STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

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IN THE MATTER OF THE APPLICATION OF RICHARDSON OPERATING COMPANY TO ESTABLISH A SPECIAL "INFILL WELL" AREA WITHIN THE BASIN-FRUITLAND COAL GAS POOL AS PROVIDED BY RULE 4 OF THE SPECIAL RULES FOR THIS POOL, SAN JUAN COUNTY, NEW MEXICO.

Requested De Novo Review by Secretary of OCC Case No. 12734 (De Novo)

APPLICATION FOR REVIEW BY THE SECRETARY OF THE ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT OF THE DECEMBER 19, 2002 ORDER OF THE OIL CONSERVATION COMMISSION AND THE JANUARY 23, 2003 DENIAL OF SAN JUAN COAL COMPANY'S APPLICATION FOR REHEARING AND REQUEST FOR STAY

Pursuant to NMSA 1978 Section 70-2-26 ("Section 70-2-26"), San Juan Coal Company ("San Juan") seeks Secretarial review of the Oil Conservation Commission ("Commission") Order of December 19, 2002 (Attachment 1), and the January 23, 2003 denial of rehearing (collectively, the "Order").[1] San Juan requests that the Secretary hold a hearing, pursuant to Section 70-20-26, "to determine whether [the Order] contravenes the public interest." San Juan submits that it does. San Juan also requests that the Secretary stay the effect of the Order pending the Secretary's decision in this proceeding.

I. INTRODUCTION.

A. Introduction to the Case.

This is a unique case presenting a direct conflict between oil and gas lessees and coal lessees seeking to develop their respective leasehold interests on the same lands. If ever there

[1] The Commission failed to act upon San Juan's January 8, 2003 Application for Rehearing. The Rehearing Application, therefore, is deemed denied as of January 23, 2003. NMSA 1978 Section 70-2-25 (Cum. Supp. 1998).

were a circumstance that justifies Secretarial review under Section 70-2-26, this case presents it. For at least three reasons, the Secretary should hold a hearing to review this matter.

First, the "public interest" under Section 70-2-26 is enormous, and it has not been considered by the Commission. The Commission determined that consideration of the public interest is beyond the scope of its jurisdiction under the New Mexico Oil and Gas Act. Order, Paragraph 64. The impacts of its decision not to consider the public interest are particularly severe because the public interest in coal development is very substantial; the Commission's Order allows infill development of a relatively marginal coalbed methane gas ("CBM") resource that will damage a major underground coal reserve, and this increase in CBM development threatens the loss of tens, perhaps hundreds, of millions of dollars in coal royalty revenue. The Order likewise contravenes the public interest by threatening increased public health and safety risk and adverse economic impact on employment in San Juan County. The Order also undermines reliability of the supply of electricity to many New Mexico communities served by the San Juan Generating Station, which relies on San Juan Coal Company as its sole coal supplier. The magnitude of the public interest, coupled with the fact that it has yet to be considered, merits Secretarial review.

Second, Secretarial review is all the more appropriate because this unique case involves a conflict between two mineral resources under the Secretary's jurisdiction: coal and CBM. Section 70-2-26 provides that in considering the public interest, the Secretary should give "due regard for the conservation of the state's oil, gas and mineral resources," but the Commission has expressly not given "due regard" for conservation of coal (emphasis added). In particular, the Commission has determined both that it lacks jurisdiction to consider waste of coal (although it considered waste of CBM) and that the requirements of Section 70-2-26, including the

requirement to give due regard to all minerals, applies expressly only to the Secretary, but not the Commission. Order, Paragraphs 62 and 64. In the wake of the Commission's decision not to consider waste and conservation of coal, it necessarily falls to the Secretary to give due regard for the conservation of both mineral resources.

Third, apart from the requirements of Section 70-2-26, this controversy raises important public policy considerations for the State that should be determined by the Secretary. It would be bad policy indeed to allow this conflict between development of two different mineral resources to be finally decided by a Commission that views its statutory charge as focused on only one of the two. This is a precedent setting case,[2] and it is incumbent upon the Secretary to set policy and precedent affecting all minerals under her jurisdiction with full and fair consideration of the all the issues presented, not just those that favor development of CBM. An effective Departmental policy for addressing conflicts in multiple mineral development must be accomplished with broad, rather than selective, vision.

B. Introduction to San Juan.

San Juan operates the San Juan Underground Mine, pursuant to a mine plan approved by this Department in 1999, on two federal and two state coal leases located west of Farmington, New Mexico and adjacent to the 1700 megawatt San Juan Generating Station, a coal fired power plant. San Juan employs approximately 300 workers in conjunction with the San Juan Underground Mine. Commission Transcript ("OCC Tr."), San Juan Coal Co. Exhibit 8. San Juan is the sole supplier of coal to the San Juan Generating Station, which is owned by Public

[2] At least one other proceeding may be affected immediately by the Secretary's decision in this proceeding. On October 15, 2002, the OCD issued a decision in Case No. 12888 (known as the "Basinwide" proceeding) in which it did not consider the waste of coal. That proceeding is now before the Commission for de novo hearing. The Commission and the parties would benefit from a Secretarial determination of the Commission's jurisdictional views.

Service Company of New Mexico, the County of Los Alamos, the City of Farmington and others. Id. The San Juan Generating Station employs over 400 people. San Juan estimates it will pay approximately $50 million per year in taxes and royalties derived from its San Juan Underground Mine operations. OCC Tr., San Juan Coal Co. Exhibit 8. San Juan estimates that its underground mine will generate up to $275 million in royalty alone over the life of the mine. Over half of this amount would go to the State of New Mexico, but the royalty stream is threatened by the Infill Application. OCC Tr., San Juan Coal Co. Exhibit 9.

The San Juan Underground Mine was developed in an effort to lower the price of coal to the Generating Station to enable the power plant to provide reasonably priced power to New Mexico and other states in the region and to compete more effectively in the marketplace. Increased development of the CBM resource through infill wells damages the coal reserve and potentially threatens the viability of the mine and the efforts to provide reasonably priced power to consumers.

II. APPLYING APPROPRIATE CRITERIA, THE SECRETARY SHOULD EXERCISE HER DISCRETION TO GRANT HEARING AND CONDUCT REVIEW OF THE ORDER.

Hearing and review by the Secretary of the Order is discretionary. Section 70-2-26 provides:

> The secretary of energy, minerals and natural resources may hold a public hearing to determine whether an order or decision issued by the Commission contravenes the public interest.

In this instance, the Secretary should exercise her discretion to hold a hearing, review the Order, and direct the Commission to deny the September 11, 2001 Application of Richardson to Establish a Special "Infill Well" Area.

The statute provides that the Secretary may hold a public hearing, but it does not state the criteria that the Secretary should apply in deciding whether to hold a hearing. In determining whether to hold a hearing, the Secretary should preview the case concerning the Section 70-2-26 criteria of "public interest" and "due regard for conservation of the state's oil, gas and mineral resources" by reviewing this Application and the response of Richardson. Then, in deciding whether to hold a hearing, San Juan submits that the Secretary should apply a two-pronged test to determine: (1) whether the Commission has adequately considered these criteria; or (2) whether San Juan raises important questions about the public interest or the conservation of mineral resources. If the Commission either has not adequately considered these criteria or if important issues concerning them are presented, then the Secretary should grant hearing and review in this matter.

Both prongs of the test are met here. With regard to the first prong of the test, the Order concedes that the Commission has not considered the Section 70-2-26 criteria. Order, Paragraph 64. As to the second prong, San Juan demonstrates that the Order raises critically important issues because it contravenes public interest and threatens waste of, and does not give due regard for, an economically important coal resource. Both prongs are addressed in Sections V and VI of this Application.

III. THE "PUBLIC INTEREST" STANDARD: WHAT DOES IT MEAN?

Section 70-2-26 does not define the term "public interest," and San Juan's research discloses no judicial interpretation of that term in the express context of the Oil and Gas Act. Consequently, the Secretary may look to the manner in which the term, "public interest," has been construed in other contexts.

In the context of water rights administration, New Mexico law confirms that considerations of both economics and public health and safety are encompassed within the concept of public interest. In Young & Norton v. Hinderlider, 15 N.M. 666, 110 P. 1045 (1915), the New Mexico Supreme Court considered what factors should be considered in determining the "public interest" in the administration of water rights. There, the Territorial Engineer (the case arose initially before New Mexico became a state; the office is now the State Engineer), applying a "public interest" analysis, rejected an application for the diversion of water for an irrigation project on the basis that the project would require the price of water delivered to irrigators to be twice as high as a competing project for which an application had been filed. See 15 N.M. at 670. Hinderlider appealed the decision to the territorial Board of Water Commissioners. Id. at 671. The Board ruled that the "public interest" test allowed consideration only of the public health and safety (and whether water was available). Id. at 674.

Young & Norton in turn appealed first to district court and then to the New Mexico Supreme Court. After the trial court affirmed the Board's decision, the Supreme Court considered the meaning of the term "public interest." Id. at 677-80. The Court began its analysis by saying that consideration of public health and safety is not a broad enough inquiry when one is to consider the "public interest." Id. at 677. Thereafter, the Court determined that "public interest" considerations are not limited to public health and safety matters. The Court proceeded to express the opinion that economic considerations, including the cost of projects and the price of commodities as a result, are also a fair element of the "public interest." Id. at 678. Applied here, it is clear that the Secretary should consider public health and safety, as well as economic considerations such as employment, and royalty and tax revenues to the State and local communities, in determining whether allowing CBM development is in the "public interest."

National Indian Youth Council v. Andrus, 623 F.2d 694 (10th Cir. 1980), recognizes the significant public interest benefits of a coal mine. There, the United States Court of Appeals for the Tenth Circuit considered the "public interest" in the context of a preliminary injunction application that sought to shut down coal mining operations on the Navajo Reservation. After the district court denied the request for preliminary injunction, the plaintiffs appealed to the Tenth Circuit. After extensive briefing, the Tenth Circuit rejected the plaintiffs' request for injunctive relief. Predictably, the court considered the "public interest," citing Battle v. Anderson, 564 F.2d 388, 397 (10th Cir. 1977). In so doing, the court stated:

> The fourth factor is the public interest. The Navajo Nation [the lessor of the coal lease at issue] benefits from the lease. The [District] Court found that the Navajo Nation will receive approximately $4.58 billion in revenues from the activities of ConPaso [the coal lessee]. In the first year of mining the Nation will receive about $709,000 in royalties. Additionally, members of the Navajo Tribe will have needed opportunities of employment available through the ConPaso project. The harm to the Navajos is real. (Record citation omitted).
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> We take judicial notice of the energy problems confronting the United States. The Government encourages the production of coal. The ConPaso operation will add to that production. The public interest will be served by permitting the project to go forward.

623 F. 2d at 696. Applied to the present situation, clearly the public interest is best served by permitting San Juan to proceed with minimum interference in the development of the San Juan Underground Mine, and limiting development of the marginal CBM resources that conflicts with the coal development. As in National Indian Youth Council, the royalty owners – in this case, both the United States and the State of New Mexico – will derive substantial royalties from the coal development. As in National Indian Youth Council, the local communities providing employees for the mine operations – in this case, the Navajo Nation, the Ute Mountain Ute Tribe, the City of Farmington, San Juan County and environs – will benefit from the large

workforce necessary to operate the mine. As in National Indian Youth Council, the harm to these communities that could arise from decisions permitting CBM infill development to proceed at the expense of the coal operation is real.

IV. THE APPLICABLE STANDARD FOR DETERMINING PUBLIC INTEREST SHOULD BE "THE GREATER WEIGHT OF THE EVIDENCE", AND NO DEFERENCE TO THE COMMISSION'S ORDER IS APPROPRIATE.

Pursuant to Section 70-2-26, the Secretarial hearing that San Juan seeks "shall be a de novo proceeding." New Mexico courts consider the term "de novo" to mean "anew." Southern Union Gas Co. v. Taylor, 82 N.M. 670, 486 P.2d 606 (NM 1971). The New Mexico Supreme Court in Southern Union, p. 671, recognizes that "this view is in accord with Black's Law Dictionary at 1677 (4th Ed. 1951), wherein 'trial de novo' is defined as: 'A new trial or retrial had in an appellate court in which the whole case is gone into as if no trial whatever had been had in the court below.'"

Because the Secretary's review is de novo, it is appropriate that the Secretary give no deference whatsoever to the Order of the Commission. For example, in Southern Union, a case involving an appeal from the Magistrate Court to be determined by trial de novo in the District Court, the New Mexico Supreme Court observed: "If the district court were in any way bound by the findings of the magistrate court, it would not be a trial de novo, or a trial anew." Id.

Based on the record of the Commission hearing below (as provided by Section 70-2-26) and upon additional evidence presented at hearing before the Secretary, the Secretary should determine the matters before it by the greater weight of the evidence. Uniform Jury Instruction No. 13-304 for civil cases provides that it is the general rule that the greater weight of the evidence standard applies to civil cases. (UJI 13-304.) Exceptions to this rule are limited and inapplicable here. That jury instruction provides: "To prove by the greater weight of the

evidence means to establish that something is more likely true than not true." The comment to UJI 13-304 recognizes that "preponderance of the evidence" has the same definition as the "greater weight of the evidence." Based upon the greater weight of the evidence, San Juan will show that the Order contravenes the public interest.

V. THE COMMISSION'S ORDER CONTRAVENES THE PUBLIC INTEREST.

The Commission refused to consider the "public interest" as provided by NMSA 1978 Section 70-2-26:

> 64. San Juan also argues that NMSA 1978 Section 70-2-26 permits the Commission to consider San Juan's objections. That section permits secretarial review of a decision of the Commission, and provides that *the Secretary* may enter such order as may be required under the circumstances in the "public interest" and "...having due regard for the conservation of the state's oil, gas and mineral resources...". However, that section does not on its face apply to *the Commission*. Even assuming it did and the Commission could consider the coal resource, "conservation" of the state's mineral resources is not at issue since the MSHA regulations require the use of protection pillars or other measures adequate to protect worker safety. The conflict here is not between oil and gas producers and coal miners, but between San Juan's obligation to its workers under the Act and MSHA regulations and its plan of operations.

Order, Paragraph 64 (Emphasis in original.) The Commission emphasizes that the request to consider the public interest applies to "the *Secretary*" and not the Commission (emphasis in original). Having concluded that on its face the Section 70-2-26 directive to consider the public interest does not apply to the Commission, paragraph 64 of the Order comments, in somewhat cryptic dicta, that one element of the public interest – conservation of the state's mineral

resources – is not even at issue.[3] Conservation of all mineral resources clearly should be at issue in hearing before the Secretary. (See Section VI of this Application.)

Perhaps as a result of not having considered the public interest, the Commission's Order contravenes it. When appropriate consideration is given to the harm infill wells threaten for coal development, and to a comparison of the royalty and related economic benefits to be derived from San Juan's underground mine and those to be derived from the requested CBM infill wells, that consideration leads to the conclusion that the "public interest" favors coal development and requires that the Infill Application be denied.

While CBM development elsewhere in the San Juan Basin has been productive, the San Juan Underground Mine Area, located on the fringes of the San Juan Basin, is far more productive for coal development than for CBM. The "public interest" is served by facilitating development of the San Juan Underground Mine, without the serious complications that would arise in the event of infill drilling of CBM wells. The public interest would be better served by denial of the Infill Application, thereby allowing the San Juan Underground Mine to be developed efficiently and productively. This Section first describes the operational impact of CBM wells on San Juan's coal mine (see Section V.A), and then compares the economic benefits of coal and CBM (see Section V.B).

A. Infill CBM Wells Will Adversely and Seriously Impact San Juan's Coal Production.

San Juan's underground mining operations use a longwall miner as the primary equipment for coal production. OCC Tr. 277-80, and San Juan Coal Co. Exhibits 10 and 12.

[3] The dicta also seems to reflect the Commission's misunderstanding of the import of MSHA regulations. Application of MSHA regulations highlights rather than negates the issue of conservation of mineral resources because adherence to the regulations requires bypass of significant quantities of coal. If the Infill Application is granted, more wells may need to be bypassed.

That equipment consists of a massive shearer-conveyor system that moves back and forth across a coal face approximately 1,000 feet wide and 13 feet high. OCC Tr. 278. The panels or blocks of coal to be mined by the longwall equipment are up to 10,000 feet long. OCC Tr. 278. The economic viability of the coal reserve at the San Juan Underground Mine depends upon the systematic development of the reserves through the use of longwall mining equipment and techniques. It would be technically difficult, time consuming, and costly to deviate from San Juan's approved mining plan. OCC Tr. 282-85. Avoiding oil or gas wells in the coal panels will cause great disruption of San Juan's planned coal mining activity, and may result in the loss of large quantities of coal that likely will be bypassed and not recovered in any subsequent operations. OCC Tr. 292-96, and San Juan Coal Co. Exhibit 13. Additional wellbores placed in the coal pursuant to the Infill Application create additional problems. OCC Tr. 292.

The existence of a wellbore in the coal seam to be mined presents San Juan with two alternatives, at least theoretically. First, San Juan can seek to acquire the rights to the well and assure the well is plugged and abandoned and the casing is milled out according to Mine Safety and Health Administration ("MSHA") requirements so that San Juan may safely mine through the well. However, San Juan has sought to acquire Richardson's wells, and efforts to reach an accommodation with Richardson have been unavailing. Consequently, at present, this first alternative is only a theoretical one. As a second alternative, which is the much less desirable alternative and often impractical, if San Juan is unable to acquire the rights to mine through a wellbore, San Juan must bypass the wellbore according to MSHA regulations that require 600

feet of unmined coal be left around the wellbore (300 feet on each side).[4] OCC Tr. San Juan Coal Co. Exhibit 13.

Bypassing a barrier pillar of coal creates at least two problems that render it an undesirable, and sometimes impractical, alternative. First, it is extremely cumbersome, time consuming, costly and potentially risky to stop San Juan's longwall mining apparatus, and disassemble, move, and reassemble it in order to bypass a wellbore. If too many wellbores exist in a given coal panel, the entire panel must be bypassed because the downtime caused by the bypass of each well would be cost prohibitive. Second, in addition to operational concerns, bypass of coal blocks or entire panels result in waste of coal and significant loss of royalty and tax revenue. See Section V.B, infra.

Hydraulic fracturing of the coalbed by CBM wells causes problems more severe and long lasting than the mere existence of a wellbore in the coal seam. A mere wellbore can be plugged and abandoned, but fracturing can permanently damage the coal so that even if eventual efforts to acquire the well are successful, the effect of fractures on the effort to mine through the fractured area would pose significant risk. Jacques Abrahamse, San Juan's ventilation engineer, testified that the hydraulic fracturing can lead to roof instability, which in turn can stop the longwall miner and inhibit proper and safe ventilation in the mine. OCC Tr. 361-67, 369-71, and San Juan Coal Co. Exhibit 16. Therefore, allowing additional fracturing of the coalbed may

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[4] The Commission apparently did not perceive the thrust of San Juan's position regarding MSHA regulations. The Order misses the mark when it suggests San Juan claims the regulations are inadequate, and then the Order asserts the regulations are adequate. Order Paragraph 44. Regardless of the adequacy of MSHA regulations to protect safety, the point is that adherence to MSHA regulations, together with the failure of negotiations between Richardson and San Juan, deprives San Juan of the ability to mine significant quantities of coal surrounding each wellbore. This result is not in the public interest. For this reason, MSHA regulations are not an appropriate basis for resolution of the conflict between coal and CBM, whether or not they may be adequate to protect safety.

foreclose San Juan from pursuing the first and favored alternative described above – acquisition, abandonment and mine-through of wells – because the damage is permanent. This scenario leaves alternative 2 – bypass of coal – which leads to inefficiency, economic loss, and waste of coal.

Acceleration of CBM production by new infill wells increases rather than mitigates the coal/CBM conflict. In general, the more wells, the greater the adverse impact on the mine. The Infill Application seeks essentially to double the number of wells completed and fractured in the coal. It is true that within San Juan's coal leases over 70 wells now exist. But no implication should be drawn that the real damage to the coal seam by gas wells has already occurred, or that the damage threatened by infill wells is not significant. Most of these 70 wells are not fractured in the coalbed, are completed in different horizons, are plugged or abandoned, or are outside San Juan's mining districts.

B. The San Juan Underground Mine Will Yield Greater Economic Benefit Than CBM Production; Coal Production Should Be Allowed To Proceed Without Additional Interference From Infill Well CBM Well Development.

Because CBM wells damage and cause bypass of mineable coal, the Secretary should compare the relative benefits of coal and CBM in the context of the public interest. Benefits to the public from the San Juan Underground Mine, including benefits to the State of New Mexico, the local communities near the San Juan Underground Mine and associated facilities, the communities served by the San Juan Generating Station, and employees of the mine and generating station are proven and monumental. In contrast, the viability of CBM development on lands occupied by the two federal coal leases and the two coal leases on State lands at the San Juan Underground Mine is uncertain, and even under optimistic scenarios, the economic return to the State of New Mexico, the United States, and local communities from CBM development

on those lands is far less than the return to be expected from coal development. Were the Secretary to allow the modest CBM prospects to interfere further with, or preclude, the development of a major and proven coal mine, the public interest would not be served and the State of New Mexico and others would lose tens, if not hundreds of millions of dollars in royalties.

San Juan's Underground Mine promises to develop a very large coal deposit. OCC Tr. 280-81. San Juan has commenced underground mining in accordance with its extensive mine plan for underground operations, which was submitted in January 1999 and subsequently approved by the Mining and Minerals Division of the Energy, Minerals and Natural Resources Department. OCC Tr., San Juan Coal Co. Exhibit 7. San Juan has invested at least $146 million in capital expenditures to develop the San Juan Underground Mine. OCC Tr. 271, and San Juan Coal Co. Exhibit 8. Based upon San Juan's mine plan, reserves within the two federal underground leases at the San Juan Underground Mine and two smaller state leases are estimated to be over 100,000,000 tons. OCC Tr., San Juan Coal Co. Exhibit 9. The San Juan Underground Mine and associated surface activities will eventually employ over 300 people. OCC Tr. 271, and San Juan Coal Co. Exhibit 8.

The San Juan Underground Mine will yield enormous royalties and other economic returns to the United States, the State of New Mexico, and local communities. Vast quantities of coal are committed to a long-term coal sales agreement with the utilities and governmental interests that own and operate the San Juan Generating Station. The long-term agreement provides great assurance to the State of New Mexico and the United States of a long-term royalty stream. OCC Tr. 272, and San Juan Coal Co. Exhibit 9. These coal sales would yield approximately $275 million in royalties from the federal and state leases based upon the 8%

royalty rate for underground operations. OCC Tr. 272, and San Juan Coal Co. Exhibit 9. The State of New Mexico would receive over half of that.

The San Juan Underground Mine is the source of coal for the San Juan Generating Station. The San Juan Generating Station is an essential supplier of electricity to New Mexico and elsewhere, and is one of the two largest generating stations in New Mexico. OCC Tr. 261. A reliable source of coal is essential to its operations and the widespread public benefit those operations afford.

In stark contrast, the economic benefit to the State of New Mexico and the United States and the other benefits to the public of the proposed CBM operations are modest compared to benefits from coal, and are far from proven. The unproven nature of the CBM reserve is illustrated by the fact that the federal oil and gas leases at issue have been in existence for many years, and to date, have yielded only modest CBM production. Moreover, although estimates of gas content and recoverable gas from coal on San Juan's two federal underground leases vary greatly, even the most optimistic estimate yields an economic benefit that is significantly less than that provided by the coal mine.

The extent of the coal that would be bypassed to avoid wellbores is described on OCC Tr. San Juan Coal Co. Exhibit 13, and the economic consequences of bypassing this coal are severe. Favoring a wellbore over its surrounding barrier pillar of coal so as to require that the coal mining operation bypass the coal costs an estimated net $800,000 in lost coal royalty per well. See OCC Tr., San Juan Coal Co. Exhibit 13. Based on testimony of Dan Smith about the value of CBM, an optimistic assessment of the royalty stream for gas produced from a good well is only $125,000, based on a royalty rate of one-eighth. OCC Tr. 564. Of course, this is an estimate only to provide an order of magnitude comparison with coal royalty. Offsetting the

$125,000 against the $800,000 yields a net royalty loss of $675,000 per well. Favoring multiple wellbores over an entire coal panel costs over $13 million in coal royalty (see OCC Tr., San Juan Coal Co. Exhibit 13) in exchange a "benefit" from CBM royalty, which by optimistic estimate of $125,000 per well, is comparatively miniscule. The coal is far more valuable than the CBM. The total coal royalty from the coal mine is estimated to be **$275 million** at the 8% underground royalty rate. See OCC Tr., San Juan Coal Co. Exhibit 9. For purposes of an order of magnitude comparison, Dan Smith testified that the total potential CBM revenue stream, using optimistic and untested assumptions (and without regard for well costs), might be from $16 million to $29 million over the life of Richardson's wells in the Infill Area, depending on the definition of "reserves." OCC Tr. 563. A total CBM royalty for Richardson based on one-eighth of that potential revenue stream would be in the range of **$2 million to less than $4 million**. The Secretary should compare the public benefits of a $275 million coal royalty stream with the benefits of a speculative $2 million to less than $4 million CBM royalty stream.

VI. THE COMMISSION'S ORDER FAILS TO GIVE DUE REGARD FOR THE CONSERVATION OF THE STATE'S OIL, GAS AND MINERAL RESOURCES.

In determining "whether an order or decision issued by the commission contravenes the public interest," the Secretary shall have "due regard for the conservation of the state's oil, gas and mineral resources." Section 70-2-26. Therefore, due regard for conservation of mineral resources is one component of the public interest analysis. This provision does not restrict the Secretary's obligation so as to require due regard only for the gas resource. Rather, the Secretary must exercise due regard for the conservation of "oil, gas, and mineral resources." (Emphasis added.) The "due regard" standard applies to all mineral resources. Coal is without question a mineral resource. Moreover, it is a mineral that is subject to extensive regulation by the Department of Energy Minerals and Natural Resources, and therefore, it is of particular concern

to the Secretary. The Mining and Minerals Division is responsible for administration of laws and regulations relating to coal mines. NMSA 1978 Section 9-5A-4(D).

The Commission has expressly refused to give due regard to conservation of coal resources. Instead, it has used selective vision to favor only the gas resource. The Commission found in paragraph 64 of its Order that Section 70-2-26, the statutory source of the "due regard" standard, applies only to the Secretary, and does not apply on its face to the Commission. The Commission's dicta in that paragraph ("Even assuming...the Commission could consider the coal resource...") falls far short of due regard. Therefore, in reviewing this conflict, no state agency has yet given due regard for conservation of the coal resource, and the Secretary must do so now. Moreover, consistent with its selective focus on gas, the Commission considered waste of gas but expressly refused to consider waste of the coal resource. OCC Order Paragraphs 61 and 62. This refusal further emphasizes that the Secretary should grant a hearing and give "due regard" for conservation of the coal resource and more balanced consideration of waste.

Just as the loss of royalty dollars to the State and United States from bypassed coal is not in the public interest (see Section V.B. of this Application), so is the great tonnage of coal around infill wells that would be bypassed evidence that the Order does not give due regard for conservation of the coal resource. An estimated 330,000 tons of coal must be left in place around each wellbore that is not plugged and abandoned, and if, by virtue of wells, it becomes necessary to bypass an entire panel of coal, up to 5.5 million tons of coal could be lost per panel. OCC Tr., San Juan Coal Co. Exhibit 13.

In the context of conservation of all mineral resources, the Secretary should recognize that Richardson has not met its burden to establish that additional infill wells are economic or

efficient pursuant to the criteria of the Oil and Gas Act, NMSA 1978 Section 70-2-17.B. Section 70-2-17.B provides that the Division may establish a proration unit for each pool as:

> ...the area that can be **efficiently and economically** drained and developed by one well, and in so doing the division shall consider the **economic loss caused by the drilling of unnecessary wells,** the protection of correlative rights, including those of royalty owners, the prevention of waste, **the avoidance of the augmentation of risks arising from the drilling of an excessive number of wells,** and the prevention of reduced recovery which might result from the drilling of too few wells (emphasis added).

Bypass of more valuable coal for less valuable gas causes economic loss and is far from efficient. Excessive CBM infill wells augment risk of spontaneous combustion and its catastrophic results. The Commission's misapplication of the Section 70-2-17.B factors result in a waste of the coal resource.

In misapplying the Section 70-2-17.B standards, the Commission overvalues the CBM and undervalues the coal; such selective vision is not in the public interest. Section 70-2-17.B requires consideration of well economics, but in paragraph 22 of its Order, the Commission characterizes determining the level of production that is deemed commercial (in accord with the need to satisfy the Section 70-2-17.B criteria) as "an academic exercise." Rather than meaningfully consider whether infill wells are economic or efficient under Section 70-2-17.B, the Commission constructs a test that may be simple but finds no support in Section 70-2-17.B: "If Richardson is willing to accept the risk, the application should be approved." Order Paragraph 22. The Commission goes on to observe, without specifics, that evidence supports "some level of commercial production." Id. To decide this case with due regard for the conservation of all mineral resources requires more than this level of analysis, and San Juan requests that the Secretary provide it.

San Juan recognizes that, in considering conservation of all resources, it is also appropriate for the Secretary to consider at hearing the venting of gas by the coal mine. San Juan has the right to vent CBM under the Supreme Court decision of Amoco Production Co. v. Southern Ute Indian Tribe, 526 U.S. 865, 879 (1999), the terms of its state leases, and other authority. Moreover, San Juan submits it is appropriate to vent the less valuable gas resource as a necessary step in the development of the much more valuable coal resource. By any relevant measure, the Commission's decision would do far more "waste" of the coal resource by allowing additional infill wells of questionable economics than venting would waste gas. In its zeal to focus on waste of the gas resource, the Commission makes good on its commitment in paragraph 62 of the Order to ignore waste of coal. The Secretary should apply more balanced vision.

VII. IMPORTANT PUBLIC POLICY CONSIDERATIONS SHOULD BE DETERMINED BY THE SECRETARY

Although Section 70-2-26 is the focus of the Secretary's determination of whether to grant a public hearing, the Secretary should also consider her policy-making role. This controversy raises important public policy considerations for the Department of Energy Minerals and Natural Resources that should be determined by the Secretary. At least two policy issues are presented.

First, this case presents a conflict between the development of two important minerals squarely within the jurisdiction of Department. NMSA 1978 Sections 9-5A.1, et seq. The Secretary has jurisdiction over both coal (administered by the Mining and Minerals Division, see NMSA 1978 Sections 9-5A-3(a)(5) and 4(d)) and gas (administered by the Oil Conservation Division, see NMSA 1978 Sections 9-5A-3(a)(6) and 4(e)). If the Secretary were to leave final resolution of this conflict to the Oil Conservation Commission, the Secretary would have allowed the agency with responsibility for but one of the two resources to set public policy that

affects them both. This policy would be particularly inappropriate in light of the Commission's express refusal to consider conservation or waste of coal. This is a precedent setting case, and the Secretary should take the initiative to be sure that the conflict is resolved according to Departmental policy that gives fair and balanced treatment to all minerals under her jurisdiction.

Second, recognizing that the Oil and Gas Act does not allow the Commission to ignore waste of coal, the Secretary should make clear that it is also bad policy to do so. The Order erroneously determines that "waste" protected by the Oil and Gas Act is defined in terms of "crude petroleum oil or natural gas," not coal. Order Paragraph 62. This conclusion may be a comfortable result for the Commission, but it disregards the actual language of the Oil and Gas Act. First, Section 70-2-2 does not define "waste." Second, waste is defined at Section 70-2-3, and the Commission, using its selective vision once again, ignores a critical part of the definition. Paragraph 62 of the Order states that the Section 70-2-3 definition of waste "refers to waste as it is 'generally understood in the oil and gas business.'" But, the Commission fails to address or even recognize that the definitions of waste in Section 70-2-3 all include the first line of the statute, and that line states: "As used in this act the term 'waste,' in addition to its ordinary meaning, shall include:" As San Juan has pointed out to the Commission, the ordinary meaning of "waste" in Webster's Dictionary specifically includes a "disused part of a coal mine." Webster's Third New International Dictionary (1981 Ed.). The Secretary should recognize, as a policy matter supported by the Act, that waste under the Act includes waste of coal. The pendency of the Basinwide proceeding where these issues will be raised again emphasizes the need for the Secretary to correct the Commission's current erroneous course.

VIII. THE ORDER SHOULD BE STAYED PENDING REVIEW BY THE SECRETARY.

San Juan requests that the Secretary stay the effectiveness of the Commission's Order pending review of this matter by the Secretary. On July 26, 2002, the Division, at the request of San Juan, stayed its order in this matter pending final decision by the Commission. The Commission issued its Order on December 19, 2002, and denied rehearing by refusing to grant it on or before January 23, 2003. If the Secretary grants a review of the Commission's Order, then neither of these decisions by the Commission will be final, because Section 70-2-26 requires that the Commission "shall modify its own order or decision to comply [with the order or decision of the Secretary]." San Juan requests, for the reasons stated in its original Application of Stay filed with the Commision (see Attachment 2), that the Secretary continue the effect of the stay in this matter pending final review by the Secretary and subsequent action by the Commission.

IX. CONCLUSION.

To date in this matter, neither the Oil Conservation Division nor the Commission has considered the public interest or given due regard for conservation of all mineral resources. The Secretary should do so now. The Commission has improperly allowed Richardson to place its economic interests before all others. In granting the right to drill additional infill wells, the Commission has succeeded in favoring the gas producer, and Richardson has succeeded in obtaining the ability to drill additional marginal wells, but the public interest is not served by this result. San Juan Generating Station loses. San Juan loses. The State of New Mexico loses. The United States loses. The public loses. Only Richardson stands to benefit from the Infill Application, and even that benefit is uncertain given the poor or marginal economics of many of

its wells. The Secretary should grant a hearing to determine whether this result should be allowed.

Respectfully Submitted,

By: _____

James Bruce
Post Office Box 1056
Santa Fe, New Mexico 87504
(505) 982-2043

-and-

Larry P. Ausherman
Walter E. Stern
Modrall, Sperling, Roehl, Harris, & Sisk, P.A.
Post Office Box 2168
Albuquerque, New Mexico 87103-2168
(505) 848-1800

-and-

Charles E. Roybal
San Juan Coal Company
300 W. Arrington, Suite 200
Farmington, New Mexico 87401
(505) 598-4358

ATTORNEYS FOR SAN JUAN COAL COMPANY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading was served upon the following counsel of record as indicated this 24th day of January, 2003:

Via Fax and U.S. Mail
W. Thomas Kellahin
Kellahin & Kellahin
P.O. Box 2265
Santa Fe, New Mexico 87504
Fax No. (505) 982-2047

Via Hand Delivery
Stephen C. Ross
Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Via Fax and U.S. Mail
William F. Carr
Holland & Hart LLP
P.O. Box 2208
Santa Fe, New Mexico 87504
(505) 982-6043

James Bruce

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

APPLICATION OF RICHARDSON OPERATING COMPANY TO ESTABLISH A SPECIAL INFILL WELL AREA WITHIN THE BASIN-FRUITLAND COAL (GAS) POOL AS AN EXCEPTION FROM RULE 4 OF THE SPECIAL RULES FOR THIS POOL, SAN JUAN COUNTY, NEW MEXICO.

CASE NO. 12734
ORDER NO. R-11775-B

ORDER OF THE OIL CONSERVATION COMMISSION

BY THE COMMISSION:

THIS MATTER came before the Oil Conservation Commission (hereinafter referred to as "the Commission") for evidentiary hearing on October 29, 30 and 31, 2002 at Santa Fe, New Mexico on application of Richardson Operating Company (hereinafter referred to as "Richardson"), *de novo*, opposed by San Juan Coal Company, a subsidiary of BHP Billiton Limited (hereinafter referred to as "San Juan"), and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 19th day of December, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. In this matter, Richardson applies for an order creating a special infill area within the Basin-Fruitland Coal (Gas) Pool (hereinafter referred to as "the Pool"). Within the special infill area, Richardson requests that two producing coal gas wells be permitted within each 320-acre spacing unit. The proposed area encompasses Sections 4 through 6 of Township 29 North, Range 14 West, N.M.P.M., Section 1 of Township 29 North, Range 15 West, Sections 16, 19-21 and 28-33 of Township 30 North, Range 14 West, N.M.P.M. and Section 36 of Township 30 North, Range 15 West, N.M.P.M. San Juan opposes the application.

3. Richardson is the current operator of wells in the Pool and owns interests in both state and federal oil and gas leases within the proposed special infill area (hereinafter referred to as "the application area"). Richardson's rights under its leases extend from the surface to at least the base of the Pictured Cliffs formation.

4. The Pool is an unprorated gas pool and is governed by Rule 104.D(3) (19.15.3.104.D(3) NMAC) of the Rules and Regulations of the Oil Conservation Division. Rule 104.D(3) permits one well to be located within each 320-acre spacing unit.

5. The Pool is also governed by pool-specific rules, the "Special Rules and Regulations for the Basin-Fruitland Coal (Gas) Pool" (hereinafter referred to as "the pool rules") established in Order No. R-8768 (and amended in Orders No. R-8768-A and R-8768-B). The pool rules require wells to be located in the northeast or southwest quarter of a single governmental section and no closer than 660 feet to the outer boundary of the unit nor closer than 10 feet to any interior quarter or quarter-quarter section line or subdivision inner boundary and permit an infill well to be drilled only after notice and hearing. Amendments to the pool rules have recently been enacted by the Oil Conservation Division in Order No. R-8768-C. The amendments permit one infill well to be drilled (or re-completed) within certain spacing units, but the Order of the Division expressly exempts the area encompassed by Richardson's application. Several applications for review *de novo* by the Commission have been filed in that matter.

6. If approved, Richardson's application would permit Richardson to re-complete eighteen existing Pictured Cliffs wells in the Fruitland formation; it would also permit Richardson to drill seven new wells and complete those wells in both formations.

7. Dugan Production Corp. (hereinafter referred to as "Dugan") forwarded a statement to the Commission after the hearing supporting Richardson's application. Dugan states that it owns oil and gas leases within the area covered by Richardson's application and believes that the application area should be developed on a well density of 160-acres or less to maximize recovery of coalbed methane prior to mining by San Juan.

8. San Juan opposes Richardson's application. San Juan is not an oil and gas operator; it is the operator of the San Juan Coal Mine. That mine is located approximately sixteen miles west of Farmington, New Mexico. San Juan holds leases to mine coal in the same area as the oil and gas operators hold leases to produce natural gas. San Juan claims that Richardson's application, seeking as it does increased well density in the Fruitland formation in the same area where coal mining is to occur, would make coal mining more

difficult and expensive, and that the hydraulic fracturing that would be used to stimulate the coalbed methane production would compromise mine safety. San Juan also claims that insufficient reserves of methane exist in the application area and therefore additional development is not warranted.

9. Well density in a specific pool may be increased when an operator is able to demonstrate that additional wells will increase the ultimate recovery of natural gas, not simply accelerate production. See, e.g., Order No. R-8768-C, NMSA 1978, § 70-2-17(B). Richardson seems to acknowledge that an application to accelerate production would not normally justify an increase in well density. However, Richardson (and Dugan) argue that this matter is unique --- accelerating production of natural gas from the Fruitland coal will prevent the waste of coalbed methane that will otherwise be destroyed when the coal is mined by San Juan. Richardson notes, and San Juan acknowledges, that gas found in the mine during operations by San Juan will simply be vented and owners of the gas not compensated for its loss. Thus, Richardson argues that its application will serve the goal of preventing waste of the natural gas in the coalbed while also protecting the correlative rights of the oil and gas leaseholders. Any acceleration of production that may occur, Richardson argues, is justified by the imminent destruction of the coal.

10. Richardson's point is well-taken and the application should be granted.

11. It is undisputed that San Juan intends to mine vast quantities of coal within the area encompassed by Richardson's application, and that San Juan intends to vent the coalbed methane rather than put it to beneficial use. It is also undisputed that the basal coal to be mined by San Juan is the source of a substantial proportion of the coalbed methane. The normal concern about the drilling of unnecessary wells does not arise when it is necessary to extract the resource quickly before its certain destruction. Prevention of waste is of greatest importance in this situation and is served by Richardson's application.

12. Furthermore, the evidence presented during the three-day hearing in this matter confirms that there are substantial recoverable reserves of coalbed methane gas in the application area, and production from wells in the application area will be both economic and efficient. The production records from wells in the vicinity demonstrate the existence of these resources. For example, Richardson's Bushman 6-1 Well when initially drilled showed gas and did not require extensive dewatering, and is producing at a median rate of 321 mcf per day. The Pittam Pond No. 1 well started out with minimal production, but climbed to 70 mcf per day and is still inclining. The State 36-3, a well located very near the mining operation, produced slowly when first completed in July that climbed to a daily production rate of 150 mcf/day. The State 16-1 started production at very low rates, but increased to over 100 mcf/day. Wells farther east and north are

showing inclining production five years after completion, and some are showing inclining production seven to eight years after completion. The WF State 36-1, 36-2 and 36-3 all are producing gas from within the application area. Even by San Juan's analysis, numerous wells in the southeastern portion of the application area are producing commercial quantities of gas and have significant reserves.

13. Richardson's wells in the application area have produced over 2.5 bcf since inception of the project around the year 2000. The production pattern to date suggests that some wells are still being dewatered and performance of these wells may increase with time.

14. The geologic evidence further confirms the potential of the area. The evidence shows that the application area is in the southern part of the San Juan Basin, outside the so-called fairway. The coals in the area are somewhat thinner than in the fairway, and the average thickness of the upper and the lower coal together is twenty-eight feet. The basal coal is of a consistent thickness across the application area, while the upper coals are thinner and more discontinuous. But the geologic evidence shows that areas where the coalbed is two feet or more thick, it is potentially gas-productive, like coalbed producing zones present in other basins. The various isopach maps of the basal Fruitland coal presented indicate that the coalbed is relatively consistent across the application area, with a range of thickness between eight feet and eighteen feet, and an average thickness of fourteen feet. The isopach maps presented of the upper Fruitland coal indicate that the upper coalbeds have a range of thickness over the application area from three feet to twenty-one feet. Such geologic evidence corroborates the production data that commercial quantities of gas exist within the application area.

15. The other evidence presented by the parties (coring data, isopach analysis, pressure analysis) also confirms that the area is capable of coalbed methane production in commercial quantities.

16. San Juan responded to this evidence during the hearing by arguing that the bulk of the wells in the area will not be commercially viable, and also argued that the costs of water disposal will overwhelm the benefit of any gas production. The evidence does not support these arguments. Although some wells in the application area are not stellar performers, others produce very well and are undeniably commercial. The bulk of the wells Richardson proposes to add in the application area are re-completions and very little production is required to make a commercially viable re-completion. Several of the wells within the application area produce quantities of gas that could support a new well. The better conditions appear to be located in the southeastern portion of the application area, and commercial production is certainly to be had there.

17. Efficient disposal of water is a major issue in coalbed methane development. Richardson's water disposal system is evolving, and will eventually reduce the costs of water disposal. The Salty Dog No. 1 disposal well is in operation in the northeast quarter of Section 1 (T.29, R.14W), and the Salty Dog No. 2 is in operation in the southeast quarter of Section 5. The capacity of these wells is approximately 1,000 to 1,500 barrels per day. Richardson supplements these wells with commercial disposal services. Richardson plans to permit additional wells since the present system is running at capacity. These wells are to be located in Sections 28, 30 and 31 (T.30N, R.14W). One of these wells will be capable of disposing of 10,000 to 12,000 barrels per day, and the others approximately 1,000 to 1,500 barrels per day. The operating costs of Richardson's entire operation will be reduced ultimately from one dollar per barrel to twelve cents per barrel. This plan is reasonable, and Richardson uses his own forces and equipment to the extent possible to keep costs down.

18. While the evidence suggests that commercial production can be obtained within the application area, it is also clear that Richardson has overestimated the amount of gas which may ultimately be recovered within the application area. Some of San Juan's arguments concerning some of Richardson's evidence, in particular the simulation evidence, are well-taken.

19. Richardson's petroleum engineer Dave O. Cox presented testimony that turned out to have been based on a computer simulation of the predicted performance of wells within the Deep Lease and the Deep Lease Extension. From the simulation, Mr. Cox testified that 160-acre spacing in the application area resulted in a recovery of 1.1 bcf per well and 320-acre spacing resulted in a recovery of 1.29 bcf per well. Mr. Cox testified that the ultimate recovery in the application area on 160-acre spacing was 66 bcf, while at 320-acre spacing it was only 39 bcf. Thus, Mr. Cox testified that granting the application would increase the value of the ultimate production from the application area by $27 million.

20. The simulation however is misleading and the results cannot be accepted. Computer simulations (or "models") can be very helpful in predicting future performance so long as certain basic facts are known. But simulations rely heavily on the assumptions that the computer is asked to make; if few facts are known and too many assumptions are made, the accuracy and reliability of the results suffers. In his simulation Mr. Cox made far too many assumptions, based to be sure on his extensive experience in the San Juan Basin, but such evidence is more properly presented as engineering judgments and opinions, not as a simulation of actual results. In many cases, the results obtained by the computer simulation were identical to the assumptions the computer was required to make in the input deck --- and the same data that was fed into the computer was then presented as "results." The presentation of engineering opinions through a simulation

seems misleading under these circumstances, particularly as many of the assumptions themselves are reasonable and based on experience within the San Juan Basin.

21. Other issues with the simulation were pointed out during Commissioner Lee's discussion of the results with Mr. Cox during the hearing, and satisfactory resolution of those issues has not been reached either.

22. Although from the foregoing it is apparent that Richardson has overestimated the amount of gas present within the application area, it also appears that the estimates of San Juan are overly pessimistic and the truth lies somewhere in between. In any event, as noted earlier, determining precisely the level of production that is deemed "commercial" within the Deep Lease, the Deep Lease Extension and the Twin Peaks area is an academic exercise because of the impending destruction of the coal by mining. If Richardson is willing to accept the risk, the application should be approved. However, the evidence also points to some level of commercial production, and the experience of Richardson and others in the area demonstrates that this finding is sound.

23. Richardson's application achieves accelerated production so as to prevent the waste of the coalbed methane resources and the evidence demonstrates that coalbed methane resources exist in the application area. Richardson's application will prevent waste of the coalbed methane resources by accelerating the production of gas from the Fruitland formation prior to San Juan mining the coal and venting the methane gas.

24. San Juan's principal objections to Richardson's application seem to be that Richardson's proposed activities will compromise mine safety and increase the cost to the mine of conducting mining operations.

25. San Juan presented testimony that coal from the San Juan Coal Mine is the sole source of coal for the San Juan Generating Station, a power station owned by Public Service Company of New Mexico and others. A contract between San Juan and Public Service Company of New Mexico obligates San Juan to supply approximately 100 million tons of coal to the San Juan Generating Station through the year 2017.

26. Until recently the San Juan Coal Mine operated as a strip mine, but the dip of the coal seams towards the east made further strip mining economically infeasible. San Juan developed an underground mine so that mining could continue. The strip mine (and an adjoining strip mine known as the La Plata Mine) will be closed.

27. In the strip mine, San Juan mined coal from the "8" and "9" coal seams; in the underground operation, San Juan will mine only the "8" seam, the basal coal seam.

28. The underground mine of San Juan will progress through longwall mining of "panels" 1,000 feet wide by 10,000 feet long. The mine is separated into "mining districts" that are connected by "mains" and "gate roads" that are tunnels excavated in the coal by means of continuous mining machines. The panels themselves are removed during mining by an immense longwall mining apparatus. The longwall mining apparatus is 1,000 feet long (the width of the panel) and it progresses 10,000 feet through the coal until it reaches the end of the panel. The roof immediately over the machine is supported during mining by 178 shields that are part of the longwall mining apparatus; once the coal is removed the shields are moved forward and the remaining coal and the roof above the coal are permitted to collapse. This collapsed area behind the apparatus is called the "gob"; it is comprised of loose coal and rock that collapses following removal of the coal and the shield. Removal of a single panel by the longwall mining machine can take an entire year. San Juan intends to mine in each district, mining in an easterly direction through the Deep Lease, the Deep Lease Extension and, perhaps, the Twin Peaks area if leases are granted there.

29. San Juan began underground mining in a pilot project around 1997. At the same time, San Juan began planning the full-blown underground mine, which is now in operation.

30. San Juan has leases to mine coal issued by the United States and the State of New Mexico, State Land Office. The "Deep Lease" consists of a lease from the United States issued in 1980, and permits mining of coal in Township 30 North, Range 15 West, Sections 13 (S/2), 14 (S/2), 23, 24, 25, 26 and 35 (Lots 1-4, N/2, N/2S/2). See San Juan's Exhibit No. 2. The "Deep Lease Extension" is a lease from the United States issued in March 2001, and permits mining of coal in Sections 17, 18, 19, 20, 29, 30 and 31 (Lots 1-4, N/2, N/2S/2). See San Juan's Exhibit No. 3. A lease from the State of New Mexico was issued in 1991, and permits mining of coal in portions of Section 32. See San Juan's Exhibit No. 4. Another lease from the State of New Mexico was issued in 1991 that permits mining of coal in portions of Section 36. See San Juan's Exhibit No. 5. It seems to be undisputed that Richardson's oil and gas leases pre-date San Juan's coal leases.

31. Within San Juan's leases, approximately seventy-six oil and gas wells exist.

32. San Juan is also interested in obtaining leases east of the Deep Lease Extension, an area referred to during the proceedings as the "Twin Peaks" area. San Juan plans to acquire leases to the two sections east of and adjoining the Deep Lease Extension by lease from the federal government.

33. The coal lease granted to San Juan by the United States in 2001 contains conditions or stipulations regarding the pre-existing oil and gas leases. The lease is made "... subject to all prior existing rights including the right of oil and gas lessees & [sic] other

mineral lessees and surface owners." The lease also specifies that it is the "sole responsibility" of San Juan "... to clear the coal tract of any legal encumbrances or pre-existing land uses that would impede or prevent coal mining on the tract." Coalbed methane is specifically excluded from the State leases, except incidental amounts that may have to be vented or flared in connection with mining.

34. In addition, San Juan agreed with the Bureau of Land Management in 1998 in connection with an amendment to the Farmington Area Resource Management Plan that San Juan would mitigate adverse impacts of the coal mining activities on oil and gas production. San Juan pledged to "take all reasonable steps to avoid adverse impacts on oil and gas resource production, gathering and transportation facilities." Among the steps discussed was "mining around existing wellbores....". San Juan pledged to compensate producers in appropriate circumstances if coal mining affects or destroys the productive capacity of oil and gas wells. See Richardson's Exhibit A-8.

35. After the Deep Lease Extension was approved by the Bureau of Land Management, San Juan lodged a protest with the Bureau concerning Richardson's and Dugan's applications for permits to drill within the area, claiming that the steel casing would have an adverse impact on the continuous mining machines and that hydraulic fracturing would have an adverse impact on roof stability and that the risk of spontaneous combustion would increase if hydraulic fracturing were performed. San Juan requested that stipulations be placed on the permits to drill to address these concerns. The Farmington Field Office denied the protest, noting the stipulation contained in the 2001 lease for the Deep Lease Extension and stating that the proposed stipulations would render the leases uneconomic and "constitute an unfair burden on the oil and gas lessees who have priority rights in developing their associated mineral resource." See Richardson, Exhibit A-26. The decision was appealed to the State Office (which largely affirmed the decision but remanded it for further examination of an environmental assessment the Field Office had performed) and the matter was apparently settled after an appeal to the Interior Board of Land Appeals.

36. Initially, San Juan, together with the Bureau of Land Management, sought to accelerate production of natural gas within the mine area, believing that the accelerated production would enhance the safety of the mining operations by lessening the risk of explosions and fire from the methane gas, some of which would be removed by the oil and gas operators. However, in August 2001, San Juan changed its position and claimed it had concerns that the hydraulic fracturing and de-watering operations inherent in coalbed methane production would elevate the risk of spontaneous combustion. During the hearing of this matter, San Juan reiterated some of these concerns and also complained that Richardson's activities would increase the probability of roof collapse, and that the existing well casings would require use of large protection pillars rendering mining less efficient.

37. The Bureau of Land Management apparently still desires accelerated production of coalbed methane in advance of mining.

38. One of San Juan's principal concerns about the application is with hydraulic fracturing. Hydraulic fracturing is necessary in most cases to achieve optimal production of coalbed methane. See Order No. R-11133-A , pages 10-12. Coal is already naturally fractured, through its cleat system, and oil and gas operators use hydraulic fracturing to enhance the natural cleat system --- proppants in the fracturing fluids help hold the resulting fissures open.

39. Before San Juan's claims concerning hydraulic fracturing are addressed, it should be noted that mining the basal coal already presents a number of engineering challenges for San Juan. Tests of the coal in the mine area indicate that an elevated level of hydrogen sulfide is present, and as a result the mining environment is highly corrosive. The environment has apparently proved more corrosive than originally believed, as San Juan's equipment is corroding quickly and roof bolts have failed. San Juan does not allege that any of these conditions are exacerbated by Richardson's activities.

40. Mine safety appears to be the sole responsibility of the mine operator. The federal Mine Safety and Health Act of 1977 (hereinafter referred to as "the Act") and safety regulations of the Mine Safety and Health Administration (hereinafter referred to as "MSHA") require that an underground coal mine operator locate and avoid each existing oil and natural gas well when mining:

> (a) Each operator of a coal mine shall take reasonable measures to locate oil and gas wells penetrating coalbeds or any underground area of a coal mine. When located, such operator shall establish and maintain barriers around such oil and gas wells in accordance with State laws and regulations, except that such barriers shall not be less than three hundred feet in diameter, unless the Secretary or his authorized representative permits a lesser barrier consistent with the applicable State laws and regulations where such lesser barrier will be adequate to protect against hazards from such wells to the miners in such mine, or unless the Secretary or his authorized representative requires a greater barrier where the depth of the mine, other geologic conditions, or other factors warrant such a greater barrier.

30 U.S.C. § 877(a). Regulations of MSHA are identical. See 30 C.F.R. § 75.1700.

41. San Juan's witness testified that the Act and MSHA's regulations require the mine to leave a protection pillar around each oil and gas well in the area where

underground coal mining will occur. According to witnesses testifying at the hearing, MSHA has interpreted 30 U.S.C. § 877(a) as requiring that the minimum radius of the pillar to the open face be no less than 300 feet (or 600 feet in total *diameter*). While the Act and regulations do not seem to require a 600-foot diameter pillar, the witnesses seemed to agree that MSHA personnel interpret the regulations in this manner.

42. Witnesses testified that MSHA permits coal mining right through an oil or gas well if the casing is milled out within the coal seam and the wellbore is plugged with expanding cement, apparently pursuant to the provision in the Act that permits a smaller barrier if it "... will be adequate to protect against hazards ...". The witnesses testified that a well cannot be prepared in this manner and mined through without the consent of the oil and gas operator, and witnesses further testified that San Juan has not acquired rights to any of the oil and gas wells in the application area (although San Juan has apparently been negotiating with Richardson on this issue). Of the seventy-six oil and gas wells present in the coal leases, only three have been re-entered and prepared for mining (the New Mexico Federal K-3, in District 1 of the mine plan, and two other unspecified wells), and these wells will be mined through. Unless and until an agreement is reached with Richardson, San Juan's witnesses testified it will be obligated to leave protection pillars around each well owned by Richardson. However, it appears from the testimony that only wells actually located in the mining districts or within 300 feet of a district must be protected with protection pillars or milled and plugged in the manner described.

43. With respect to oil and gas wells that San Juan is unable to acquire, the Act and the MSHA regulations require that the mine operator leave a protection pillar as described above. The small size of the wellbore and/or casing, and the typical length of a fracture in the Fruitland coal, argues that the margin of safety set forth in the Act and regulations is more than adequate for these wells.

44. San Juan also seems to claim that the Act and regulations themselves are inadequate. The evidence and testimony do not support this argument. It is extremely unlikely that a normal hydraulic fracturing job will create fractures that extend 300 feet from a wellbore. The evidence suggests that fractures will not travel into the shales and mudstones above the basal coal, but instead will progress through the coal to the boundary with the rock layers above (the "roof") and run along this boundary. The fractures are unlikely to leave the coal. Thus, it appears that in most cases, fractures should not extend beyond the protection pillars required by MSHA, will not extend into the rocks above the coal, and will not otherwise endanger the mining operations. If San Juan is concerned that fractures may extend further, its obligation under the Act seems to be to leave a larger barrier to assure that the mine workers and the mine are protected.

45. San Juan's argument that the MSHA regulations are inadequate suffers also from a lack of credibility because San Juan has not alerted MSHA to its concerns related to hydraulic fracturing and the inadequacy of the regulations. Although one of San Juan's witnesses stated that the matter had been discussed with an employee of the Bureau of Land Management and seemed to argue that this was tantamount to addressing the matter with MSHA, it seems that such an important issue should have been addressed directly with MSHA.

46. With respect to oil and gas wells that San Juan is able to acquire and properly prepare for mining, San Juan hopes to dispense with the required protection pillar. San Juan's argument with respect to these situations is that the hydraulic fracturing required to stimulate the coalbed methane wells will weaken the already weak roof and cause the gob seals to leak. San Juan claims the fractures will affect the load transferring capabilities of support structures. San Juan identified the introduction of water during hydraulic fracturing as another concern.

47. As has been noted several times now, San Juan's plan to mine through the area around each existing oil and gas well can only be exercised so long as the miners are protected against the hazards of the existing oil and gas wells, and it appears to be San Juan's sole responsibility to do so.

48. On the roof stability issue, it is evident that San Juan is more than capable of addressing any incremental increase in roof instability caused by hydraulic fracturing. As San Juan's witness Mr. Abrahamse pointed out, the roof of the major passageways consists of only two feet of coal and the roof above the coal consists of loose mudstones and shales, and is already unstable even without fractures. The mine experienced an unusual number of roof falls (five) during the development of the gate roads and mains. These conditions are apparently not unique to San Juan; the western region of the United States seems to be prone to poor roof conditions.

49. To address the unstable roof conditions, San Juan has taken numerous additional safety measures. It has enhanced its roof control systems. Additional bolting, cribbing and meshing are being installed. Bolts are now installed using a dry drilling process to prevent introducing water into the rocks. Eight-foot roof bolts are used with wire mesh (to prevent fretting), and monster mats and beams are used as well. Cribbing (direct support of the roof from the floor) is now placed in appropriate circumstances. During the development of the main heading roads, San Juan cut openings through the coal seam that were only nine to ten feet high in the fourteen foot seam, leaving a more secure roof of up to five feet thick.

50. These extensive precautions appear more than adequate to address any incremental increased risk posed by additional hydraulic fracturing in the application area. Not only are the locations of each well known to San Juan and mapped as required by the Act and MSHA regulations, but San Juan seems to have extensive knowledge of mine safety practices and techniques and uses a range of tools to address roof stability issues. Special precautions such as those described by Mr. Abrahamse can be taken to prevent falls in areas where a well bore is located. And, if conditions are too difficult, San Juan always has the option of leaving a protection pillar to further enhance safety.

51. San Juan's witness identified another issue related to roof falls, and that was the potential for a roof failure in front of the shields at the longwall machine. San Juan's concerns on this point were indefinite. Although San Juan's witness testified that fractures near a well bore might fail to transfer the load properly to rocks ahead of the longwall apparatus, San Juan seemed more concerned with the potential for spontaneous combustion after temporary suspension of operations while rock is cleared. The spontaneous combustion issue is addressed below, and, as discussed in paragraph 46, it is highly unlikely that fractures will travel in the rock strata above the coal; since the fractures will remain in the coal, the failures described by San Juan are not likely to occur.

52. San Juan's complaint about the use of water during hydraulic fracturing is not convincing. Use of water during hydraulic fracturing does not seem to pose much of an additional hazard to coal mining, because most of the frac fluids are recovered immediately following fracturing. Moreover, the coal already contains substantial amounts of water, substantially more than is introduced in a fracturing operation.

53. The paper of William P. Diamond (Richardson's Exhibit C-28) supports the view that hydraulic fracturing is not a threat to coal mining operations; its conclusion (although based on coal mines in other states and regions) seems to suggest that roof instability cannot be definitively tied to hydraulic fracturing of wells. The operations described in Mr. Diamond's paper involved fractures that were actually mined through --- and in those cases roof stability was not affected.

54. San Juan also seems more than capable of addressing any incremental risk of spontaneous combustion resulting from hydraulic fracturing.

55. Spontaneous combustion in coal is caused by oxidation and hydration. The risk of spontaneous combustion increases whenever loose material is present such as in the gob, where water or oxygen are present or where the coal is dry. The risk of spontaneous combustion in the San Juan Coal Mine is considered to be slightly greater than in the eastern United States. Apparently the risk of spontaneous combustion is

independent of the danger of a build up of explosive concentrations of methane gas (which San Juan discussed very little). San Juan claims that the fractures created by fracturing will aerate the coal, and permit air to leak through seals into the gob.

56. San Juan conceded that wells outside of the mining districts do not create a risk of spontaneous combustion (or of roof instability).

57. Within mining districts, MSHA regulations require methane gas to be vented to prevent development of an explosive concentration of methane. San Juan's witnesses described the extensive ventilation program at the mine that includes direct ventilation and monitoring. San Juan has sunk a large ventilation shaft from the surface to the mine near Panel 101, and has created six gob vent boreholes in Panel 101 that will be exposed to the surface as mining progresses. San Juan is venting approximately 800,000 to 1 million cubic feet of methane gas each day through the ventilation system.

58. A ventilation circuit is also used to prevent combustion of methane gas at the mining face. The air is pumped into the five portal areas of the mine, travels into the mine and passes across the face at the longwall machine. The air is then exhausted through the various gate roads to the ventilation shaft. If, during monitoring through the atmospheric monitoring system, or after sampling with a bag or tube bundle, the methane concentration is found to be too high at the working face, curtains must be installed or auxiliary fans installed to bring the concentration down. If concentrations are high enough, personnel are evacuated until the situation can be controlled.

59. Unfortunately, although ventilation controls the buildup of methane gas, the risk of spontaneous combustion increases with exposure to oxygen. Thus, the gob is carefully controlled to guard against spontaneous combustion through what was described as a "bleederless" ventilation system. The bleederless system at San Juan seals off the blocks of coal in the adjoining gate roads and limits the air-flow across the gob. See San Juan's Exhibit No. 19. The blocks of coal serve as anchor points for the seals, which are permanent walls built of concrete blocks or poured concrete. They are sealed to the adjoining rock with special materials and their construction is strictly governed by MSHA regulations. Pure nitrogen is pumped into the area behind the seals to neutralize the atmosphere and prevent combustion. The nitrogen displaces the oxygen and thus reduces the potential for spontaneous combustion. It is injected some distance behind the longwall face so that the air at the face is fresh enough for the workers. The gases in the gob are carefully monitored and analyzed. MSHA has approved the use of the bleederless system at San Juan, the second coal mine in the United States to utilize such a system.

60. These measures, particularly the monitoring efforts, convince this body that the risk of combustion (either of methane or from spontaneous combustion of coal) will be

carefully controlled by San Juan. Even assuming cracks left from hydraulic fracturing exist in some protection pillars or blocks of coal near the gob left by hydraulic fracturing, the location of each wellbore will be known to San Juan and special precautions can be taken if needed (including leaving a protection pillar around the wellbore if needed). Nothing presented by San Juan during the hearing of this matter suggests that the precautionary measures described will fail to control the risk presented by Richardson's wells.

61. Finally, as noted, San Juan argues that coal will be more difficult and expensive to extract if protection pillars must be left in the mine. The apparent argument is that the Commission must consider the "waste" of the coal resource.

62. However, the Commission lacks jurisdiction to consider such a claim. To be sure, the Commission has jurisdiction to prevent "waste." NMSA 1978, § 70-2-11(A). But "waste" protected by the Oil and Gas Act is defined in terms of "crude petroleum oil or natural gas," not coal. See NMSA 1978, § 70-2-2. The definitions of "waste" contained in section 70-2-3 refer to waste as it is "generally understood in the oil and gas business," not the coal business. And the Oil and Gas Act expressly provides the Commission with jurisdiction to consider waste of potash if affected by oil and gas operations (NMSA 1978, § 70-2-6(A)) but fails to provide parallel authority to consider waste of coal.

63. San Juan argues that the Commission must consider the possibility that Richardson's operations will threaten "injury to neighboring leases or properties." See NMSA 1978, § 70-2-12(B)(7)). It not necessary to directly address this argument, as the evidence does not support a finding that granting Richardson's application will harm San Juan's operations (see above). Moreover, it is most likely that the statement in section 70-2-12(B)(7) applies solely to neighboring oil and gas leases and properties, and that the words "lease" and "property" have the meanings as understood in the oil and gas industry. See 8 Williams & Myers, Oil and Gas Law (definitions of "lease" and "property").

64. San Juan also argues that NMSA 1976, § 70-2-26 permits the Commission to consider San Juan's objections. That section permits secretarial review of a decision of the Commission, and provides that *the Secretary* may enter such order as may be required under the circumstances in the "public interest" and "... having due regard for the conservation of the state's oil, gas and mineral resources ...". However, that section does not on its face apply to *the Commission*. Even assuming it did and the Commission could consider the coal resource, "conservation" of the state's mineral resources is not at issue since the MSHA regulations require the use of protection pillars or other measures adequate to protect worker safety. The conflict here is not between oil and gas producers and coal miners, but between San Juan's obligation to its workers under the Act and MSHA regulations and its plan of operations.

65. The application of Richardson should be granted, for the reasons discussed above.

66. Prior to the hearing in this matter, Richardson filed a motion to dismiss the protest of San Juan. Richardson argues in the motion that San Juan's protest must be denied because San Juan lacks standing in this matter. San Juan argues that Richardson's application put the coal mining plans and activities at issue, and that Richardson's application has the potential to harm San Juan's interests.

67. Rule 1203.A of the Rules and Regulations of the Oil Conservation Division (19.15.14.1203.A NMAC) provides that "... any ... person may apply for a hearing." Moreover, Rule 4(b) of the pool rules permit an "interested party" to appear and participate. These rules explicitly permit San Juan to appear and participate in these matters.

68. In order to obtain standing for *judicial* review in New Mexico, litigants must allege that a direct injury might occur as a result of the court proceeding. See New Mexico Right to Choose/NARAL v. Johnson, 1999-NMSC-5, paragraph 61, 126 N.M. 788, 975 P.2d 841; De Vargas Savings & Loan Ass'n v. Campbell, 87 N.M. 469, 472, 535 P.2d 1320, 1323 (1975); Ramirez v. City of Santa Fe, 115 N.M. 417, 420, 852 P.2d 690, 693 (Ct. App. 1993); City of Las Cruces v. El Paso Elec. Co., 1998-NMSC-6, P16, 124 N.M. 640, 954 P.2d 72. San Juan's allegations herein (that if Richardson's application were approved it would suffer injury) seem adequate to meet the judicial test. Between Rule 103.A., Rule 4(b) of the pool rules, and the allegations of injury by San Juan, it seems certain that San Juan has standing in this administrative proceeding, whatever the applicable standard.

69. Richardson also argues in the motion that San Juan's protest must be denied because of the priority of Richardson's rights under the various oil and gas leases and the various stipulations imposed in those leases. However, this body has explained recently that its function is not to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. See Order No. R-11700-B ("Conclusion of Law"). The conflicting leases present a very difficult problem; the problem seems to be an emerging one in the concurrent development of coalbed methane and coal. See 6 American Law of Mining § 200.04[2][c] (1997) ("Coal v. Oil and Gas Development"). However, the priority of the various leases is a matter for the courts, is not a matter that this body can address, and is not a matter upon which a decision in this matter should be based.

70. The other grounds asserted in the motion to dismiss are also unavailing and the motion to dismiss should be denied.

71. So that the Commission could understand the assumptions upon which Mr. Cox' simulation was based, Mr. Cox was requested to provide back-up data, which Richardson submitted on November 12. San Juan subsequently filed an objection to the data, and filed a Motion to Strike all the supplemental materials. San Juan argues that some of the material is from other proceedings before the Division and Richardson did not make the material a part of the record during the hearing.

72. The material submitted by Mr. Cox is not particularly relevant and, as noted above, the Commission specifically rejects the results of the computer simulation that the material purports to support. The material was requested by the Commission and Exhibit E in particular has been very helpful in assessing the results of the simulation and therefore should become a part of the record of these proceedings. However, Exhibit E-4 is a portion of the transcript from Case No. 12888, a case that is presently before the Commission on several applications for review *de novo*. While the Commission may agree to take administrative notice of the Division's record in Case No. 12888 during its review *de novo*, it is premature to address that issue. This material should not become a matter of record and should not be considered. The Motion to Strike should be granted with respect to Exhibit E-4, and denied with respect to the remaining "E" exhibits.

73. Subsequent to Mr. Cox's filing, San Juan filed a Motion to Supplement the record with the Affidavit of Dan Paul Smith, a witness for San Juan during the hearing of this matter. San Juan argues that Mr. Smith's affidavit is necessary to supplement his testimony during the hearing concerning desorption data. During questioning by Commissioner Lee, Mr. Smith had testified that he did not have the desorption data available and had left the data at his office in Houston. Commissioner Lee did not request to look at any material and San Juan made no mention of the need to supplement the record on this point during the hearing. San Juan argues that since Mr. Cox was permitted to submit additional data, Mr. Smith should also be permitted to do so. Richardson opposes this supplementation of the record, pointing out that this material should have been submitted during the hearing, and that to permit supplementation would deny Richardson the right to cross examine Mr. Smith concerning it.

74. San Juan's motion should be denied. Just because Mr. Cox was asked to provide additional data does not mean that each party should now be permitted to provide additional materials and testimony that were not presented during the hearing. The Commission did not request additional data from Mr. Smith like it did from Mr. Cox. San Juan did not object to the Commission's request of Mr. Cox. With the exception of the data supplied by Mr. Cox, the record was closed following the three-day hearing and additional evidentiary submissions are not appropriate.

75. Two additional points need to be made. It is evident that San Juan has failed to plan for the disposition of the oil and gas wells in the application area. San Juan planned its underground mining operation beginning in 1997 and committed huge financial resources to the underground mine: the longwall mining apparatus alone cost over $150 million. Yet, during the hearing it became apparent that San Juan still has no discernable plan for dealing with the seventy-six existing oil and gas wells present within its coal leases. San Juan's failure to plan for these wells is more puzzling because of the stakes: San Juan is the only source of coal for a major power station that provides a great deal of the electricity used in the State of New Mexico. Richardson's proposal to drill seven additional wells and re-complete eighteen more has to be viewed with these facts in mind. Seven additional wellbores and eighteen re-completions will not add appreciably to San Juan's difficulties, and restricting Richardson's development will not ameliorate San Juan's failure to reasonably plan its underground mining operation. San Juan's argument that severe economic consequences will flow from the granting of Richardson's application is thus severely strained; but it is also apparent that it is a problem largely of its own making.

76. Second, coalbed methane development and coal mining have been performed cooperatively in other parts of the country, and nothing in the record of these proceedings suggests a technical impediment to similar coordinated development is present here. Many of the technical obstacles identified by San Juan have already been addressed in its extensive roof protection program and the implementation of the new bleederless ventilation system. Cooperation with the oil and gas industry could lead to additional innovative techniques to further improve safety. The resources, coal and coalbed methane, are simply too valuable to the nation's energy security to simply dismiss one resource (coalbed methane) as "not as valuable" as another. San Juan's extensive planning for this project should have included a plan that would permit both coal mining and the development of the coalbed methane resource so waste of either could be avoided. The Bureau of Land Management sought to accomplish just that objective by encouraging Richardson to recover as much coalbed methane as possible; San Juan should not only follow the Bureau's lead, but should also seek ways to put the methane it will otherwise vent and waste to beneficial use.

IT IS THEREFORE ORDERED THAT:

1. An exception to Rule 4 of the Special Rules and Regulations for the Basin-Fruitland Coal (Gas) Pool and Rule 104.D(3) (19.15.3.104.D(3) NMAC) shall be and hereby is granted. The applicant, Richardson Operating Company, is hereby authorized to drill, complete and produce an optional infill well within each 320-acre gas spacing unit within the previously described special infill area.

2. The following conditions shall apply to the authority granted by this Order:

a. The initial coalbed methane well located on a 320-acre spacing unit shall be located in compliance with the setback and quarter section placement requirements set forth in Rule 7 of the pool rules.

b. An infill coalbed methane well on an existing 320-acre unit shall be located in the quarter section of the unit not already containing a Basin-Fruitland coal gas well, and shall be located in compliance with the setback requirements set forth in Rule 7 of the pool rules.

c. The plat (Form C-102) accompanying an Application for Permit to Drill for a subsequent infill well on an existing unit shall have outlined thereon the boundaries of the unit and shall show the location of the existing Basin-Fruitland coal gas well plus the proposed new infill well.

3. The Motion to Dismiss filed by Richardson shall be and hereby is denied, for the reasons set forth above.

4. The Motion to Strike of San Juan shall be and hereby is granted and denied in part, as set forth above.

5. The Motion to Supplement the Record of San Juan shall be and hereby is denied.

6. Inasmuch as Commissioner Lee is participating in the meeting during which this order is issued by conference telephone, and will be unable to execute the Order, the Chair is hereby delegated to execute the Order on behalf of the Commission.

7. Jurisdiction is retained for the entry of such further orders in this matter as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

Lori Wrotenbery

By: LORI WROTENBERY, CHAIR

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

OIL CONSERVATION DIV.
02 JUN 14 PM 4:54

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

APPLICATION OF RICHARDSON OPERATING COMPANY TO ESTABLISH A SPECIAL "INFILL WELL" AREA WITHIN THE BASIN-FRUITLAND COAL GAS POOL AS AN EXCEPTION TO RULE 4 OF THE SPECIAL RULES FOR THIS POOL, SAN JUAN COUNTY, NEW MEXICO.

Case No. 12734

APPLICATION OF SAN JUAN COAL COMPANY FOR STAY OF ORDER NO. R-11775

San Juan Coal Company ("San Juan") respectfully requests pursuant to Commission Rule 1220, that the Director of the New Mexico Oil Conservation Division ("OCD") stay the effectiveness of the June 6, 2002 Order of the Division, Order No. R-11775, pending consideration of this matter by the Oil Conservation Commission ("Commission") pursuant to San Juan's Application for hearing de novo and thereafter, if necessary, pending any subsequent review by the Secretary of the Energy, Minerals, and Natural Resources Department. Specifically, while the Commission hears and decides this matter, San Juan requests that the Director prevent Richardson Operating Company ("Richardson") or others from pursuing any drilling, recompletion, or fracturing of wells, or related activities purportedly authorized under Order No. R-11775. As grounds for this Application, San Juan states:

1. Concurrent with the filing of this Application for Stay, San Juan is filing its Application for Hearing De Novo of Order No. R-11775. To preserve the status quo while the Commission considers San Juan's Application, neither Richardson nor others should be allowed

to drill, recomplete, or fracture wells in the Basin-Fruitland Coal Gas Pool within the area encompassed by the Order.

2. Denial of a stay would prevent San Juan from obtaining meaningful review by the Commission (and the Secretary) of significant issues stemming from the conflict between coal bed methane ("CBM") and coal development. That is, if Richardson is allowed to proceed with drilling, recompletion or fracturing activities before the Commission decides this matter, the damage that San Juan seeks to avoid through Commission review will have already occurred. Moreover, the Commission and Secretary will have been deprived of the opportunity to decide the important policy issues presented by this precedent-setting case before the damage is done. Therefore, the Director should preserve the status quo by granting the stay.

3. Consistent with Commission Rule 1220B, a stay is necessary to protect public health and the environment; to "prevent gross negative consequences" to San Juan; and to prevent waste of the coal resource. Each reason is addressed in turn below.

4. A stay is necessary to protect public health and the environment. The drilling, recompletion, and fracturing activities of wells that are authorized by the Order irrevocably and significantly increase the risk of spontaneous combustion and explosion during subsequent coal mining operations. The subbituminous coal at San Juan Mine is prone to spontaneous combustion, and explosions or mine fires that result from spontaneous combustion prompted by CBM well development and operation could cause injuries or fatalities. To a limited degree, some of the hazards to health and safety posed by CBM development under the Order might be mitigated by bypassing blocks of coal. But the very process of bypassing coal increases significantly the risk of spontaneous combustion because the attendant long delays in mining can complicate the ventilation that is necessary to prevent spontaneous combustion. Moreover, San

Juan will present evidence to the Commission, as it has in these proceedings to date, that precluding or restricting additional drilling and fracturing activities, not requiring the bypass of coal, is the appropriate means to address safety concerns. Without a stay, the dangerous conditions San Juan seeks to avoid could be permanently inflicted by CBM development before the Commission, or possibly the Secretary, has the opportunity to consider it.

5. A stay is necessary to prevent gross negative consequences to San Juan. Drilling, recompletion and fracturing of wells authorized by the Order will irrevocably damage San Juan. San Juan is currently developing a world class underground coal seam at its San Juan Mine, with an initial capital investment of $146,000,000. Longwall production is planned to be operational this year. Drilling, recompletion or fracturing of wells in the coal seam is incompatible with longwall mining of these areas because it requires San Juan to bypass the wells. Bypass of wells damages San Juan by lost coal and by down time. Bypass of a single well leaves a block of approximately 330,000 tons of unmineable coal. Also, it takes about one month of downtime to move the longwall mining equipment in order to bypass the coal surrounding a well. The number of wells to be bypassed permanently increases the damage in lost coal and production time to San Juan. The loss of coal caused by increasing the number of wells can be even greater than the product of approximately 330,000 tons times the number of wells; if more than 2 or 3 wells are located in a coal panel, it may be necessary to bypass an entire panel of coal, and panels are generally almost 2 miles long. Unless a stay is granted, the drilling, recompletion or fracing of wells authorized by the Order will create irreversible mining conditions that will cause great damage to San Juan over time.

6. Without a stay, there is great risk that coal resources will be wasted. The magnitude of the potential waste of coal is illustrated in part by the volume of coal that the

existence of a wellbore may cause to be bypassed. One well may cause the bypass of 330,000 tons of coal, with an estimated royalty loss of $800,000.00, assuming an 8% royalty rate; bypass of an entire panel may cause a loss ten times greater. As more CBM wells are drilled, the greater the potential for waste of the coal reserves that will not be mined by San Juan. This results in irreparable harm to the United States, the State of New Mexico, and the coal reserve. The Order determines that "[t]he New Mexico Oil and Gas Act has specific statutory mandates concerning the prevention of waste of potash in addition to prevention of the waste of oil and gas; however, no such specific mandates exists concerning waste of coal." See Order, Finding No. 26. While the Order may be correct that there is no "specific mandate" concerning waste of coal, the Oil and Gas Act does not ignore other mineral resources, such as coal, and the legislature expressly charges the Secretary with authority to consider, upon any Secretarial review of the decision, to consider a matter "having due regard for the conservation of the state's oil, gas, and mineral resources...." (Emphasis added.) NMSA § 70-2-26 1978. At a minimum, even if the OCD and Commission do not expressly consider waste of mineral resources such as coal, it should preserve the status quo to allow the Secretary to do so, as required by the legislature, in factual circumstances where the damage has not already occurred for failure to issue a stay.

7. Beyond the considerations for granting a stay identified in Rule 1220B, other factors also support the issuance of a stay: avoidance of irreparable harm to San Juan; preserving the opportunity for the Commission, and possibly the Secretary, to determine new and important issues; consideration of the public interest; and comparison of great harm to San Juan with mere delay to Richardson. These considerations are described below.

8. A stay is necessary to avoid irreparable harm to San Juan. If pursuant to the Order, Richardson fractures additional wells, those actions will permanently burden the coal

seam with additional instability and spontaneous combustion risk. The damage is irreversible. It is impossible to "unfrac" a well. Drilling and recompletion pose similar risk. Damage from these activities is perhaps not as irreversible as fracturing because the Commission could require that new wells or recompletions be plugged, abandoned and milled out upon a favorable ruling by the Commission, but major inefficiencies would result.

9. A stay is necessary to provide meaningful opportunity for the Commission, or possibly the Secretary, to decide important new issues of public concern. If upon authority of the Order alone, Richardson takes the action that San Juan seeks to prevent, then the damage is done before the Commission has the opportunity to consider and decide these issues. To deprive the Commission and Secretary of meaningful review undercuts the authority of the Commission and the Secretary. For example, the Commission or Secretary presumably would like to decide whether it is good policy to issue a decision that causes the bypass of millions of tons of coal, where the State's share of the lost royalty that is associated with that coal is worth many multiples more than the value of the corresponding gas royalty.

10. Public interest justifies a stay. The Secretary is required by NMSA '70-2-26 1978 to consider the "public interest," with due regard not just for oil and gas, but also for other "mineral resources." The value of the coal to be bypassed as a result of CBM wells is vastly greater than the value of the CBM. On the federal leases alone, total coal royalties are estimated to be in excess of $250 million; half of that amount goes to the State. In addition, the state's royalty share of the two state sections in San Juan Mine is at risk. It is not appropriate to accelerate development of far less valuable gas resource before the Commission and/or Secretary have the opportunity to decide what is in the public interest, when such acceleration threatens the viability of a much more valuable coal resource.

11. If the stay is denied, the threatened harm to San Juan far outweighs any possible harm to Richardson (or others) if the stay is granted. Most of the leases Richardson holds have been in existence for decades without the production Richardson now seeks. Any additional delay in drilling, recompletion, or fracturing by Richardson of a few months during which the Commission can hear and decide this case are not unreasonable. In particular, there is no credible threat that gas of Richardson's will be lost during the few months it takes for review by the Commission and possibly the Secretary. As reflected in BLM's September 25, 2001 letter to Peter A. Bjork, Richardson's counsel, BLM has determined that San Juan's current mining operations are not adversely affecting Richardson's claim to gas reserves. On the other hand, if Richardson were to proceed to drill, recomplete and fracture wells, the damage to the coal seam and San Juan's operations would be great and irreparable.

THEREFORE, San Juan Coal Company respectfully requests that the Director grant a stay of the effectiveness of the June 6, 2002 decision, Order No. R-11775, pending final decision by the Commission and the Secretary in this matter. A proposed form of Stay Order is attached as Exhibit A to this Application.

Respectfully Submitted,

By: _____

James Bruce
Post Office Box 1056
Santa Fe, New Mexico 87504
Telephone: (505) 982-2043

-and-

Larry P. Ausherman
Walter E. Stern
Modrall, Sperling, Roehl, Harris, & Sisk, P.A.
Post Office Box 2168
Albuquerque, New Mexico 87103-2168

Telephone: (505) 848-1800

-and-

Charles E. Roybal
San Juan Coal Company
300 W. Arrington, Suite 200
Farmington, New Mexico 87401
Telephone: (505) 598-4358

ATTORNEYS FOR SAN JUAN COAL COMPANY

I HEREBY CERTIFY that a true and correct copy of the foregoing pleading was hand-delivered to counsel for the OCD, the Commission and Richardson Operating Company, and mailed to counsel for Dugan Production Corporation this 14th day of June, 2002.

By: _____
Jim Bruce

W0234615.DOC

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED
BY THE OIL CONSERVATION DIVISION
FOR THE PURPOSE OF CONSIDERING:

APPLICATION OF RICHARDSON OPERATING
COMPANY TO ESTABLISH A SPECIAL "INFILL
WELL" AREA WITHIN THE BASIN-FRUITLAND
COAL GAS POOL AS AN EXCEPTION TO RULE 4
OF THE SPECIAL RULES FOR THIS POOL,
SAN JUAN COUNTY, NEW MEXICO. Case No. 12734

STAY ORDER
APPLICATION OF SAN JUAN COAL COMPANY
FOR STAY OF ORDER NO. R-11775

This matter having come before the Director on San Juan Coal Company's Application for Stay of Order No. R-11775, the Director, having considered the Application and the surrounding circumstances, finds that the Application is well taken and should be granted.

Therefore, it is ORDERED that the June 6, 2002 Order of the Division, Order No. R-11775 is hereby stayed pending final decision of the Oil Conservation Commission, and final decision of the Secretary of the Energy, Minerals, and Natural Resources Department in the event any party invokes Secretarial review under the Oil and Gas Act, NMSA '70-2-26 1978. Neither Richardson Operating Company nor any others are permitted to take any action pursuant to Order No. R-11775.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Dated: _____

_____
LORI WROTENBERY, Director

EXHIBIT A