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Environmental Hearing Board Charts Jurisdictional Course through Murky Waters of Pennsylvania's Arcane Conservation Law

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On November 20, 2013, the Pennsylvania Environmental Hearing Board (EHB) provided a compass for operators interested in applying for compulsory pooling orders with respect to oil and gas resources below the Onondaga Horizon. In *Hilcorp Energy Company v. Pennsylvania DEP*, the Board ruled it does not have original jurisdiction to issue orders under Pennsylvania's Oil and Gas Conservation Law (Conservation Law). Rather, operators must first file an application with the Department of Environmental Protection (DEP), whose decision may be appealed to the EHB.[1]

To put the Hilcorp case in context, Pennsylvania enacted the Conservation Law in 1961 to fulfill its commitment to the Interstate Oil and Gas Commission (IOGC). The IOGC's stated mission is to "promote[] the conservation and efficient recovery of domestic oil and natural gas resources while protecting health, safety and the environment."[2] The Conservation Law established well spacing requirements and provisions for the integration of interests, also known as pooling. As adopted, the Law conferred upon an agency known as the Oil and Gas Conservation Commission regulatory powers relating to spacing and pooling. The Conservation Law does not apply to the Marcellus Shale because the law is limited to wells drilled below the Onondaga Horizon.

In the decades since its enactment, the Conservation Law has rarely been implemented, leaving many questions about how courts will interpret the statute. Adding to the uncertainty is the significant restructuring of state agencies since the Conservation Law was enacted—the Oil and Gas Conservation Commission was abolished in 1970 with the creation of the Department of Environmental Resources (DER). Before *Hilcorp*, a concern for those interested in invoking these provisions was to whom one should apply for a spacing or pooling order. In August 2013, one producer decided to test the waters.

When the oil and gas industry was in its earliest stages, the rule of capture incentivized aggressive extraction with little to no regard for the efficiency of that extraction, or its impact on the surface. When a well drew oil or gas from a common source of supply, or reservoir, and that reservoir happened to stretch below the surface of a neighboring property, the neighbor's only remedy was to drill a well of his or her own. This often led to a high number of derricks per reservoir, causing unnecessary disturbance at the surface, and the unintended consequence of releasing pressure from the reservoir—pressure required for the extraction of the resource.[3]

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[1] EHB Docket No. 2013-155.

[2] Interstate Oil & Gas Compact Commission, Vision, Mission, Values, (Nov. 18, 2013)

[3] *See Barnard v. Monongahela Natural Gas Company*, 65 A. 801 (Pa. 1907); see also Brigid R. Landy and Michael B. Reese, Getting to "Yes": A Proposal for a Statutory Approach to Compulsory Pooling in Pennsylvania, 41 ELR 11045, 11047-49 (2011).

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For a more detailed description of the negative impacts of the rule of capture, and how the integration of interests addresses these concerns, see K&L Gates Oil & Gas Alert A New Conservation Law for Pennsylvania?

By the early 1920s, industry and government leaders alike began to recognize the need to regulate over-drilling. After some years of debate about the best approach to regulation, and who should be responsible for it, six states pledged to enact policies to reduce the waste of oil and gas. By signing the Interstate Oil and Gas Compact, states committed to the mission of promoting efficient extraction of the resources. Minimum spacing requirements between wells and provisions for pooling interests within those spacing units were the cornerstones of this agreement. The Commission continues to provide a model statute featuring these provisions.[4] Pennsylvania joined the compact in 1941 which motivated the passage of the Commonwealth's Conservation Law in 1961.

Since its passage, the Conservation Law has rarely been implemented, providing almost no guidance for companies wishing to apply for a pooling order. This absence of activity is explained in part by the relative dormancy of the oil and gas industry in Pennsylvania in the latter half of the 20th century and by the fact that Pennsylvania's Conservation Law only applies to wells drilled below the Onondaga Horizon.[5] The Marcellus Shale sits just above this horizon, meaning the Conservation Law does not apply to the formation where most of the activity over the last decade has taken place.

Adding to the confusion is the fact that through a series of legislative changes described below, Pennsylvania's General Assembly abolished the commission originally charged with implementing the Conservation Law, thus leaving open the question: who has the authority to issue an order?

Hilcorp Energy is seeking an order establishing well spacing and drilling units covering 3,267 acres of the Utica formation in Lawrence and Mercer Counties. The company originally filed its application with DEP. DEP told Hilcorp it did not have the authority to act on the application, and that it must submit the application to the EHB. Hilcorp did so, and in the alternative, requested the EHB instruct the Department to issue the spacing order. This dichotomy led the judge to request a briefing on the question: Does the EHB have original jurisdiction to decide the matter, or must the DEP first take an action?

Statutory History of the Conservation Law

In 1961, the Conservation Law was enacted, and called for the establishment of an "Oil and Gas Conservation Commission" (Commission) to carry out its provisions.[6] The Commission was given authority to conduct hearings[7] and establish well spacing and drilling units:

> The commission shall, within forty-five days after the application for spacing is filed, either enter an order establishing spacing units and specifying the size and shape of the units, which shall be such as will, in the opinion of the commission, result in the efficient and economic development of the pool as a whole or shall enter an order dismissing the application. The uniform size of the spacing units shall not be smaller than the maximum area that can efficiently and economically be drained by one well:

[4] Interstate Oil & Gas Compact Commission, Model Statutes, (Nov. 18, 2013),
[5] 58 P.S. §§ 402(6), 403(b)(1).
[6] *Id.* §§ 402(1), 405.
[7] *Id.* § 407(3), (4).

> Provided, That if at the time of a hearing to establish spacing units, there is not sufficient evidence from which to determine the area that can be efficiently and economically drained by one well, the commission may enter an order establishing temporary spacing units for the orderly development of the pool pending the obtaining of the information required to determine what the ultimate spacing should be.[8]

The statute also gave the Commission power to integrate privately held interests within those units: "[T]he commission, upon the application of any operator having an interest in the spacing unit, shall make an order integrating all tracts or interests in the spacing unit for the development and operation thereof and for the sharing of production therefrom."[9]

Ten years after the Conservation Law was enacted, the General Assembly undertook a major restructuring of state agencies with the passage of Act 275 of 1970 (Act 275). Act 275 amended the Administrative Law Act of 1929, creating DEP's predecessor, the Department of Environmental Resources. The amendment abolished the Commission and transferred its functions to DER.[10] At that time, DER had within it an adjudicatory branch known as the Environmental Hearing Board.

Shortly after Act 275, regulations were enacted pursuant to the Conservation Law, naming DER as the agency responsible for receiving applications, providing notice, and conducting hearings related to pooling applications.[11]

In 1974, the EHB issued one of the only opinions to make mention of the Conservation Law. In *Pennzoil Co. v. DER*, the EHB took the position Act 275, "was not intended necessarily to convey to the board the subject matter jurisdiction to make the initial decision . . . ."[12] Rather, the EHB found DER should make the initial determination, and then a hearing could take place on appeal, satisfying the general requirement of Administrative Agency law for such a hearing prior to any adjudicatory action.

In 1989, the General Assembly clarified the duties of the EHB with the Environmental Hearing Board Act. The Act established the Board as an independent and quasi-judicial agency, separating it from DER. The Act also established the jurisdiction of the EHB, giving it "the power and duty to hold hearings and issue adjudications under 2 Pa.C.S. Ch. 5 Subch. A (relating to practice and procedure of Commonwealth agencies) on orders, permits, licenses or decisions of the [D]epartment [of Environmental Resources]."[13]

In 1995, as part of further restructuring, DER's responsibilities were divided between two new agencies: DEP and the Department of Conservation and Natural Resources.[14]

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[8] *Id.* § 407(4).

[9] *Id.* § 408(a).

[10] "The following departments, boards and commissions are hereby abolished and their functions transferred to the Department of Environmental Resources:

. . .

Oil and Gas Inspectors' Examination Board

Oil and Gas Conservation Commission."

71 P.S. §510-103(a).

[11] 25 Pa. Code §§ 79.01-79.33.

[12] 974 E.H.B. 252 (1974), 1974 WL 2998 (Pa. Env. Hrg. Bd. 1974).

[13] 35 P.S. § 7514(a).

[14] 71 P.S. § 1340.503.

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A Vintage Statute in Modern Times

Despite all of these changes, the language of Pennsylvania's Conservation Law itself has remained unchanged since 1961, still referencing the Oil and Gas Conservation Commission as the entity responsible for its implementation. The General Assembly did not explicitly state which government agency should fill the shoes of the Commission, which it abolished in Act 275. The Commission's duties, encompassing both administrative and adjudicatory functions, are still intertwined in the statute.

As noted above, once an application for pooling has been received, the Conservation Law requires the Commission, in a brief time frame, to provide notice to all interested parties, hold a public hearing to determine the size and shape of the acreage to be included in the spacing order, and where wells can be drilled within it.[15] The law directs the Commission to appoint "experts, engineers, geologists, inspectors, investigators, hearing officers, attorneys, clerks, reporters, and other employe[e]s as may be necessary for the proper conduct of the work of the commission."[16]

Hilcorp Energy Company v. Pennsylvania DEP

In *Hilcorp Energy*, the Environmental Hearing Board ruled DEP must first take the final action of issuing the spacing order. Then, a party may appeal that action to the EHB. In other words, the EHB does not have original jurisdiction over applications filed pursuant to the Conservation Law.

In reaching its decision, the Board emphasized how the EHB Act of 1989 established the Board as an independent, quasi-judicial agency, completely distinct from the Department.[17] The Board explains its jurisdiction, as conferred by the EHB Act, is over actions of the Department.[18] While not every decision of the Board stems from an appeal of a DEP action, the "vast majority" do.[19]

For the bulk of its reasoning, the EHB points to the divergent nature of the responsibilities and procedures of DEP and the EHB as they exist today. According to the Board, DEP is better situated to handle these applications and provide a more fair process for applicants. Specifically, the Board found DEP better equipped to handle the quick turn around required by the Conservation Law. Section 407 requires the Commission to issue an order within 45 days of receipt of the application. In that time, a public hearing must take place with at least two weeks' prior notice. The Board ruled DEP should handle this process, issue the order, and then the parties may appeal to the Board. According to the Board, this appeal, which will include ample time for discovery in accordance with the EHB's established procedures, and a *de novo* standard of review of the DEP's decision, provides better due process protections for applicants and challengers to the order.[20]

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[15] 58 P.S. § 407.

[16] *Id.* § 415.

[17] *Hilcorp Energy Co. v. DEP*, EHB Docket No. 2013-155, at 4.

[18] 35 P.S. § 7514(a). While the EHB notes its jurisdiction is generally derived from the Environmental Hearing Board Act, it does not explain whether its power to review spacing or pooling orders by DEP emanates from the Conservation Law or the EHB Act.

[19] *Hilcorp Energy Co.*, at 4 (*citing* 35 P.S. §7514(a)), 8.

[20] *De novo* review allows the Board to examine all of the facts as if they were "new," meaning it does not need to defer to the findings of fact of the DEP. Rather, it can conduct its own fact finding through a hearing process. The Board contrasts this approach with that suggested by the parties, which is to have the EHB issue the initial order. *Hilcorp Energy Co.*, at

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The Board highlights the technical nature of issuing a spacing order, noting DEP is staffed by the kind of professionals described in the Conservation Law, while the EHB is not.[21] The Board then notes its holding is consistent with *Pennzoil Co. v. DER*, discussed above.[22] Finally, Judge Mather's concurring opinion points to the existence of regulations outlining DEP's role in the implementation of the Conservation Law as support for its conclusion.[23]

The Board dismissed Hilcorp Energy's complaint without prejudice, but did not explicitly order DEP to issue an order in this case. It simply stated, "Such requests are required to be submitted to the Pennsylvania Department of Environmental Protection for its consideration."[24]

Based on this decision from the EHB, operators interested in invoking the Conservation Law should file their applications with DEP. Interested parties may also want to be on the look out for changes to the existing regulations implementing the Conservation Law, as DEP may soon be taking a closer look at how it will review these applications.

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12-13. In that case, the review of the EHB's decision by the Commonwealth would be limited to a "substantial evidence" standard of review—requiring much greater deference to the initial decision maker. Furthermore, the Board found, the Commonwealth would be working from a limited record due to the abbreviated schedule to hold the hearing, and the lack of discovery before the Board. *Id.*, at 13.

[21] *Id.*, at 10.

[22] *Id.*, at 16.

[23] *Id.*, at 9; at 22-24 (Mathers, J., dissenting).

[24] *Id.*, at 18.