitation by filing a supplement to the supplement to the permit application. 39 C.S.R. 1-4.3. The Commission, or sometimes just the staff, rules on the application for the spacing of that one well.[2]

Importantly, if the Commission feels that there is not enough evidence to be able to determine the "area which can be drained efficiently and economically by one deep well", the Commission can issue a temporary order granting temporary well spacing until more information is available. W.Va. Code §22C-9-7(a)(5).

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[1]Although they are not relevant here, there are also procedures for statutory deep wells that enable a neighboring mineral tract owner or operator who feels they are being, or going to be drained, by a statutory deep well to file an application with the Commission to initiate spacing by establishing a drilling unit around the well. If the Commission agrees that the neighbor is affected by the initial well, then the Commission establishes the area around the well is being drained and declares that a "unit". Everyone who owns some of the minerals in the unit receives a portion of the royalty in proportion to his ownership of the total minerals in the unit.

In addition the driller of the original well can ask the Commission to declare a unit around the original well. The result is to space any future statutory deep well far enough away that it will not offset the original well. And as a part of that process the neighbor gets a proportion of the royalties from the original well, etc.)

[2]This well spacing process includes "unitization" so that the owner of every mineral tract being drained by the well will get a proportionate share of the royalties – what WVSORO calls "royalty sharing". Also the well spacing process includes a process by which the lessee of the neighboring tract of mineral land (or the mineral neighbor himself), can participate in the funding of the drilling of the well and share in the profits paid out of the other 7/8's of the income from the sale of the gas. See generally, W.Va. Code §22C-9-7.

The purpose of this and the other processes of the Commission is to prevent “waste” (W.Va Code §22C-9-1(a)(2)) by spacing the drilling of gas wells.[3] (A concomitant result of that process is that the mineral owners of the area drained by one well (the unit”)share the royalties, and the mineral owner or lessee/operators of the neighboring mineral tracts share in the well’s profits.)

But what if the operator is going to drill a large number of wells and wants them all to be spaced less than 3000 feet apart? Filing an application for an exception for every individual well would be time consuming and otherwise expensive.

The statute and rules provide a second process for well spacing for this situation. An operator can apply for "special field rules" to be granted an area-wide exception to the presumptive 3000-foot limitation. The “causes” being appealed to this court are appeals arising out of that process, the adoption of special field rules.

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[3]The primary function of the Commission is to "Regulate well spacing" (W.Va. Code §22C-9-4(f)(1)) to prevent waste (See citation in body). The spacing of gas wells prevents "waste". Waste of minerals occurs if the wells are too far apart. If two wells are too far apart, they leave an area of minerals in between that will not be drained by those two wells, but is too small to justify the drilling of a third well. Economic waste occurs when the wells are drilled too close together. When that happens the reservoir pressure is exhausted too quickly and the two wells get out less total gas than one well would have, and the extra expense of drilling extra unnecessary wells is economic waste. "Excessive drilling is wasteful, both in terms of the cost of drilling unnecessary wells (economic waste) and in terms of unnecessary and undesirable dissipation of native reservoir energy resulting in loss of otherwise producible hydrocarbons (physical waste)." Howard R. Williams & Charles J. Meyers, *Oil and Gas Law*, Matthew Bender, "Pooling and Unitization" §905.1(1).

The statutory authority for granting special field rules is thin.[4] Almost everything about “special field rules” is in the Rule -- 39 C.S.R. 1-6. But at the end of the process the Commission "shall enter a spacing order or dismiss the application. . .". The result is that for the area included in the special field rules there is a new, closer presumption of the minimum distance set by this form of well spacing order.

Importantly, if there is reason for there to be an exception for an individual well to this new minimum well spacing distance set by the special field rules, then an operator can again ask for an exception to the special field rules for that well. 39 C.S.R. 1-4.3.

Argument.

This appeal is a direct appeal of four orders of the Commission using special field rules to set up spacing for certain Marcellus Shale gas wells for an astonishing 489,000 acres in seven counties! This is certainly several orders of magnitude larger than any previous special field rules order of the Commission![5]

The spacing between wells that was ordered below by the Commission in the present case is 1000-foot spacing. According to the applicant/Chesapeake's Senior Reservoir Engineer, that is a Marcellus Shale gas well drilled every 40 acres! *Transcript of*

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[4] W.Va. Code §22C-9-4(g) allows the Commission to delegate the establishment of special filed rules to the staff under certain circumstances. The Commission does have broad general authority to regulate well spacing. But otherwise "special field rules" are not mentioned in the statute.

[5]It is not possible of course to cite an order to this effect since the fact to be established is the absence of an order. This was learned by counsel from informal conversations with Commission personnel.

proceedings taken on 17th day of May, 2007, at 9:00 a.m. before the Oil and Gas Conservation Commission ("Tr.") p. 46. The parties that petitioned the Supreme Court will no doubt have further illustrations of how close together this is.

WVSORO's position in this brief is first that there was insufficient evidence presented below to justify any change to the existing 3000-foot well spacing presumption for statutory deep wells. Alternatively, the well spacing granted should only have been 1500-foot spacing (or more) and THAT spacing should only be temporary. The 1000-foot/40 acre well spacing of Marcellus Shale wells, the surface footprint of which can be 5 acres, is too close together.

Actions of the Commission are subject to judicial review by the Circuit Court pursuant to Section §29A-5-4 of the West Virginia Administrative Procedures Act. See W.Va. Code §22C-9-11. In the words of that Administrative Procedures Act section, the decisions of the Commission making an exception to the 3000-foot presumption at all, and then setting the well spacing at1000 feet, were, "(5) Clearly wrong in view of the reliable, probative and substantial evidence on the whole record; [and] (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion."

It is clear that the Commission's ruling was arbitrary. The applicant/Chesapeake's own witness said that the 1000-foot spacing request was "arbitrary" -- their own witness! Tr. 48.

It was also arbitrary, and clearly wrong, because of the lack of reliable, probative and substantial evidence in the record. The Commission's Rule 39 C.S.R. 1-16 clearly states that before granting special field rules, the Commission "shall",

16.2. . . . require evidence from an applicant as follows:

. . .

6.2.d. **Reservoir data** anticipated for an average proposed drilling unit within the spaced area; **and**

6.2.e. **A comparative economic evaluation of spacing patterns**, based on estimated production and rate of production of oil and/or gas of the average proposed drilling units within the spaced area. [Emphasis added].

None of that appeared in the record. The applicant/Chesapeake's witness admitted so in the hearing at Transcript pages 50-51. So there was not enough evidence in this case in the record to justify an exception to the 3000-foot well spacing.

It is important to note that these are special field rules of unprecedented size. One-half million acres are in question in the cases on direct appeal. More applications for special field rules are waiting in the wings. Thousands of wells are planned. Well spacing for one of, if not the most, important gas "play" in the history of the State is at stake. There ought to be some scientific basis before issuing a permanent special field rule order!

The only evidence that the Applicant/Chesapeake produced was testimony from an engineer and a geologist that Chesapeake had been using 1500-foot spacing and had not seen any evidence of "communication" between the wells. Tr. 49. In fact the Applicant/Chesapeake's senior geologist testified that they have 1700 planned locations (Tr. 25), and all of this planning is based on 1500-foot spacing, not 1000-foot spacing. They only moved their request down to 1000 feet in case they get crowded by being near another deep well or have coal or surface owner issues according to the Applicant/Chesapeake's own testimony. Tr. 48. (And there are not many, maybe 25 or so other deep wells in the area under consideration. Tr. 29-30.)

So really, 1500-foot is what they want and plan to use. They just do not want to have to come in and get exceptions when there is a sound justification for 1000-foot spacing.

In essence the Commission is delegating the granting of exceptions to 1500-foot spacing (the evidence for which is already too thin) to the applicant/Chesapeake. It is arbitrary and capricious and an abuse or unwarranted exercise of discretion to delegate the granting of exceptions to the spacing requirements of a special field rule to a driller. The Commission should not entrust to any driller the Commission's responsibility to prevent waste of gas, to protect correlative rights, to consider the interest of coal owners, or its other responsibilities. These responsibilities indirectly, but very substantially, affect surface owners. And this delegation requires a level of faith in drillers that surface owners have learned through hard and repeated experience should not be conceded to any driller.

It is one thing where there are differences of opinion over whether there is sounds justification for spacing less than 1500 feet. But the Commission's 1000 foot order allows the driller to space wells closer than 1500 feet without any sound justification. Even if so close as to cause "waste", the commission's carte blanche order allows closer spacing based on whim.

Scores of influences through levels of decision making can change a corporation's plans. A representation made to a Commission is one influence that will easily get lost in that shuffle.

Also, intentions change, even if 1500 feet is Chesapeake's current intention. In life and business, stuff happens. Chesapeake was going to build a headquarters here at one point,

and now instead is moving much of its staff to Oklahoma! Companies get bought out. The individuals and lawyers who now stand before the Commission on behalf of the company can be long gone. In addition, portions of Chesapeake's holdings can get sold to other operators, operators who at best would not feel bound by representations made today, or who at worst get unsophisticated investors to pay them to drill wells, crowd them together to save money buying leases, get their money and move on. Or the driller could move a well closer than 1500 feet just to save money on a well location by putting it in a surface owner's meadow instead of on a ridge top where responsible spacing would place it.

In the event any of that happens, and a well is proposed closer than 1500 feet (or 3000 feet) for any illegitimate reason, neither that surface owner, nor any of the other the affected parties, will have any recourse as a practical matter, and perhaps as a legal matter, if the 1000-foot well spacing of the special field rules is allowed to stand.

The special field rules should be denied for lack of evidence. If Chesapeake has 1700 well locations planned, they should use the ones that are 3000 feet apart until more is known about the formation and until the Commission can see where fracing technology for both vertical and horizontal wells takes the science and engineering of producing the Marcellus Shale formation.

If special field rules are granted at all, the well spacing should be for 1500 feet or more. In the words of the applicant/Chesapeake's own witness, the 1000-foot spacing is "arbitrary". Ibid. And if the applicant/Chesapeake is granted 1500-foot well spacing the orders should only be temporary. If drillers some day in the future "obtain new information

which may lead then to space wells closer than 1,500 feet" (Tr. 47) the applicant/Chesapeake or its successor, or other affected parties should come back and get them changed then. The order below is the opposite. The applicant/Chesapeake is getting 1000-foot spacing now because some day in the future they might get new information justifying it!

More likely, there will be information in the future that tells us that the temporary spacing should be changed to 3000 or 4000 feet. New technology is not going to require wells closer together. New technology is likely to tell us that there are ways to get resources out if gas wells are drilled 3000 or even 4000 feet apart. A year or two ago Marcellus Shale wells were not drilled at all. New fracing ideas and technology come along and we are having a boom. And now there is already a yet newer wave of horizontal drilling techniques. These newer techniques can go out 4000 feet in opposite directions, so spacing would be 8000 feet!

If there are going to be special field rules at all, over WVSORO's objection, what should be done is to follow the language of W.Va. Code §22C-9-7(a)(5).

> (5) No drilling unit established by the commission shall be smaller than the maximum area which can be drained efficiently and economically by one deep well: **Provided, That if there is not sufficient evidence from which to determine the area which can be drained efficiently and economically by one deep well, the commission may enter an order establishing temporary drilling units for the orderly development of the pool pending the obtaining of information necessary to determine the ultimate spacing for such pool.** [Emphasis added.]

Admittedly this specific statutory provision is not part of the Rule for granting special field rules. It is in the unitization/royalty sharing provision of the statutes. But unitizing flows from well spacing. And the Commission has very general and broad power to regulate

well spacing. It is only very general statutory authority that is relied upon to do special field rules in the first place. So that very broad, general statutory authority should be used, using W.Va. Code §22C-9-7(a)(5) as support for the position, to issue special field rules that only allow 1500-foot spacing, and only allow that temporarily until there is sufficient evidence for a permanent ruling less, or greater, than 1500 feet.

Conclusion.

This Court should overturn the special field rules orders of the Commission, or at least remand the decisions for the gathering of more substantial evidence. It should make any applicant prove, and prove with the science required by the Rule, that the well spacing for which it asks is the well spacing that is needed. In the alternative, the 1000-foot spacing is, in the words of the application/Chesapeake's witness, "arbitrary" and should be overturned. Only 1500-foot well spacing (or more) should be allowed. And if that well spacing is allowed , it should only be temporary.

Respectfully submitted:

West Virginia Surface Owner Rights Organization.
Intervener/Petitioners
By Counsel

/s/ David McMahon [intended as signature]

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CERTIFICATE OF SERVICE

I, David McMahon, do hereby certify that I have served a true and exact copy of the foregoing brief upon all counsel of record by e-mailing a true copy in Portable Document Format (.pdf) on the _*15*_ day of June, 2009, to:

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