



Marcellus Shale: The Real Price of Compulsory Integration In New York

Tuesday, 07 December 2010

Written by [Peter Mantius](#)

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A massive gas drilling rig extracts natural gas from the ground below. Photo: Peter Mantius

The natural gas industry made Joe Todd an offer he couldn't refuse.

He told them no, but New York State's industry-drafted 2005 "compulsory integration" law made resistance pointless.

Todd had turned away a landman who tried last year to convince him to lease his property to a Denver-based gas driller. Then he received an official letter in January that said he had to surrender his subterranean property rights for a financial stake in the same Colorado driller's new well operation less than a mile from his home in Big Flats, N.Y. He ripped up the letter and threw it in the trash.

The drilling started up anyway.

In September, Todd's neighbors, Donetta and Paul Morey watched their well water turn black in their sinks and toilets. When they tried to test for methane by lighting a match near the well, a flame shot into the air, singeing Donetta's eyebrows and setting her hair on fire. She quickly pulled away and patted out the flames.

Two days later, the well water Todd and his family had relied on for 22 years suddenly turned murky and smelly. So had the well water of at least seven other households in this stable, middle-class neighborhood just north of the Elmira-Coming Regional Airport. The residents suspected that their water problems were linked to

the gas drilling, but state and local officials dismissed those suspicions.

Realizing that the burden of proving a connection was on their shoulders, Todd and the others started meeting regularly with an eye toward hiring an attorney and a water tester. Some members of the group, including the Moreys, had signed leases with the drilling company, Anschutz Exploration Corp. Several others, like Todd, had declined.

But the state's compulsory integration statute cancels their right to refuse to deal with a gas well driller.

The legislation was a product of the Independent Oil and Gas Industry of New York, according to Christopher Denton, an Elmira attorney who has represented landowners in dozens of compulsory integration cases.

"This is IOGA's statute," Denton said of the industry trade group. "They drafted it, introduced it, got a sponsor for it and pushed it through with no legislative hearings whatsoever."

The law "does some good," Denton said, by establishing a much-needed orderly procedure for assembling land for drilling. "But the substance provisions screw the landowner," he added.

Legally, compulsory integration is similar to eminent domain, where a government can seize private property for a general public purpose such as a highway or a school. In compulsory integration, the government-supervised seizure of private property benefits a mining company.

In theory, both types of seizure are supposed to provide fair compensation for landowners. But Denton believes New York's law is a miserable failure when it comes to compensation. "It's really worse than eminent domain, where at least you get paid at 100 percent," he said.

When Todd received his compulsory integration notice, he had three choices. He could have decided to invest in the well and assume the financial risks of a "dry hole" or expensive accident – what Denton calls the "J.R. Ewing" option. Under the second option, Todd could have chosen not to invest, but rather to have his share of well costs taken out of his future earnings. Instead, Todd by default took the third option. He has no responsibility for the well's costs and is entitled to a royalty payment.

Denton calls the default option the "ostrich" because it requires the lowest level of commitment. The royalty rate typically paid to the ostriches is 12.5 percent – far below market.

Compulsory integration now plays a crucial role for gas drillers assembling sites in New York. No well can be drilled without a state permit. And no permit can be awarded until the drilling company creates an approved 640-acre "spacing unit" at the proposed well site. The spacing unit is made up of property leased to the drilling company, plus property owned by holdouts who won't lease.



Todd turned to bottled water after his well water suddenly turned murky and smelly, shortly after gas drilling began. Photo: Peter Mantius

Compulsory integration may only be applied if the driller obtains leases on property totaling at least 60 percent of the proposed spacing unit. After that threshold is reached, the company can force the holdouts to join against their will.

To some, that arrangement seems an outrageous violation of basic private property rights.

“It is a way to get around negotiating price with landowners, a way to acquire gas rights at below-market rates, and a way to force people into leases or lease terms they don’t want,” said Fracktracker, a website managed by a group founded at the University of Pittsburgh’s Graduate School of Public Health.

When the gas industry floated a milder version of New York’s compulsory integration statute in Pennsylvania this year – the leasing threshold was 75 percent instead of 60 percent – it met vehement opposition and died.

In New York, opponents never had a chance to mobilize because there were no public hearings before the bill sailed through, Denton said. Albany attorney Thomas West claims on his website bio that he “played a key role” in winning passage of the 2005 bill. Denton agreed, saying, “Tom West shepherded it through the Legislature.”

At the time, West served as a lobbyist for Chesapeake Energy Corp., and he has continued to represent the drilling company since then. He’s also represented Chesapeake and other drillers at dozens of compulsory integration hearings in Albany. And in 2008, when the gas industry began to see enormous potential in tapping the gas-rich Marcellus Shale in New York with a controversial new type of hydraulic fracturing, or fracking, West helped craft amendments to deal with technical obstacles, according to a June 2008 blog posting on his firm’s website. “The primary impetus for this bill is the industry’s interest in the Marcellus Shale,” the blog explained.

By then, drillers had already started mining the Marcellus in Pennsylvania with the latest fracking techniques, which involve drilling horizontally and using sand, dangerous chemicals, explosives and 5 million of gallons of water per well. Drillers have been no less excited about potential riches from the formation in New York, but the state Department of Environmental Conservation has held off on permits until it finishes its rules to deal with the harmful side effects of the latest fracking techniques.

Marcellus drilling in New York is on hold until the DEC releases those rules. Also, the state Legislature recently passed a bill establishing a moratorium on fracking through May 15, 2011, which Gov. David Paterson may either sign or veto.

While they wait for access to the Marcellus mother lode, Anschutz and others have obtained permits to drill horizontally in New York’s Trenton Black River formation, a less tempting target roughly twice as deep as the Marcellus. In order to create the spacing unit needed to obtain a permit to drill the Black River in Big Flats, Anschutz began seeking leases on at least 60 percent of the land in its proposed 640-acre spacing unit. The drilling site just off Yawger Road is a 61-acre parcel owned by John Dow, an aviation services executive, and his wife Daphne Dow.

After securing a lease on the Dow property and another on a 180-acre parcel owned by Chemung County, Anschutz was more than half way to its golden threshold of 60 percent. It received another boost when Gale E. Wolfe, Chemung’s Director of Environmental Services, leased her 31-acre horse training facility, which sits adjacent to the Dow property.

A landman for Anschutz scoured Todd’s Big Flats neighborhood for additional leases and met with some success, including the Moreys. “Some gentleman came to our door,” Donetta Morey said. “He was a nice

looking man who seemed honest. We did not get a lawyer. They misrepresented themselves quite well, and we fell for it.”



Photo: AAPL.org

The landman who signed up the Moreys, Jason C. Marks, indicated in the Moreys' leasing documents that he was a member of the Northern Appalachian Landman's Association, which was organized in 2004 in Olean, N.Y., and bills itself as "the voice of the Marcellus landman." Efforts to reach Marks through NALA were not successful.

Anschutz easily surpassed the 60 percent threshold before applying for and receiving a drilling permit in December 2009. At that point, the DEC set a compulsory integration hearing for Jan. 13, 2010, in Albany, and Thomas West, representing Anschutz, sent out notices to the holdouts. Drilling began in February, according to the DEC website. Eventually a second well, Dow 2, was drilled. Jim Monaghan, a spokesman for Anschutz, said the wells have been prepared for production without the use of fracking and are near the production stage. Monaghan said the company, which is owned by Denver billionaire Philip Anschutz, was surprised to hear allegations that the drilling activities harmed local water wells. "The allegations didn't square with our folks' knowledge of hydrology," Monaghan said. The company expects the DEC to continue its investigation and fully supports those efforts, he added.

According to the DEC's well database, Dow 1 reaches down more than 9,000 feet before angling horizontally for another 3,000 feet to points directly under or near the properties owned by the Todds and the Moreys. The community's water problems didn't develop until September, several months after the drilling began, and there's still no incontrovertible evidence that their water problems are connected in any way to the well drilling.

In fact, the DEC has all but dismissed the residents' suspicions. "Pre-existing methane was already present at shallow depths when the wells were drilled," the DEC said in a "fact sheet" dated "November 2010." It was "unlikely that gas from deeper formations could migrate through multiple well casing strings into any aquifers near the surface," the agency added.

The Town of Big Flats and Chemung County have said they didn't have sufficient evidence and authority to take action against the well operators.

"Everybody we talk to is putting it back on us," said Karen Farrell, who like the Moreys and Todds has lived in the neighborhood for more than 20 years. "It seems that everybody is in cahoots."

Big Flats Supervisor Teresa Dean said the town's options are limited to giving the residents information on procedures and prices for hooking up to the town's water system. "Our hands basically are tied," she added, because the DEC has jurisdiction over gas well drilling.

Dean said the DEC's conclusion that methane was present near the surface even before the wells were drilled seemed defensible. She said Mike Nicolo, a resident who lives near the Todds and Moreys, had well water problems and "could light his faucet" about 10 years ago. Nicolo confirmed to DCBureau that he'd had water problems before he hooked up to town water several years ago. But he said he'd never had his suspicious water tested and he'd never stopped drinking it.

Jim McDermott, on the other hand, said he did have his well water tested before he moved into the Big Flats neighborhood about a year ago. It was clean. In the middle of September, his water went "milky." The DEC has since warned him that it contained "combustible gas."

Kathleen Shoemaker, co-owner of Pump Doctors, a local well services company, said methane, which is odorless, had rarely if ever turned up in the Big Flats wells her company had worked on since 1983. She told DCBureau she thought the nearby gas wells might have played a role in the latest cluster of well water problems.

"At one point in September when a gas well on Yawger Road capped off, we had a number of incidents show up -- two wells with methane and one that blew black stuff," Shoemaker said. "Whatever happened, something created pressure to push things up into the water table."

Todd conceded that Shoemaker's diagnosis was hardly definitive. But he questioned how the DEC could dismissively assert that well casings failures were "unlikely" when the same "fact sheet" states that the casing tests weren't finished. Gas well casing failures have been identified as culprits in water well problems in Cleveland and Dimock, Pa.

And researchers for Garfield County in Colorado found higher numbers of contaminated water wells near deep gas wells drilled in areas with extensive natural faults. In some cases, the molecular structure of the gas from tainted water wells matched that of the deeply buried gas, suggesting migration to surface water supplies, according to a 2009 report in ProPublica.

Pennsylvania regulators have ordered the drilling company in Dimock to spend millions of dollars to build a water pipe to serve the affected residents. The company, Cabot Oil and Gas, has challenged the ruling. Todd said he's frustrated that New York's environmental regulators have been comparatively laid back about the water well problems in Big Flats.

Meanwhile, he continues to have to buy bottled water by the case and make regular trips to the laundromat. Donetta Morey says she lacks good alternatives to taking showers in the tainted water, and she just puts up with the skin rashes that result. As the DEC draws closer to completing its rules for high-volume hydrofracking of the Marcellus, Denton said the state Legislature should consider overhauling the compulsory integration statute to make it fairer for landowners who are forced to surrender property.

Todd said he wondered what a gas drilling boom might mean to New York's Southern Tier.

"If what happened to us in Big Flats happened in the Trenton Black River (before the latest high-volume hydrofracking techniques), what if they do the Marcellus here?" he said. "The more I see of it, this is an invasion. It scares the hell out of me.

"If it can happen to my well, it can happen anywhere."

**IF IT CAN HAPPEN TO MY
WELL. IT CAN HAPPEN
ANYWHERE.**

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"He ripped up the letter and threw it in the trash"

Brilliant! If NIMBYs would stop fighting landowner coalitions and join them, they would know how to handle compulsory integration. What have they learned from their obstructionist organizations? How have their opposition

groups prepared them for what may be coming?



Andy Leahy 11 hours ago

Peter,

Let's start with this: It's fundamentally incorrect to blame New York's (or any state's) compulsory integration law for the underlying legal principal of someone's rights to mobile property (in this case, natural gas) getting taken away by an extractive enterprise situated upon a neighbor. That's the rule of capture, which goes back to English common law, and to disputes over hunting game. And it's still out there, this rule of capture, as an underlying legal principle, everywhere in America. The rule of capture came long before compulsory integration, long before IOGA-NY, and long before our modern-day showdown over hydraulic fracturing. All compulsory integration statutes are modern-day tweakings and softenings to the underlying rule of capture.

Though shocking to the uninitiated, most rational people can eventually recognize that the rule of capture is a necessary rule for fossil fuels extraction in a capitalist society (unless you decide to federalize mineral ownership, which many countries have chosen to do). Without this rule, you can't have much of any oil and gas industry within the checker-boarded American system of private land ownership. And that's what American courts long ago recognized when they applied the rule to the nascent oil industry. We're talking, like, the 1800s here. Without the rule of capture, someone can always say, "Hey, that's my oil!" — and how you gonna prove it one way or the other? It's just endless litigation.

The well-spacing laws soften this rule of capture by — on one level, restraining neighbors from drilling needless additional wells — while on another level calling for them instead to share in the proceeds of a single well, even if it was drilled next door.

Next, there's this: You say, in 2005, in New York, "opposition never had a chance to mobilize" to fight modifications to the state's pre-existing well-spacing rules because it was all done without hearings or controversy. That's provably incorrect. The changes were accomplished in full public view — and right in the midst of a fairly heated and wide-ranging public controversy — especially in the Southern Tier of NY, where most booming natural gas production was then concentrated. It's true that there was fairly little environmentally minded opposition or involvement during the 2005 change. But it's important to factually note that drilling wasn't a red-hot environmental issue at the time. And that the change wasn't about environmental impact. It was about property rights and proceeds.

The main difference between the 2005 controversy and the 2010 controversy is that the hottest issue, back then, was not killing drilling. Instead, it was the desire for everybody to get fairly paid (already) from past and future Trenton-Black River drilling and resource extraction, mostly in the Southern Tier. Millions of dollars in landowner-owned royalty income were getting locked up in escrow — under state government orders, for months or even years at a time — while New York State's environmental regulators were kerflummoxed over one primary, thorny question: How should we treat the holdouts?

The law then on the books was ripe for endless litigation — from opportunistic parties who had done nothing, signed nothing, invested nothing, and risked nothing — but who, unaccountably, threatened to hold their hands out, after natural gas was successfully found, for *all* the value presumed to flow from under their share of the production unit. New York faced a classic case of useless gridlock, in which all were being hurt, and nobody was being helped. For all its faults, the 2005 revision put an end to all this endlessness, and let ordinary people finally get paid, and let industry do the work that it does to pay its bills, to make its investors happy, to keep its workers employed (and to feed the fossil-fuels monkey maintained by our silent consumer majority).

Another thing — factually, the default royalty option for unsigned parties in New York is not 12.5 percent, and there

is no deduction for 300 percent of drilling costs. You made two mistakes here. You got the "default" terms wrong, and you confused the "default" with the "carry" option. The current default rule for unsigned owners is they get the lowest royalty contracted for by anybody inside the unit who actually took a chance and signed on the dotted line — but no less than 12.5 percent. (The legislature could change that, in the future, and there have been proposals for that.) And, like customary royalty, there's no deduction for drilling costs. (There may be deductions for post-production processing and transportation costs — an obscure but very key, fine-print consideration for anybody who happens to own oil and gas in New York State.)

The way things are going in New York (I hope), there is unlikely to be many future leases at 12.5 percent royalty. In the future (I hope), New York State will finally get its regulatory act together, and will set the stage for large, widely-producing (but low-surface-impact) shale gas units where all of the included leases were actually worked on by knowledgeable professionals.

Another error — you said all spacing units in New York are 640 acres. To me, that means you didn't even read the 2005 changes, or the 2008 changes, or even the NYS DEC's very helpful explanatory web-posted materials about either. In 2005, New York State's legislature — in the interest of getting stuff done — actually effectively took the radical step of politically defining and simplifying geology, including the thorny question of oil and gas flowage through various layers of rock. Rather than allowing specialists to dither over the size and shape of every unit on a customized basis, they simply prescribed a whole table of unit sizes — for various rock layers, at various depths. In general, the deeper the rock, and the more flowing the rock, the bigger the desired unit, and the more widely spaced the drilling, per the public interest. (This is based on a principle of achieving maximum resource return for minimal surface impact, a rule that an increasingly small fraction of modern-day environmentalists still recognizes as part of their underlying philosophical worldview.)

There were also places where you misled your readers by leaving stuff out.

You say compulsory integration strikes some as "an outrageous violation of basic private property rights." (Again, it's the underlying rule of capture.) But let me ask you this — wouldn't it be more outrageous for a holdout, owning only 1 percent of the unit's natural gas, to assert that his subterranean private property rights are so touchy and inviolate that he's entitled to veto all drilling in the neighborhood — rendering useless the rights of the remaining 99 percent to produce their resource (including, incidentally, the guy who was ready, willing, and eager to host the drilling rig on his surface)?

You make the 2008 changes sound sneaky — paving the way for shale gas. But, really, they had more to do with this: The prior, 2005 changes completely failed to recognize what turned out to be already on the horizon. Believe it or not, the 2005 changes still envisioned shale gas units at a preposterously close spacing of 40 acres per well, vertically drilled, no matter what the depth, because of the known denseness of the shale. It's clear that the brightest oil and gas minds in New York, in 2005, did not see coming the future of full-frack, 600-acre Marcellus shale units with six horizontal legs, radiating like pitchforks in either direction (or even a 1200-acre unit with 12 horizontal legs, which I'm reading is now technologically possible). In 2008, those guys were scrambling to fix their prior, short-sighted mistake.

You hold up PA as an example of a state which, by contrast, couldn't politically handle adopting an integration law similar to NY's. But you decline to actually explain how PA is effectively different from NY — right now, in real life, on the merits, on the status quo. In PA, the well gets drilled, whether the nearby holdouts like it or not, same as in NY. In PA, the gas gets captured, from the holdouts, whether they like it or not, same as in NY. But in PA, the holdouts are not compensated! In NY, they are — and, some might say, generously so.

Like virtually all modern-day critics, you completely fail to appreciate that PA's statute actually encourages resource waste, while NY's is truly, honestly, fundamentally, and progressively conservationist. And I mean "conservationist" in the oldest and most hallowed sense of the word.

Let's get it straight. In PA — until those citizens understand the full ramifications and work to change their law — a horizontal drilling leg must stop the moment it has no choice but to directly strike the boundary of an unleased

party, even if it's just a sliver of overlying land. Those oil and gas drillers are down there, right now, in PA — willy-nilly, all over the countryside — making all kinds of odd-shaped units and drill paths, driven largely by the pattern of who at present has signed, and who at present cannot be found or has refused, a mile or more overhead.

Make no mistake about it: In PA, significant, odd-shaped chunks of precious fossil fuels are simply being orphaned forever in the underlying shale! In PA, the horizontal leg must stop, and the private sector can never be expected to return to get that gas, sitting beyond the stoppage. Even when gas hits \$50 a MMBTU, it won't make any financial sense to go back and get it, in most cases. There is only one realistic chance to produce this gas cost-effectively, and — drillsite by drillsite, unit by unit, acre for acre — that chance is while the private sector has its drill bit running on the horizontal, and while its completion contractor is ready to follow through with the frack.

Bottom line: Yes, PA's political sensibility and its policy currently produces way more natural resources, way more money, and way more jobs — compared to NY. But PA is also set up to waste lots in the long-run. NY's policy is technically ready to produce natural resources in a highly rational, highly rectangular, non-wasteful way. But NY has been politically restrained so far from getting started, because of the deference we grant to people who incorrectly claim the exclusive mantle of environmental concern.

Anti-drilling activists are always limited in their usefulness because they ask only certain questions. Mostly it's: "How can we beat this?" Local law? Zoning law? Or maybe we need a study? Environmental impact review? Or what if we got federal regulation involved? Or a state or local moratorium? What about drainage basin commissions? Can they stop this? Or property rights lawsuits? How about nuisance lawsuits?

The point is that anti-drilling activists filter reality through these kind of persistently single-minded questions. It's not a full picture of the necessary inquisitiveness, as measured journalistically, or by the public interest. On the compulsory integration question — the few times New York's situation has been examined — I consistently find that media people have been very much naively locked into just the questions posed by activists.

But there is a much wider array of questions out there — questions that are crucial to the full, ultimate public interest in people surviving in this world, with fairness and respect to this world, and with fairness and respect to each other.



Lunzie1 15 hours ago

Instead of buying bottled water, buy a table-top gravity-fed water purifier. You will save money in the long run, not contribute \$\$ to the mega-corporations that own bottled water companies, and add to the waste stream with all those plastic bottles.



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