BEFORE THE

OIL & GAS COMMISSION

KEITH J. KERNS, *et al.*,	:	Appeal No. 910
Appellants,	:	Review of Chief's Order 2015-348;
	:	Chesapeake Exploration, LLC;
-vs-	:	Our Land Co South Unit
DIVISION OF OIL & GAS RESOURCES MANAGEMENT,	:	**ORDER OF THE COMMISSION GRANTING MOTION TO DISMISS**
Appellee.	:	

Appearances: Phillip J. Campanella, Counsel for Appellants Keith J. Kerns, *et al.*; Daniel Martin, Brian Becker, Tasha N. Miracle, Assistant Attorneys General, Counsel for Appellee Division of Oil & Gas Resources Management.

On November 17, 2015, Appellants Keith J. Kerns, *et al.*, filed with the Oil & Gas Commission, a ***Notice of Appeal*** from Chief's Order 2015-348. Chief's Order 2015-348 approved an application for unitization, associated with an oil & gas drilling unit known as the Our Land Co South Unit.[1] The Appellants own certain property overlying a portion of the oil & gas resources committed to this unit.

BACKGROUND

This matter now comes before the Commission pursuant to a ***Motion to Dismiss*** filed by the Appellee Division on February 24, 2016. Appellants responded thereto on April 1, 2016, and the Division replied on April 13, 2016. On June 9, 2016, the Commission heard oral arguments on this motion.

[1] This unitization was sought by Chesapeake Exploration, LLC ["Chesapeake"]. Chesapeake did not petition to intervene into this matter. Chesapeake is not a party to this appeal, and has not participated in any manner in this appeal.

An evidentiary hearing has not been conducted in this appeal. However, certain factual matters are contained within the pleadings and other filings of the parties. The following facts will aid in a full understanding of the issues presented, and do not appear to be in dispute:

1. Keith J. & Corey A. Kerns, Mark & Linda Zantene, Helen Zantene, Connie Huhn and the Robert J. Zantene Trust [the "Appellants"] own property in Harrison County, Ohio.

2. In 1981, the Appellants, or their predecessors in interest, leased certain oil & gas rights to a company known as New Frontier Exploration, Inc. ["New Frontier"]. Appellants contend that the 1981 leases contained specific restrictions regarding: (1) assignment, (2) joinder with other leases, (3) the number of wells to be drilled, and (4) the size of drilling units. In or shortly after 1981, three wells were drilled, which wells produced from the Clinton Formation on the leased acres.

3. In or around December 22, 1983, New Frontier was "merged out of existence." New Frontier is no longer in operation.

4. The 1981 leases with New Frontier had been assigned, or otherwise transferred, to American Energy-Utica ["AEU"].

5. On November 10, 2014, Chesapeake Exploration, LLC ["Chesapeake"] filed with the Division of Oil & Gas Resources Management [the "Division"] an application seeking unit operations in the Utica/Point Pleasant Formations underlying lands in Harrison County, Ohio. The proposed unit would be known as the Our Land Co South Unit, and would be comprised of 50 separate tracts, encompassing a total of 592.8175310 acres. The Unit Plan proposed the drilling of three horizontal oil & gas wells from a single well pad.

6. Chesapeake's application acknowledged that Chesapeake had been unable to secure voluntary leases for two tracts within the proposed unit (these two tracts totaled approximately 2 acres). Chesapeake's application also specifically addressed eight tracts of land, totaling 120.549972 acres, which had originally been leased to New Frontier, stating:

> Furthermore, an additional 120.549972 acres owned by AEU (approximately 20.33509% of the unit Area) is depicted as Non-Conforming Acreage which, while leased, due to the terms within the lease cannot be pooled without either the consent of the mineral owners, lease modifications, or a unitization proceeding. [2]

7. On January 23, 2015, the Division notified the Appellants of Chesapeake's unitization application. During the application process, the Appellants made filings with the Division opposing the application. On March 11, 2015, the Appellants, or representatives of the Appellants, attended a Division hearing addressing Chesapeake's application.

8. On February 23, 2015, Appellants filed a ***Complaint*** in the United States District Court for the Northern District of Ohio, alleging claims in connection with a potential "takings" of their natural gas rights. Chesapeake and the Division were parties to the federal suit. The Appellants asked the federal court to make certain determinations regarding the property rights of Chesapeake vis-à-vis the Appellants' property rights. At the time of Appellants' filing in the federal court, the Division Chief had not yet acted upon Chesapeake's pending application for unitization. On September 1, 2015, the federal court **dismissed** Appellants' case for failure to state a federal claim ripe for review. *Kerns, et al. v. Chesapeake Exploration, LLC, et al.*, 15-CV-346 (2015).

9. On July 13, 2015, the Division issued Chief's Order 2015-348 [the "Unitization Order"], approving Chesapeake's application for unitization and formally establishing the Our Land Co South Unit. The Unitization Order addressed the Appellants' properties as follows:

> 4) Chesapeake's application for unitization of the Our Land Co South Unit also proposed to include eight tracts for a total of 120.549972 acres that were previously leased to American Energy-Utica ("AEU"). According to the application and subsequent testimony, Chesapeake was unable to come to a voluntary agreement with AEU to include the 120.549972 acres in the proposed Our Land Co South unit. AEU is therefore considered a "non-participating working interest owner" in the Our Land Co South unit as to the 120.549972 acres.

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[2] The Appellants own an additional 65.217 acres, for which the Appellants **have** separately negotiated voluntary leases. These 65.217 acres are included within the Our Land Co South Unit, but are not directly subject to the terms and conditions of the Unitization Order.

10. While the Division issued the Unitization Order on July 13, 2015, Appellants did not receive notice of the issuance of the Unitization Order until November 4, 2015 when the Division provided a copy of the Unitization Order to Appellants' counsel.

11. On November 17, 2015, the Appellants filed a ***Notice of Appeal*** from Unitization Order 2015-348 with the Oil & Gas Commission. Appellants contend that the Unitization Order is unlawful or unreasonable, and ask this Commission to reverse and vacate the order. Appellants' grounds for appeal include the following allegations:

> The Chief erred in failing to grant Appellants' Motion to Dismiss [filed by Appellants with the Division during the Division Chief's review of Chesapeake's unitization application] for the reason that the Applicant Chesapeake failed to engage in meaningful negotiations with the Appellants to lease the [non-conforming acres] prior to filing its [Unitization] Application.
>
> The Chief erred in failing to rule that the [Unitization] Application is premature and an abuse of process because the Application seeks to substitute forced unitization for good faith and meaningful negotiations between the Appellants and the Applicant Chesapeake, particularly since the Appellants have offered to lease the [non-conforming acres] upon the same terms [as other leases for which the Appellants have signed voluntary leases in this unit].
>
> The [Unitization] Order directs the involuntary taking of Appellants' land and mineral rights without a declaration that the taking is for a public use, * * * all in violation of * * * the Ohio Constitution and the Fourteenth Amendment to the United States Constitution.
>
> The [Unitization] Order unconstitutionally deprives the Appellants of their incidents of ownership including the exclusive right to possession, control, custody, use, benefit and disposition of their land and mineral rights by unlawfully authorizing Chesapeake to enter into the subsurface of Appellants' land by means of horizontal drilling * * * to remove oil, gas and natural gas liquids from beneath Appellants' land, and to take possession of said minerals and to dispose of them.

RULING UPON THE MOTION TO DISMISS

O.R.C. §1509.28 allows the Division to join separate mineral interests, for the purpose of creating a drilling unit that will produce from an identified pool or from a portion of an identified pool. In attempting to establish such unit operations, there may be properties for which the operator could not successfully negotiate voluntary leases. Where such unleased properties exist, the operator may apply to the Chief for "forced" unitization under O.R.C. §1509.28.

To apply for such unitization, the applicant must own the mineral rights to at least 65% of the land overlying the proposed pool. Also, in reviewing the application, the Division Chief must affirmatively find that:

> * * * [s]uch operation is reasonably necessary to increase substantially the ultimate recovery of oil and gas, and the value of estimated additional recovery of oil or gas exceed the estimated additional cost incident to conducing the operation.

(See O.R.C. §1509.28(A).) If these conditions are met, the Chief may statutorily establish unit operations, and may allow the inclusion of unleased properties within a statutory unit. *See Gary L. Teeter Revocable Trust v. Division and R.E. Gas Development,* (Oil & Gas Commission, #895; Sept. 17, 2015).

A Chief's order authorizing unit operations must be based upon terms and conditions that are "just and reasonable." *(See O.R.C. §1509.28(A).)* The terms and conditions of a Unitization Order may include provisions for items such as royalty payments, or working interest payments, to unleased mineral owners.

In this case, Unitization Order 2015-348 brought two unleased properties into the Our Land Co South Unit, setting forth terms and conditions applicable to the owners of the unleased minerals for these two tracts.[3]

[3] Ultimately, one of the unleased mineral owners voluntarily entered into a lease.

Unitization Order 2015-348 also specifically addressed the mineral interests that the Appellants, or their predecessors, had leased to New Frontier in 1981. Chesapeake now identified these minerals as being owned by AEU. The mineral interests associated with these 120.549972 acres were included in the Our Land Co South Unit under the authority of Unitization Order 2015-348. The Unitization Order set forth specific provisions addressing, and limiting, the financial obligations of AEU with regards to these 120 acres (*i.e.*, acknowledging that, as the owner of these non-conforming acres, AEU would be a "non-participating working interest owner" in the Our Land Co South Unit that may be financially "carried").

Through the immediate appeal, the Appellants ask the Commission to reverse and vacate Unitization Order 2015-348. Primarily, the Appellants argue that the Chief's approval of Chesapeake's application for unitization establishes unit operations without proper consideration of the Appellants' individual property rights. Appellants further contend that the Chief's order results in an improper and unconstitutional "taking" of the Appellants' property.

The Oil & Gas Commission is a creature of statute, created under Chapter 1509 of the Ohio Revised Code. See *Bass Energy v. Division and Duck Creek Energy*, (Oil & Gas Commission, #815; Jan. 29, 2010); *City of Munroe Falls v. Division and D & L Energy*, (Oil & Gas Commission, #793; Aug. 7, 2008). As a creature of statute, the Commission possesses only those powers which have been expressly conferred by the General Assembly or which are necessarily implied. See *Chesapeake Exploration v. Oil & Gas Commission* (2011) 135 Ohio St.3d 204, *quoting Delaney v. Testa*, 128 Ohio St. 3d 248, 2011-Ohio-550. Thus, the authority and jurisdiction of this Commission is both defined and limited by the express provisions of Revised Code Chapter 1509.

Questions regarding the validity of leases, as well as questions regarding other property rights disputes, are beyond the regulatory authority of the Division Chief. See *Bruce Doolittle vs. Transcontinental Oil & Gas, Inc.*, (Franklin C.P., #94CVF02-839; Nov. 30, 1994). Because these issues are beyond the Chief's regulatory authority, such issues are likewise beyond the jurisdiction of this Commission when reviewing the actions of the Chief. *Id.*

This Commission is not authorized to adjudicate property rights. *See Clarence Tussel, Jr., et al., v. Division and Kastle Resources Enterprises*, (Oil & Gas Commission, #818; July 16, 2010, ruling upon a motion in *limine*); *Bass Energy v. Division and Duck Creek Energy, supra.*

In this appeal, the 120.549972 non-conforming acres at issue are, in fact, subject to leases. As the leases associated with these acres are not held by Chesapeake, and have not been voluntarily committed to the Our Land Co South Unit, the Chief included terms in the Unitization Order, identifying these minerals as being owned by a "non-participating working interest owner."

Since leases for the 120.549972 acres **do** exist, these acres cannot be classified as **unleased** mineral interests. Despite the Appellants' arguments to the contrary, Unitization Order 2015-348 does not require that the 12.5% royalty applied to unleased mineral interest owners would also be applied to the 120.549972 acres held by a non-participating working interest owner. Unleased mineral owners are fundamentally different from **leased, but non-participating**, owners, and are treated distinctly under the terms and conditions of the Unitization Order.

A lease is the essential instrument that sets forth the rights and remedies of involved parties:

> The rights and remedies of the parties to an oil and gas lease must be determined by the terms of the written instrument Such leases are contracts and the terms of the contract with the law applicable to such terms must govern the rights and remedies of the parties.

See Harris v. Ohio Oil Co. (1897) 57 Ohio St. 118; *Snyder v. Ohio Department of Natural Resources*, 2014 Ohio 392.

The Appellants may have concerns relating to the 1981 leases. But, these questions cannot be addressed by the Division or decided by this Commission. Only a court of competent jurisdiction can adjudicate property rights, can evaluate the validity of leases, or can determine the subsurface legal relationship between parties, such as Chesapeake, AEU and the Appellants.

It is also well-settled law in Ohio that administrative agencies and tribunals may not decide constitutional questions. *See Mobile Oil Corp. v. City of Rocky River* (1974) 38 Ohio St.2d 23; *State, ex rel. Park Investment Co. vs. Board of Tax Appeals* (1972) 32 Ohio St.2d 28.

Thus, any contention by the Appellants that O.R.C. §1509.28, or the Chief's application of O.R.C. §1509.28 to the immediate facts, infringes upon the Appellants' constitutionally-protected rights must also be taken up before a court of competent jurisdiction, and simply cannot be determined by this Commission. *See Bass Energy, Inc. v. Division & Duck Creek Energy, Inc., supra*; *Clewell Family Farm, LLC v. Division*, #862 (July 1, 2014, ruling on order on partial summary judgment).

Frankly, both the Appellants and the Division appear to acknowledge the jurisdictional limitations of this Commission with regards to property rights and constitutional questions. However, the Appellants continue to assert that they are adversely affected by the terms and conditions of Unitization Order 2015-348, and contend that the Commission has some jurisdiction or authority to fashion a remedy for them.

Notably, because the 120.549972 acres of concern are viewed by the Division as **under lease**, the only provision of the Unitization Order that specifically applies to these acres is the provision found at item 6 on page 4 of 8 of the Unitization Order, wherein the Division allows the "non-participating working interest owner" to be "carried," or otherwise financed, if unable to meet its financial obligations in connection with the unit operations.

If the Appellants contend that AEU is not a proper lessee, or that the Division has incorrectly relied upon Chesapeake's assertions that the 120.549972 acre are non-conforming acres **under lease** and available for inclusion in the Our Land Co South Unit as minerals owned by a "non-participating working interest owner," then the correct forum in which to litigate such disputes would be a court with the appropriate powers and authorities to review and resolve the property rights associated with these 120.549972 acres.

Significantly, O.R.C. §1509.36 anticipates that some issues attendant to the regulation of oil & gas operations may be more appropriately reviewed by the courts in the first instance. Thus, the jurisdiction of the Commission under O.R.C. §1509.36 is not exclusive, and O.R.C. §1509.36 expressly provides:

> Sections 1509.01 to 1509.37 of the Revised Code, providing for appeals relating to orders by the chief or by the commission, or relating to rules adopted by the chief, do not constitute the exclusive procedure that any person who believes the person's rights to be unlawfully affected by those section or any official action taken thereunder must pursue in order to protect and preserve those rights, nor do those section constitute a procedure that that person must pursue before that person may lawfully appeal to the courts to protect and preserve those rights.

See State ex rel. Fisher v. Nacelle Land & Mgt. Corp. 90 Ohio App.3d 93 (11th Dist., 1993).

ORDER

FOR GOOD CAUSE SHOWN, and based upon the forgoing, the Commission **FINDS** the Division's ***Motion to Dismiss*** well-taken and hereby **DISMISSES** appeal #910.[4]

Date Issued: July 7, 2016

Robert C. Smith
ROBERT C. SMITH, Chairman

Donald L. Mason
DONALD L. MASON

Rocky Roberts
ROCKY ROBERTS

[4] In light of this ruling, the merit hearing scheduled for September 15, 2016 is hereby **cancelled** and no rulings upon the discovery motions that have been pending in this appeal will be rendered.

INSTRUCTIONS FOR APPEAL

This decision may be appealed to the Court of Common Pleas for Franklin County, within thirty days of your receipt of this decision, in accordance with Ohio Revised Code §1509.37.

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