United States Department of the Interior

Bureau of Land Management
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In Reply Refer To:
SDR 2003-03
3165.3 (93000)

March 10, 2003

CERTIFIED - RETURN RECEIPT REQUESTED
7001 0360 0001 0166 3286

DECISION

San Juan Coal Company
c/o Modrall, Sperling, Roehl, Harris and Sisk
Bank of America Centre
500 Fourth St. NW
Albuquerque, NM 87102

: Approval of Five APDs or Sundry
: Notices for Gas Wells Within Area
: of Underground Coal Mine

Field Office Upheld; APDs/Sundry Notices Remain Approved

On December 24, 2002, the San Juan Coal Company (San Juan or SJCC) filed a request for State Director Review of several recent approvals by the Farmington Field Office (FFO). By letters dated November 25; December 4; and December 20, 2002, the FFO approved five applications for permit to drill (APDs) or Sundry Notices (SN) filed by Dugan Production Company (Dugan).

Your request was filed timely for all of the well applications for which you seek a review. You requested the opportunity to present your case for denial of the approvals orally. This occurred on January 27, 2003. Attorneys for Dugan Production Company attended the oral presentation, and followed with a written response submitted on February 7, 2003. You submitted your final written response on February 21, 2003.

The approvals involve five distinct well locations, listed in the table below. To reduce the likelihood of adverse effects on coal mining, the BLM requested that Dugan move all five well locations. The final location of all five wells is listed in column 2.

Well Name	Location (all in San Juan Co., NM)	Date Approved by FFO	Field / Target Formation
Riviera Com #90	T. 30 N., R. 14 W., sec. 18: 1955 FNL, 1535 FEL	11/25/02	Basin / Fruitland coal
Centennial Com #91	T. 30 N., R. 15 W., sec. 24: 1250 FNL, 1500 FEL	12/04/02	Basin / Fruitland coal

Dugan Production Corp.
Case No. 12888
Exhibit No. 4

Turks Toast #7 (aka Turks Toast #90-S-M)	T. 30 N., R. 14 W., sec. 17: 1335 FNL, 935 FWL	12/20/02	Twin Mounds / Fruitland Sand Pictured Cliffs
Centennial Com #90	T. 30 N., R. 15 W., sec. 24: 1850 FSL, 1150 FWL	12/20/02	Basin / Fruitland coal
Turks Toast #8 (aka Turks Toast #91-S-M);	T. 30 N., R. 14. W., sec. 17: 1765 FSL, 1700 FEL	12/20/02	Twin Mounds / Fruitland Sand Pictured Cliffs

The wellsites in sec. 24, T. 30 N., R. 15 W., are located within the boundaries of the San Juan "Deep Lease" coal lease, serialized as NM 28093. The "Deep Lease" was effective on March 20, 1980. The wellsites in secs. 17 and 18, T. 30 N., R. 14 W., are located within the boundaries of the San Juan "Deep Lease Extension" coal lease, serialized as NM 99144. The "Deep Lease Extension" became effective March 1, 2001.

In its written submission, San Juan made six main arguments in support of its request to have the drilling and sundry notices approvals overturned. Besides clarifying its written submission, SJCC presented two new issues at the oral presentation, listed as 7 and 8. We considered Dugan's rebuttal in our response, but the rebuttal is not reproduced here. The BLM's response follows each of your arguments.

San Juan Arguments

1) "The FFO failed to give appropriate consideration to the royalty and related economic benefits to be derived from coal mining as compared to CBNG development. The FFO failed to take into account the public interest in underground mining of coal, including economic considerations, public health and safety, and royalty/tax revenues."

BLM Response

The environmental assessments (EA) prepared by the FFO did identify the potential for a loss of recoverable coal. The EAs acknowledge the potential conflict between CBNG development and the underground mine. The EAs note that development of the CBNG prior to mining would result in recovery of gas that might otherwise be lost. It could also serve the purpose of degassing the coal and potentially reducing the hazard of an underground fire.

For the three wells proposed to be drilled within the area of the "Deep Lease Extension" (NM 99144), the FFO cites the terms of the coal lease as part of its rationale for approving the applications. The EAs resulted in a finding of no significant impact (FONSI) because the BLM does not share your view that development of the CBNG would prevent future mining of the coal.

2) "BLM has ignored the powerful tool available to it under the Federal oil and gas leases at issue here to halt oil and gas development activities in the public interest. Section 4 of the oil and gas leases in which Dugan claims an interest provides in pertinent part: 'It is agreed that the rate of prospecting and developing... from the lands covered by this lease shall be subject to the control in the public interest by the Secretary of the Interior, and in the exercise of his judgment the Secretary may take into consideration, among other things, Federal and State laws...'"

BLM Response

It is true that Section 4 of Federal oil and gas leases permit the BLM to control the rate of lease development. We do not interpret this provision to prevent development of a lease, or cause a portion of the recoverable reserves within the lease to be lost. The BLM has cited this section in instances where drainage of oil and or gas is occurring, as a means of requiring the lessee to diligently develop the lease and protect the lessor from drainage. The provisions of Section 4 were used by the FFO as its authority for requiring acceleration of development of the Fruitland Formation in advance of your mining operation.

3) The BLM failed to follow the provisions of its own Farmington RMP, as revised in 1998, and also failed to follow NEPA's procedural requirements. You then list the 4 alternatives provided in the Decision Record for the RMPA, and state that FFO "...failed to consider at least the last two of the four quoted alternatives in processing the two Sundry Notices that sought approval to recomplete wells in the Fruitland coal formation, which are the effective equivalent in the present circumstances to APDs."

BLM Response

We can see how the RMPA can be interpreted as emphasizing coal development over other resource uses. That is not the position of the BLM. By developing its oil and gas leases, Dugan is exercising its valid existing rights. The RMPA, and later leasing of the coal did not curtail these rights. The 'Protocol', which San Juan signed, and later became part of the RMPA, is explicit in emphasizing these prior rights.

In the chapter, Planning Alternatives, the RMPA (page 10) states that, "The proposed leasing of coal does not change RMP amendment program policies and decisions on existing oil and gas leases, particularly those held by production (one producing well). Prior existing rights remain in effect for all operators and lease holders."

The RMPA (pages 12-13) identified three alternatives that were considered but eliminated without further analysis. Alternatives 1 and 2 would have reduced the area available to coal leasing so as to eliminate many of the conflicts with existing oil and gas developments and rights-of-way. Both were rejected because the perceived conflicts might be eliminated by the time San Juan actually initiated mining in the area, and because it would not meet San Juan's long range need for coal reserves. Alternative 3 would have delayed leasing until the oil and gas pools were depleted. Alternative 3 was rejected because it would not meet San Juan's schedule for initiating underground mining on the "Deep Lease" in 2000.

The section Oil and Gas, under the Chapter titled Environmental Consequences (page 26 of RMPA), states that, "Existing leases, held by production, would continue to be developed and existing wells would continue to produce, as they have in the past. The development of existing leases, under the proposed action, would be coordinated with the coal mining company and could be delayed, until mining has been completed in a specific area. Specific agreements, reached between the coal mining company and the operator of existing oil and gas wells, would determine the type and level of impact to oil and gas production."

We believe the language cited above is clear that the FFO would continue to permit drilling and development of the existing oil and gas leases. Wells would be located so as to be compatible with your mining operation. When Dugan submitted its APDs, the FFO checked your mining plan, and later required that Dugan move all five of the well locations to reduce adverse impacts to mining. The RMPA did not recognize the potential consequences to mine economics and mine safety that you now present.

We do not believe that the Interior Board of Land Appeals (IBLA) decision in 157 IBLA 259 (Wyoming Outdoor Council) applies here. The types and level of impacts caused by CBNG drilling, completion and production were known and analyzed in NEPA documents that considered new leasing and gas development.

4) The December 20 decisions [of the FFO] were in violation of NEPA and its implementing regulations in two respects. First, the failure to consider the alternatives specified in the 1998 RMP Amendment, and other reasonable alternatives violates NEPA requirements that BLM consider a range of alternatives. Second, the FFO failed to adequately consider the potential impacts of the proposed drilling and completion in the coal formation on SJCC's coal mining activities. That failure violates NEPA."

BLM Response

The Decision Record changed the section Current/Future Oil and Gas Operations (page 10 of the RMPA) to state, "Future well development, on existing oil and gas leases, would be coordinated with Bureau staff, the oil and gas company and the mining company. Actions that would be considered for new Applications for Permit to Drill (APD) are (1) approval, (2) suspension of lease terms, if requested by the oil and gas operator and deemed appropriate by the Bureau, (3) directional drilling of formations and (4) a phase-in of drilling, as mining is completed." We note that the modification eliminated the phrase, "...to avoid proposed or active coal mining areas."

It is clear that the FFO analyzed and rejected as non-viable the other alternatives. Suspension of lease terms would be ineffective, since the leases are both held by production and in their extended term. Most importantly, lease suspensions would result in a loss of developable CBNG; we believe that there would be no economically recoverable CBNG post-mining. Coal mining physically removes the CBNG. Directional drilling is ineffective, because the well bore would still have to be located within the coal bed. Phase-in of drilling is ineffective, because this office believes that there would be no economically recoverable CBNG post-mining.

Finally, the FFO believed that relocation of the well sites would reduce or eliminate adverse cumulative impacts to coal mining.

5) In advance of its December 20 Decisions, BLM had not properly assessed, in accordance with 43 CFR 3162.5-1 and 3162.5-3, the conflicts presented by the existence of SJCC's coal leases and development activities and all relevant environmental impacts and potential safety precautions arising from, or necessitated by, the operations anticipated under the APDs."

BLM Response

Frankly, we have no data to determine whether or not hydro-fracturing of the coal would increase the likelihood of mine roof failure. You provide no direct evidence that hydro-fracturing of the coal would further weaken the mine roof, nor that introduction of fracturing fluids would increase the likelihood for spontaneous combustion. You do provide a copy of the transcript of Dr. Stephen L. Bessinger's testimony before the New Mexico Oil Conservation Commission (OCC), in the *De Novo* hearing of case No. 12,734 (Richardson's application for infill drilling in the Basin-Fruitland Coal Gas Pool).

Dr. Bessinger stated his professional opinion that hydro-fracturing of the coal would result in weakening of the roof rock. He conducted an experiment at the hearing, exposing a sample of the roof rock to immersion in water. He noted that the rock began to decompose after a short period of time. He used this

as an analog that hydro-fracturing of the coal would likely result in the same effect underground. You have already experienced several failures of the mine roof, in locations remote from any CBNG development. Dr. Bessinger's experiment and testimony could indicate that mine roof failure may be a problem anywhere the coal and overlying rock are water-saturated. The OCC issued Order R-11775-B on December 19, 2002, which authorized the drilling of an optional infill well within each 320-acre gas spacing unit. The FFO approved three of the well applications the day after this Order was signed.

6) "While coal-CBNG development conflicts are of nationwide significance, the conflict here, between an underground coal mining operation and CBNG development, present unique issues concerning health and safety and the potential waste of one mineral resource or the other. While not yet specific to underground mines, BLM has adopted a national policy to address development conflicts generally, Instruction Memorandum (IM) No. 2000-81."

BLM Response

This IM is concerned mostly with the conflict between CBNG development and surface mining of coal. The intent was to maximize recovery of both resources by requiring the drilling and development of CBNG in advance of mining. That was the rationale behind the letter of May 21, 2001, in which FFO required Dugan to accelerate CBNG development prior to coal mining. That window of opportunity closed when San Juan began to oppose CBNG development within the mine area.

For surface coal mining, the existence of a well bore and hydro-fractured coal is not a hazard. In New Mexico, the BLM has extrapolated the provisions of the IM to apply it to conflicts between CBNG development and underground mining. The IM is written to provide the flexibility needed to consider the value of both the coal and CBNG resources; unfortunately, that results in some ambiguity, too. For example, the IM suggests that the BLM may assess the oil and gas operator for its failure to timely develop coalbed methane in advance of mining. But, we may also assess the coal mine operator for avoidably bypassing coal, and we may direct the coal mine operator to analyze all possible mining plans to allow maximum recovery of the coalbed methane and deeper hydrocarbons.

The language in the IM that is of most value to San Juan requires that the BLM consider financial impacts when deciding if any of the potential actions are in the public interest. We agree that the value of the mined coal is significantly greater than the value of the produced CBNG. The mined coal will generate significantly higher royalties for the Federal and State governments than will the CBNG. The coal will fuel a power plant that provides electricity for the local population, and has many local employees.

The IM recommends that the BLM facilitate an agreement between the oil and gas lessees and the coal lessee. In 2002, the FFO facilitated several meetings between the parties, and achieved nothing. It appears to us that all parties need to see an escalation of the risk until they come to the table.

7) Regarding the issue of 'prior existing rights' you acknowledge that Dugan's leases predate your coal leases. However, you believe that the BLM should not consider lease issuance dates, but development plan approval dates. Using this measure, San Juan had approved plans for development of its coal leases before Dugan filed plans to develop the coalbed natural gas within its leases.

BLM Response

Foremost, we believe that the issue of 'valid' or 'prior' existing rights needs to be settled for this case. We herein reject your argument that we should consider the date development plans are approved in lieu of lease issuance dates.

Dugan's leases were in effect long before San Juan acquired the coal leases. San Juan took both leases with the understanding that there was prior oil and gas development. The "Deep Lease Extension," in particular, acknowledges the existing oil and gas leases as prior existing rights to which it is junior. The "Deep Lease" is more problematic, because it does not include clear language regarding the pre-existing oil and gas leases. However, the RMPA is clear that, while the BLM would not issue new oil and gas leases covering the same land as the coal leases, we would continue to permit development of the existing leases.

In general, the BLM does not direct the rate of prospecting and development of oil and gas leases. Our lessees are thus able to make their exploration and development decisions upon the current economics and likelihood of success. We do direct development when we identify a drainage situation, or, as with Dugan's leases, when we identify a situation where the CBNG will be lost if not developed pre-mining.

We see no irregularities in Dugan developing the deeper portion of the coals before moving west, toward the outcrop. In addition, the FFO required Dugan (and other lessees) to accelerate development of the CBNG within their leases precisely due to your impending mining operation, as a means of recovering gas that would otherwise be vented or lost through mining. The production of CBNG was also recognized as having the potential to reduce the methane hazard in your underground mine.

8) You believe that the BLM has approved development on the Dugan leases as a means of avoiding a Fifth Amendment 'takings' situation, wherein Dugan may assert that its lease rights were denied unreasonably. You believe that the BLM has abdicated its responsibilities by not facilitating an agreement between the coal and oil and gas interests.

BLM Response

It is true that 'takings' is a concern of the BLM. Dugan's Federal oil and gas leases predate your coal leases. Their terms do not stipulate a priority for developing the coal leases at the expense of CBNG development. The RMPA recognizes Dugan's valid existing rights. We firmly believe that there will be no economically developable CBNG within the No. 8 coal seam post-mining. Thus, prior mining would prevent Dugan from recovering CBNG, and would likely reduce the company's revenue and Federal royalties on the CBNG. Your mine plan requires that the CBNG be vented; this may be a waste of an otherwise recoverable resource.

Footnote 9 on page 12 of your request describes your offer to compensate the BLM for its losses in a 'takings' claim by Dugan and/or Richardson Operating Company. We do not believe that filing a request for an SDR is the manner in which to initiate such an offer. More important, the BLM and San Juan alone cannot decide the reasonable value of the economically recoverable CBNG. Dugan and Richardson have to agree the payment is fair and equitable compensation.

From our perspective, the FFO had tried to follow the guidance in the IM by facilitating a settlement in the spring of 2002, but all of its efforts were unsuccessful. You believe that the oil and gas operators are trying to force you to pay an exorbitant amount of money to buy out their interest in the Fruitland CBNG.

And, they believe you are underestimating the volumes of recoverable CBNG, and that you are discounting the importance of their resources. We believe that an agreement can only be achieved if the parties submit to binding arbitration. What is obvious to the BLM is that the longer San Juan delays in eliminating the impediments to mining, the greater the economic leverage that Dugan and Richardson hold over you and your mine.

Decision

We believe that the FFO acted properly in approving the five APDs/Sundry Notices. If these wells are not drilled before mining ensues, the CBNG will never be recoverable.

If you wish to file a petition for a stay of the effectiveness of this Decision during the time that your appeal is being reviewed by the Board, the petition for a stay must accompany your notice of appeal. A petition for a stay is required to show sufficient justification based on the standards listed on the attached document (Form 1842-1). Copies of the notice of appeal and petition for a stay must be submitted to each party named in this Decision and to the Interior Board of Land Appeals and to the appropriate Office of the Solicitor (see 43 CFR 4.413) at the same time the original documents are filed with this office. If you request a stay, you have the burden of proof to demonstrate that a stay should be granted.

Sincerely,

Carsten F. Goff
Deputy State Director
Resource Planning, Use and Protection

1 Attachment

cc: (w/o attachment)
Field Solicitor
WO(310)
MSO(920)
CSO(920)
WSO(920)
USO(920)
NM(010)
NM(020)
NM(030)
NM(040)
NM(044)
NM(050)
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