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

IN THE MATTER OF THE APPLICATION OF REDWOLF PRODUCTION, INC. FOR EXPANSION OF THE SPECIAL INFILL WELL AREA AND FOR EXCEPTION TO THE WELL DENSITY PROVISIONS OF THE SPECIAL RULES AND REGULATIONS FOR THE BASIN-FRUITLAND COAL GAS POOL, SAN JUAN COUNTY, NEW MEXICO

CASE NO. 14191

APPLICATION

Redwolf Production, Inc., ("Redwolf"), through its undersigned attorneys, Montgomery and Andrews, P. A., and Cavin & Ingram, P. A., hereby makes application to the Oil Conservation Division for an order expanding the Special Infill Well Area established pursuant to Order No. R-11775 and providing for an exception to the well location provisions of the Rules and Regulations for the Basin-Fruitland Coal Gas Pool (71629) for the drilling of an original and one infill well within the SE/4 of a standard spacing and proration unit consisting of the S/2 of Section 25, Township 30 North, Range 15 West NMPM in San Juan County, New Mexico. In support of its application, Redwolf states:

1. Redwolf is the operator of the following well drilled to and pending completion in the Fruitland Coal formation, Basin-Fruitland Coal Gas Pool, in that standard 320-acre ± spacing and proration unit comprised of the S/2 of Section 25, Township 30 North, Range 15 West, (the "Subject Lands"):

Kelly FC Well No. 1
(API No. 3004533326)
1180' FSL & 900' FEL (Unit P)

2. Redwolf also operates the following well drilled to and currently producing from the Grassy-Gallup oil pool (96339) and the Basin-Dakota prorated gas pool (71599), also located in the S/2 of said Section 25:

Kelly Well No. 1
(API No. 3004526494)
990' FSL & 880' FEL (Unit P)

Commingled production from the Grassy-Gallup and Basin-Dakota pools is authorized pursuant to Administrative Order No. DHC-3486.

3. The above-referenced Fruitland Coal spacing unit is located within the low-productivity area[1] of the Basin-Fruitland Coal Gas Pool defined by Rule 7(C) of the Special Rules and Regulations for the Pool, promulgated by Order R-8768-F dated July 17, 2003.

4. Rule 7(D) of the pool rules for this area within the Basin-Fruitland Coal Gas pool provides as follows:

Rule 7D: Well Density

> (1) Well density within the low productivity area: "No more than two (2) wells per standard 320 acre gas spacing unit may be located in the "*Low-Productivity Area*" of the Pool as follows:
>
> (i) The *optional in-fill well* drilled on an existing spacing unit shall be located in the quarter section not containing the *initial Fruitland Coal Gas Well*[.]

5. Redwolf seeks authorization to drill an additional Basin-Fruitland Coal Gas infill well at a standard location within the SE/4 of the Subject Lands as follows:

Kelly FC Well No. 1-H
Section 25: NE/4 SE/4 (Unit I)

[1] The adjacent high-productivity area was established to identify, through a notice and hearing process, areas where infill drilling may not be indicated. (Para. 8, Order No. R-8768-F). Notice and hearing is not required for infill drilling outside that area.

6. Redwolf is the owner of an undivided 100% interest of the oil, gas and other minerals (except coal) pursuant to that Mineral Deed dated March 2, 1987 executed by the owner of the Subject Lands, Kelly Family Land Co., Inc., ("Landowner"). Redwolf's mineral interest in the Subject Lands is subject to a 23% reversionary interest in the Landowner after payout of the initial well drilled pursuant to that Development Agreement dated July 24, 1985. The interests of both Redwolf and the Landowner are subject proportionately to a 4% production payment owned by San Juan Coal Company. Redwolf, Landowner and San Juan Coal Company are the only interest owners of the oil and gas rights in the Subject Lands.

7. Redwolf's mineral interest in the S/2 of Section 25 is subject to a surface occupancy restriction that limits drilling locations to the E/2 SE/4. Therefore, the remainder of the Subject Lands, including the SW/4, is not available for a surface drillsite location.

8. San Juan Coal Company operates the San Juan Coal Mine, an underground coal mine located in T-30-N, R-14-W and T-30-N, R-15-W, approximately sixteen miles west of Farmington, New Mexico. The planned mining area for the San Juan Coal Mine includes mining and removal of the Fruitland Coal constituting the Basin-Fruitland Coal Gas Pool within the Subject Lands and adjacent sections.

9. Redwolf's Kelly Well No. 1 is among the seventy-six pre-existing oil and gas wells identified in Order No. R-11775-B issued by the Oil Conservation Commission on December 19, 2002 in Case No. 12734[2].

[2] Case No. 12734, De Novo: *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.* Order No. R-11775-B, finding paragraph 31.

10. On information and belief, certain underground mining operations for the San Juan Coal Mine are currently in close proximity to, or extend beneath the SW/4 of the Subject Lands. It is anticipated that in the future, mining operations will have removed substantially all the coal contained within the Fruitland Coal formation underlying the entirety of the Subject Lands.

11. As a consequence of San Juan Coal Company's proposed mining operations, Redwolf will be unable to produce otherwise recoverable hydrocarbon reserves from the Gallup and Basin-Dakota formations produced by the Kelly Well No. 1 and from the Fruitland Coal formation producible from the Kelly FC Well No. 1, or from any other formation within the S/2 of Section 25.

12. In connection with its mining operations, San Juan Coal Company constructs a series of continuous miner "entries" or "gate roads" by mining out the coal in horizontal penetrations that are 20' in width and 12' in height that provide equipment access in advance of "longwall" mining operations.

13. In addition, San Juan Coal Company has drilled a number of wells from the surface to the Fruitland Coal formation that intercept the continuous miner "entries". It is the apparent purpose of these wells to produce coalbed methane gas and allow it to vent to the atmosphere.[3] Otherwise, these wells are gas wells as defined by 19 NMAC 15.1.7G(5) of the Division's rules and regulations. One or more of these wells have been drilled on the Subject Lands. These wells have not been permitted by the Division and are being drilled by the use of unlined, below-grade pits.

14. The continuous miner entries and the wells drilled by San Juan Coal Company have drained and continue to drain and deplete coalbed methane gas owned by

[3] Division Rule 404A.(1) provides that no gas from a gas well shall be permitted to escape to the air.

Redwolf underlying the Subject Lands. As a consequence, Redwolf's correlative rights are being impaired and the waste of otherwise recoverable hydrocarbon resources is occurring.

15. Following the completion of the longwall mining operations referenced in paragraph 12, above, the roof of the mine area behind the longwall will be allowed to collapse. The resulting rubble and formational instability will preclude any further drilling within the Subject Lands. As a consequence of San Juan Coal Company's proposed operations, access to, and recovery of hydrocarbon resources in all formations will be prevented. Further, the wellbores of the Kelly No. 1 and Kelly No. 1 FC wells will be destroyed.

16. Gas produced from Redwolf's Kelly No. 1 well is transported to the Dugan Production Turk-Toast Gathering System by a pipeline that traverses the S/2 of Section 25. There exists a significant risk that the pipeline will be severed as a result of the anticipated subsidence of the surface and sub-surface following the collapse of the underground mine roof. The severance of the pipeline and the release of gas will pose a hazard to human health, safety and the environment.

17. Recently, San Juan Coal Company retained a service company who entered onto the Subject Lands to make plans to plug Redwolf's Kelly No. 1 and Kelly No. 1 FC wells. The entry by the service company was without Redwolf's knowledge or consent. Redwolf was only made aware of San Juan Coal Company's efforts to plug the wells because the service company sent an invoice to Redwolf. In previous proceedings, San Juan Coal Company acknowledged that it cannot plug and then mine through an oil

or gas well without the consent of the operator. (Finding paragraph 42, Order No. R-11775-B.)

18. Prior to the issuance by the Commission of Order No. R-8768-F on July 17, 2003, the Division issued Order No. R-11775 in Case No. 12374 establishing a Special Infill Area allowing for infill development in the Fruitland coal formation. The purpose of the Special Infill Area was to facilitate both the *incremental* and *accelerated* production of coalbed methane reserves. The Special Infill Area is comprised of the following lands:

TOWNSHIP 29 NORTH, RANGE 14 WEST, NMPM
Sections 4 through 6: All

TOWNSHIP 29 NORTH, RANGE 15 WEST, NMPM
Section 1: All

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM
Sections 16: All
Sections 19 through 21: All
Sections 28 through 33: All

TOWNSHIP 30 NORTH, RANGE 15 WEST, NMPM
Section 36: All

19. The Special Infill Area established by Order No. R-11775 immediately adjoins the Subject Lands. In view of the extensive record established in Case No. 12374, and the findings and conclusions set forth by the Division in Order No. R-11775 (Exhibit 1), by the Commission in Order No. R-11775-B (Exhibit 2), and by the Final Decision of the Secretary[4] dated October 1, 2004 (Exhibit 3), it is in the interests of administrative efficiency and economy for the Division to take administrative notice of those proceedings as a basis for expanding the Special Infill Area and according the additional relief requested in this Application on an expedited basis.

[4] Requested De Novo Review by the Secretary of OCC Case No. 12734.

20. An exception to Rule 7D(1)(i) of the pool rules for the Basin-Fruitland Coal Gas Pool to allow the additional infill well in the SE/4 of Section 25 is necessary to increase the ultimate recovery from proration unit and will not impair correlative rights. Further, the increased incremental and accelerated recovery of coalbed methane gas is necessary to offset the drainage that is being caused by San Juan Coal Company's continuous miner gate roads and gas wells.

21. The proposed infill well location conforms to the provisions of Rule 7(A) of the Special Pool Rules for the Basin-Fruitland Coal Gas Pool and will not be located closer than 660 feet to the outer boundary of the spacing unit or closer than 10 feet to any interior quarter-quarter section line or subdivision inner boundary.

22. Approval of this Application authorizing the drilling of the additional Fruitland Coal Gas well on the same quarter-section of the spacing unit will allow the owners therein to produce their just and equitable share of gas from the pool and will allow the production of additional coalbed methane reserves that would otherwise go un-recovered. Approval of this Application will further be in the interests of conservation, the prevention of waste and the protection of correlative rights.

23. The jurisdiction and the authority of the Division to grant the relief sought by the Application in this matter are established in the Oil and Gas Act. NMSA 1978 §§70-2-1, et seq. Section 70-2-2 of the Oil and Gas Act prohibits the waste of crude oil and natural gas outright. Section 70-2-11 of the Act provides:

> (a.) The Division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the Division is empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably

necessary to carry out the purposes of this act, whether or not indicated or specified in any section hereof.[5]

Further, Section 70-2-12(B) of the Act provides:

> Apart from any authority, express or implied, elsewhere given to or existing in the Oil Conservation Division by virtue of the Oil and Gas Act or the statutes of the state, the Division is authorized to make rules, regulations and orders for the purposes and with respect to the subject matter stated in this subsection;...
>
> (2) to prevent crude petroleum oil, natural gas or water from escaping from strata in which it is found into other strata; ...
>
> (7) to require wells to be drilled, operated and produced in such manner to prevent injury to neighboring leases or properties; and ...
>
> (10) to fix the spacing of wells[.]

In addition to the referenced statutory provisions, applicable rules and regulations of the Division include Rules 102 (Permit To Drill, Deepen Or Plug Back), Rule 106 (Sealing Off Strata), Rule 404 (Natural Gas Utilization) and Rule 1101 (Application For Permit To Drill, Deepen Or Plug Back).

WHEREFORE, REDWOLF PRODUCTION, INC. requests that this Application be set for hearing before one of the Division's examiners on October 16, 2008, and that after Notice and Hearing as required by law, the Division enter its order providing as follows: (A) authorizing the drilling of a second well in the E/2 SE/4 of Section 25 as an exception to Rule 7D of the Special Rules and Regulations for the Basin-Fruitland Coal Gas Pool; (B) expanding the Special Infill Well Area authorizing the accelerated production of coalbed methane gas from the Subject Lands; (C) prohibiting the plugging or destruction of wells on the Subject Lands; (D) prohibiting the waste of oil or natural

[5] *See, also*, NMSA 1978, § 70-2-6; "...[The Division] shall have jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act ...."

gas or the violation of correlative rights by San Juan Coal Company from the Subject Lands; and (E) granting such further relief as the Division deems appropriate.

Respectfully submitted,

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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:

CASE NO. 12734
ORDER NO. R-11775

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.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on October 18, November 13, and November 14, 2001, at Santa Fe, New Mexico before Examiner Michael E. Stogner.

NOW, on this 6th day of June, 2002, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and its subject matter.

(2) The Basin-Fruitland Coal (Gas) Pool is an "unprorated gas pool" not subject to Part II of the Division's rules entitled "*Gas Proration and Allocation*" (Rules 601 through 605). However, the Basin-Fruitland Coal (Gas) Pool is subject to: (**a**) Division Rule 104.D (3), which restricts the number of producing wells within a single gas spacing unit within non-prorated gas pools to only one (see official notice to all operators issued by the Division Director on October 25, 1999), and allows producing wells within this pool to produce at capacity; and (**b**) the "*Special Rules and Regulations for the Basin-Fruitland Coal (Gas) Pool,*" established by Division Order No. R-8768, as amended by Orders No. R-8768-A and R-8768-B, which rules provide for:

(**i**) 320-acre spacing units (Rule 4);

(**ii**) wells to be located in the NE/4 or SW/4 of a single governmental section and no closer than 660 feet to the

outer boundary of the spacing unit nor closer than 10 feet to any interior quarter or quarter-quarter section line or subdivision inner boundary (Rule 7); and

(iii) infill wells only after notice and hearing (Rule 4).

(3) In accordance with Rule 4 of the special pool rules governing the Basin-Fruitland Coal (Gas) Pool, Richardson Operating Company ("Richardson") seeks the creation of a special infill well area comprising the following-described lands within the pool in San Juan County, New Mexico ("infill area") to be governed by special provisions allowing two producing coal gas wells per 320-acre spacing unit:

TOWNSHIP 29 NORTH, RANGE 14 WEST, NMPM
Sections 4 through 6: All

TOWNSHIP 29 NORTH, RANGE 15 WEST, NMPM
Section 1: All

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM
Section 16: All
Sections 19 through 21: All
Sections 28 through33: All

TOWNSHIP 30 NORTH, RANGE 15 WEST, NMPM
Section 36: All.

(4) Richardson is the current operator of wells in the Basin-Fruitland Coal (Gas) Pool and owns interests in both State and Federal oil and gas leases within the proposed infill area. Richardson's rights under its leases extend from the surface to at least the base of the Pictured Cliffs formation.

(5) San Juan Coal Company ("SJCC"), a subsidiary of BHP Billiton Limited, appeared in opposition to Richardson's application. SJCC owns a Federal coal lease (the "Deep Lease") covering the following lands:

TOWNSHIP 30 NORTH, RANGE 15 WEST, NMPM
Section 13: S/2
Section 14: S/2
Sections 23 through 26: All
Section 35: All.

A State coal lease covering the following lands will be developed in conjunction with the Deep Lease:

TOWNSHIP 30 NORTH, RANGE 15 WEST, NMPM

Section 36:	All.

SJCC also owns a second Federal coal lease (the "Deep Lease Extension") covering the following lands:

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM

Sections 17 through 20:	All
Sections 29:	All
Section 30:	All
Section 31:	All.

A State coal lease covering the following lands will be developed in conjunction with the Deep Lease Extension:

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM

Section 32:	All.

(6) SJCC currently operates an open pit and pilot underground coal mine on the western side of its above-described coal leases; however, the closest mining operations are approximately one-half mile from the western edge of the proposed infill area.

(7) On August 31, 2001 SJCC filed an application with the United States Bureau of Land Management ("USBLM") for a coal exploration license covering the following lands:

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM

Sections 9 and 10:	All
Section 15:	All
Sections 21 and 22:	All
Sections 27 and 28:	All
Sections 33 and 34:	All.

SJCC is also attempting to lease the following land from the State:

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM

Section 16:	All.

This area is referred to herein as the "Twin Peaks Extension Area."

(8) The Basin-Fruitland Coal (Gas) Pool underlying the proposed infill area will be affected by SJCC's current mine plan and by SJCC's plan to mine the Twin Peaks Extension Area.

(9) The proposed infill area was defined by Richardson's oil and gas leases and is overlapped by SJCC's coal leases.

(10) The proposed infill area is underlain by several coal seams, including what are referred to as Coal Seam No. 8 and Coal Seam No. 9. Richardson intends to perforate and fracture stimulate only Coal Seam No. 8, which is the seam SJCC plans to mine in its underground operation.

(11) Richardson's application is an attempt to prevent the waste of hydrocarbon resources by accelerating the production of gas from the Fruitland coal interval prior SJCC mining operations.

(12) SJCC is currently in the process of converting from surface mining operations to an underground mine system (consisting of "mine districts") to mine the Coal Seam No. 8. SJCC's underground operations will utilize continuous miner units to establish a network of tunnels around coal blocks each approximately 10,000 feet long and 1,000 feet wide. These coal blocks are then mined by a "longwall" miner machine that runs parallel to the 1,000-foot face of the coal block. The mine plan is to mine each mine district through the system, expanding the mining in an easterly direction towards Richardson's existing coal gas wells and gathering system.

(13) The longwall miner process allows for the extraction of the coal but vents the coal gas and leaves behind a void. The roof then collapses into a rubble heap called the "gob," which contains a residue of debris including some gas.

(14) SJCC intends to mine the coal before the coal gas is produced by Richardson, which would require SJCC to vent to the atmosphere coal gas present in the coal seam, and contends that there will be gas remaining in the gob left after it has mined the coal.

(15) SJCC operates the San Juan Mine (the "Mine") to supply coal to the San Juan Generating Station, operated by Public Service Company of New Mexico. The Mine was originally a surface mine. The coal supplied by SJCC to the San Juan Generating Station has been supplemented by coal from the nearby La Plata Mine. In order to replace dwindling coal reserves at the surface operations of both mines, SJCC commenced a pilot underground mine in

early 1998 in order to demonstrate the viability of such an operation.

(16) At about the same time, SJCC began development of an underground mine permit application to be filed with the Mining and Minerals Division ("MMD") of the New Mexico Energy, Minerals, and Natural Resources Department. In October, 1999 SJCC received authorization for development of the underground mine from the MMD.

(17) Effective March 2001, SJCC obtained the Deep Lease Extension, which lies on the eastern boundary of the Deep Lease. This lease will allow SJCC to meet its coal supply contract with Public Service Company of New Mexico that extends through 2017.

(18) Originally SJCC took the position that it was in the best interests of all parties, including SJCC, to have Richardson drill and produce coal gas with infill wells in order to accelerate withdrawal; however, in August, 2001, SJCC changed its position due to concerns raised about: **(i)** spontaneous combustion; **(ii)** the existence of well casings in the coal seam; **(iii)** the hydraulic fracturing of the Fruitland interval; and **(iv)** the de-watering of the coal.

(19) SJCC presented evidence showing that the development of coal bed methane gas in advance of underground mining could pose certain safety and operational risks that would be increased by Richardson's proposed infill development.

(20) In accordance with Mine Safety and Health Administration ("MSHA") regulations, wellbores not properly abandoned in advance of underground mining operations must be avoided. A 300-foot radius protection pillar is required around wellbores not properly abandoned. Proper abandonment involves milling out the casing and cementing the wellbore. To create a protection pillar SJCC would need to disassemble its longwall apparatus the required distance from such a wellbore and re-establish it within the mining district an equal distance past the wellbore; therefore, the volume of coal to be by-passed by SJCC will be at least 600 feet long by 1,000 feet wide and 13 feet high.

(21) SJCC is concerned about the time lost in moving its underground mining equipment and the volume of coal lost to create these pillars.

(22) Evidence was presented by SJCC concerning increased risk for spontaneous combustion within its Mine caused by: **(i)** prolonged periods of down time required in order to move the longwall apparatus; **(ii)** the fracturing of the coal seam by the oil and gas operations, which serves to hamper SJCC's ability to manage its ventilation systems; and **(iii)** the de-watering of the coal seam, which dries the coal.

(23) Richardson's proposed infill area would allow the following:

(i) recompletion in the Basin-Fruitland Coal (Gas) Pool of 18 existing Pictured Cliffs formation wells and the downhole commingling of production from both zones; and

(ii) drilling of 7 new wells to be completed as downhole commingled wellbores in the Pictured Cliffs formation and the Basin Fruitland Coal Gas Pool.

(24) The geological and engineering evidence presented demonstrates that:

(i) the No. 8 coal seam is present throughout the proposed infill area and is thick enough to support coal gas production in commercial quantities;

(ii) the proposed infill area is within that portion of the Basin-Fruitland Coal (Gas) Pool that is under-pressured;

(iii) this coal seam appears to be methane-gas saturated;

(iv) it is necessary to de-water the coal in order to obtain gas production:

(v) the gas content yield in the No. 8 coal seam within the proposed infill area ranges from 178 to 281 standard cubic feet per ton of coal; and

(vi) based on an average thickness of 20 feet, the initial gas in place within this coal seam ranges from 2.06 BCF to 3.24 BCF per 320-acre unit.

(25) The engineering evidence presented by Richardson demonstrates that infill drilling on a single 320-acre unit within the proposed infill area will serve to: (i) de-water the coal seam more quickly and efficiently; and (ii) allow for additional hydrocarbon reserves to be recovered.

(26) The New Mexico Oil & Gas Act has specific statutory mandates concerning the prevention of the waste of potash in addition to prevention of the waste of oil and gas; however, no such specific mandates exists concerning waste of coal.

(27) Richardson's application will prevent waste of its hydrocarbon resources by

accelerating the production of gas from the Fruitland formation prior to SJCC mining the coal and venting the methane gas.

(28) SJCC presented testimony that some of the coal gas that would be vented by mining operations could be recovered at the surface, but did not establish the amount that could be so recovered or the economic feasibility of such recovery.

(29) SJCC's concerns about mine safety and fire prevention can be alleviated by:

(i) leaving a 300-foot radius protection pillar around any current or future wellbore as required by MHSA Regulations; or in the alternative

(ii) milling out the casing in any wellbore through the coal seam and properly plugging and abandoning the wellbore with cement, in which case a coal protection pillar would not be needed.

(30) Application of the latter method would also alleviate SJCC's concerns about reduction of recoverable coal reserves due to the necessity to leave coal in place around wellbores.

(31) In order to minimize waste of gas reserves and to protect the oil and gas mineral interests correlative rights, the Division should grant Richardson's request to establish a special infill area [as described in Finding Paragraph No. (3) above] that provides an opportunity to accelerate the production of gas from the Fruitland Coal formation prior to SJCC's mining operations.

IT IS THEREFORE ORDERED THAT:

(1) As an exception to (i) Rule 4 of the "*Special Rules and Regulations for the Basin-Fruitland Coal (Gas) Pool,*" established by Division Order No. R-8768, as amended by Orders No. R-8768-A and R-8768-B, and (ii) Division Rule 104.D (3), 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 following described Special "Infill Well" Area:

TOWNSHIP 29 NORTH, RANGE 14 WEST, NMPM
Sections 4 through 6: All

TOWNSHIP 29 NORTH, RANGE 15 WEST, NMPM
Section 1: All

TOWNSHIP 30 NORTH, RANGE 14 WEST, NMPM
Section 16: All
Sections 19 through 21: All
Sections 28 through33: All

TOWNSHIP 30 NORTH, RANGE 15 WEST, NMPM
Section 36: All.

(2) The following conditions apply to the authority granted by this order:

(A) THE INITIAL COAL GAS 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 special pool rules.

(B) THE INFILL COAL GAS WELL on an existing 320-acre unit shall be located in the quarter section of the unit not containing a Basin-Fruitland coal gas well, and shall be located in compliance with the setback requirements set forth in Rule 7 of the special pool rules.

(C) THE PLAT (Form C-102) accompanying the Application for Permit to Drill (OCD Form C-101 or federal form) for the 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 well.

(3) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

SEAL

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.

S E A

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

Lori Wrotenbery

By: LORI WROTENBERY, CHAIR

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

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 the Secretary of
OCC Case No. 12734 (De Novo)

FINAL DECISION OF THE SECRETARY

THIS MATTER comes before the Secretary of the Energy, Minerals and Natural Resources upon the Hearing Officer's Recommended Decision issued by Tom Mills, Deputy Secretary of the Energy, Minerals and Natural Resources Department on the 1st day of October, 2004. Having considered the Recommended Decision, which is attached hereto as Exhibit 1 and incorporated herein by reference, and the record in this case, and being fully informed in the premises,

THE SECRETARY FINDS AND CONCLUDES:

1. The Secretary accepts and adopts the Hearing Officer's statement of the case, the discussion of the case and the Findings and Conclusion, as the Findings and Conclusions of the Secretary.
2. The Secretary has jurisdiction over the parties and the subject matter of this case.

3. The Recommended Decision is well taken and should be adopted by the Secretary.

IT IS THEREFORE ORDERED:

A. The Recommended Decision is adopted, approved and accepted in its entirety.

B. This Order is effective immediately.

C. A copy of this Order shall be served on all persons listed on the attached certificate of Service

D. This matter is closed.

RESPECTFULLY SUBMITTED at Santa Fe, New Mexico on this 1st day of October, 2004.

Joanna Prukop, Secretary
Energy, Minerals and Natural Resources Department

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

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 the Secretary of
OCC Case No. 12734 (De Novo)

CERTIFICATE OF SERVICE

I hereby certify that on the 1st day of October, 2004, a copy of the Recommended Decision of the Hearing Officer to the Secretary and the Final Decision of the Secretary were sent by U. S. Mail, postage prepaid or hand delivered, to the following counsel of record:

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Tom Mills, Deputy Secretary
Energy, Minerals and Natural
Resources Department

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

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 the Secretary of OCC Case No. 12734 (De Novo)

RECOMMENDED DECISION OF THE HEARING OFFICER TO THE SECRETARY

COMES NOW Tom Mills, Deputy Secretary of the Energy, Minerals and Natural Resource Department (EMNRD), acting as the designated hearing officer in this matter, and states that the following is his summary of the procedures and facts in this matter and his recommended decision for Joanna Prukop, Secretary of EMNRD ("Secretary"). Jurisdiction of this matter arises from NMSA 1978, Section 70-2-26.

Preliminary and Procedural Matters

1. By decision of December 19, 2002, the Oil Conservation Commission ("OCC" or "Commission") granted Richardson Operating Company's ("Richardson") Infill Application. The decision allows Richardson to drill wells with spacing reduced from 320 acres to 160 acres in an area that is also leased for the development of the underground mine belonging to the San Juan Coal Company ("San Juan"). The Commission denied San Juan's Application for Rehearing on January 23, 2003, by taking no action on the Application.

2. On January 24, 2003, San Juan filed an application for a hearing and review by the Secretary of the Energy Minerals and Natural Resources Department ("EMNRD" or "Department") of Order Number R-11775-B issued by the Commission in Case Number 12734. The application was made pursuant to NMSA 1978, Section 70-2-26 (hereafter simply Section 70-2-26).

Ex. 1

3. Section 70-2-26 gives the Secretary the discretion to hold a public hearing "to determine whether an order or decision issued by the commission contravenes the public interest". The hearing is de novo, following which the Secretary "shall enter such order or decision as may be required under the circumstances, having due regard for the conservation of the state's oil, gas and mineral resources, and the commission shall modify its own order or decision to comply therewith". (Quoting relevant portions of the Section).

4. Richardson Operating Company filed a response on January 27, 2003. A reply and surreply followed.

5. On January 29, 2003, Joanna Prukop, Secretary of EMNRD, issued an order setting a hearing on the Application for February 10, 2003, arranging for public notice, appointing Deputy Secretary Tom Mills as the hearing officer for the case and requiring him to prepare a summary of the evidence and file a recommended decision.

6. On January 30, 2003, Deputy Secretary Mills issued a Pre-Hearing Order addressing a number of issues including designating all of the record before the Commission as a part of the record in this case, filing and service requirements, discovery deadlines and hearing requirements.

7. Publication of the Notice of Special Hearing was made on February 2, 2003, in The Albuquerque Journal. The Notice included instructions for becoming a party to the case or otherwise providing comment on the matter.

8. The hearing commenced at 9 a.m. on February 10, 2003 at the offices of EMNRD in Santa Fe, New Mexico. The participating parties were San Juan Coal Company and Richardson Operating Company. Counsel represented each party. No other person or entity applied for party status, and there are no other parties. A court reporter recorded the witnesses' testimony. Exhibits were offered and accepted. Public comment was also provided.

9. The Secretary has jurisdiction over the subject matter and over the two parties to this proceeding. The parties had adequate notice of the hearing and the issues to be considered. The hearing was held within twenty days of the Commission's January 23, 2003 denial of rehearing as required by Section 70-2-26. At the commencement of the February 10, 2003 hearing both Richardson and San Juan stated they were prepared to proceed or did not object to proceeding.

10. The record before the Secretary in this matter includes the record before the Commission; the evidence, testimony and statements presented at the

February 10, 2003 hearing; the parties' pleadings and attachments thereto, and correspondence submitted to and from the Department in this proceeding.

11. Two motions by the parties were addressed at the beginning of the hearing. In the Application, San Juan Coal Company requested a stay of the Commission's Order. The Hearing Officer denied the stay stating the relief should be requested from the Commission. On February 3, 2003, Richardson filed a Motion for Clarification of the Secretary's January 29th Order. The hearing officer denied the motion stating the determination of the public interest was a material issue in the proceeding.

12. Counsel for San Juan orally moved that the Hearing Officer order the parties to mediate their dispute. Counsel for Richardson opposed the motion on the ground that Richardson believed mediation would be fruitless based upon prior discussions between the parties regarding the buy-out value of Richardson's leases. The Hearing Officer took San Juan's motion for mediation under advisement.

13. The hearing ended on February 10, 2003, and parties were given the opportunity to file Proposed Findings of Fact and Conclusions of Law. Each party did so on February 20, 2003.

14. The evidence from the record referred to and cited in the text of this Decision constitutes the summary of the evidence required by the Secretary's above-referenced Order of January 29, 2003.

Standard of Review

15. Section 70-2-26 requires that the hearing before the Secretary be a "de novo proceeding". New Mexico has a long history of de novo hearings that was traced in the recent case of State v. Foster, 2003-NMCA-099, 134 N.M. 224, 75 P.3d 824 (2003). The New Mexico Constitution provides district courts with appellate jurisdiction over cases originating in lower courts saying that the trial shall be de novo unless otherwise provided by law. N.M. Const. art. VI, Section 27. Under state law, appeals from lower courts to the district court, "shall be tried anew in said courts on their merits, as if no trial had been had below, except as otherwise provided by law". NMSA 1978, Section 39-3-1 (1955). In other words, the district court conducts a new trial as if the trial in the lower court had not occurred. State v. Foster. See also the Supreme Court's decision in Southern Union Gas Company v. Taylor, 82 N.M. 670, 486 P.2d 606 (1971), which holds that the district court may enter a judgment as if the case originated in that court.

16. By de novo review, the Court of Appeals explained in Clayton v. Farmington City Council, 120 N.M. 448, 902 P.2d 1051 (1995), it means judicial review that at a minimum includes additional evidentiary presentation beyond what is presented below and allows the court more discretion in its judgment than simply reversing the decision and remanding the case. Many decisions have described a trial de novo as a trial anew in the sense that the reviewing court considers issues on its own and is not bound or even influenced by the lower court's actions.

17. Under the de novo standard of review the Secretary must make an independent assessment of the record, in contrast to a substantial evidence review. "We note that substantial evidence review is different; there, evidence is viewed in the light most favorable to the prevailing party and all inferences arising from the factual findings of a trial court are indulged in...(citations omitted)." Aken v. Plains Electric Generation & Transmission Cooperative, Inc., 132 N.M. 401, 49 P.3d 662 (2002). Review on a de novo basis means no formal deference is paid to the trial court [here, OCC] decision. Galbaldon v. Erisa Mortgage Company, 124 N.M. 296, 949 P.2d 1193 (Ct. App. 1997)

Motion to Compel Mediation

18. At the hearing of this matter, counsel for San Juan orally moved the Hearing Officer to order the parties into mediation. Counsel for Richardson opposed this motion on the grounds that the gulf between the parties' positions on the terms of a possible buy-out of Richardson's interests by San Juan would render mediation fruitless.

19. The Hearing Officer took San Juan's motion to order mediation under advisement.

20. Section 70-2-26 does not explicitly grant the Secretary authority to order mediation. The authority cited by San Juan in support of its motion is a case about rule making, not mediation. While the case does state, "[t]he authority granted to an administrative agency should be construed so as to permit the fullest accomplishment of the legislative interest or policy.", the very next sentence says, "however, such an approach to construction does not warrant allowing an administrative agency to amend or enlarge its authority under the guise of making rules and regulations". Public Service Company v. New Mexico Environmental Improvement Board, 89 N.M. 223, 227, 549 P.2d 638 (Ct. App. 1976). The case also has language reminding us that administrative bodies are creatures of statutes and have no common law or inherent powers.

21. Those state agencies that do employ mediation to resolve cases derive their authority to require mediation in their rules from a specific statutory

authority. See NMSA 1978, Section 52-5-4(B) pertaining to the Workers Compensation Administration.

22. In this case the Secretary is acting in a quasi-judicial role. Nevertheless, the authority of judges in New Mexico to establish mediation programs in matters such as domestic relations cases derives from a specific statutory grant of authority. See NMSA 1978, Section 40-12-5.

23. The Secretary has no specific legal authority to order the parties into mediation, and for this reason, it is recommended that San Juan's motion for mediation be denied.

Discussion of the Case, Findings of Fact and Conclusions

24. From this point forward, material is presented to summarize the evidence from the OCC hearing and the February 10, 2004 proceeding, to discuss the issues raised in the case and make recommendations to resolve those issues. The discussion starts with a summary of the OCC's findings regarding its jurisdiction and the Secretary's jurisdiction.

25. OCC's Order R-11775-B in Case Number 12734 (hereafter the "Infill Order") created a special infill area ("infill area") within the Basin-Fruitland Coal Gas Pool where two wells may be drilled on each 320 acre spacing unit. In reaching its decision the OCC specifically held as follows:

Paragraph 62. The Commission lacks jurisdiction to consider the waste of the coal resource;

Paragraph 64. On its face, Section 70-2-26 does not apply to the Commission; even if it did, waste of coal is not at issue because the Mine Safety and Health Administration's ("MSHA") rules require leaving protection pillars around wells; and

Paragraph 69. The Commission cannot legally base its decision on Richardson's asserted priority of rights under the terms of various oil and gas leases, federal coal leases and stipulations pursuant thereto because the issue, like the issue of title, is one for determination by the courts rather than the Commission.

26. Despite these holdings, the Commission considered many of the facts necessary to the Secretary's determination of public interest. For example, the Commission made findings in Paragraph 9 regarding the waste of gas by the coal mine ventilation system that would justify accelerated production, Paragraphs 11-18 and 22 regarding the wells' commercial viability, Paragraphs 33 and 34 discussing the lease language, Paragraph 35 discussing the appeal through the Bureau of Land Management process and Paragraph 63 discussing the lack of evidence to support a claim of injury to San Juan's property. The Commission made these findings

within its jurisdictional authority, but they are relevant to the Secretary's broader jurisdiction to determine the public interest with due regard for the conservation of the state's oil, gas and mineral resources. The Secretary's authority goes beyond the Commission's authority, though many of the factual issues are common to both the Secretary's and the Commission's jurisdiction.

27. The Secretary granted San Juan's request for a hearing as part of the de novo review of the OCC decision because the Commission did not specifically consider the public interest issues involved with due regard for the conservation of the state's oil, gas and mineral resources.

28. Eighty-five percent (85%) of the land in the infill area is federal land.

29. Richardson is a lessee of the oil and gas rights in a portion of the infill area but within the areas subject to dispute in this case.

30. Richardson argued that the OCC decision did not contravene the public interest, because the lease rights for oil and gas development have priority over San Juan's coal lease because they were granted earlier in time.

31. Richardson also argues that the OCC Order is necessary to avoid waste of the coalbed methane, because if mining takes place first, the methane will be released from the coal to provide the ventilation needed for mining safely.

32. San Juan owns two state and two federal leases as described on San Juan Coal Co. Exs. 2 through 5. San Juan's federal leases are known as the "Deep Lease" and the "Deep Lease Extension" (San Juan Coal Co. Exs. 2 and 3 respectively). It has two state coal leases with the State Land Office (San Juan Coal Co. Exs. 4 and 5). San Juan operates an active coal mine, the San Juan Underground Mine, on its four leases

33. The Bureau of Land Management ("BLM") is the federal agency responsible for the management of federally owned mineral interests in oil, gas and coal.

34. The Department, through the Oil Conservation Division, and upon review to the OCC and the Secretary, is the agency with jurisdiction over questions of well spacing generally, and specifically, whether the infill well application should be granted. The Department's jurisdiction in this regard extends to federal, state and fee lands.

35. The evidence established there are seventy-six (76) wells penetrating the Fruitland Coal in the infill area, including nineteen (19) fracture-stimulated coalbed methane wells Richardson operates.

36. The evidence established 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 economical and efficient.

37. Accelerating natural gas production from the Fruitland coal will prevent the waste of coalbed methane that will otherwise be destroyed when San Juan mines the coal.

38. The Commission order allows Richardson to drill two additional wells penetrating the Fruitland coal in the infill area and to recomplete thirteen (13) additional wells in this area. No new Richardson well under the contested Order will be drilled in a mine district on State of New Mexico lands pursuant to the Commission order.

39. San Juan plans to extract over 100 million tons of coal from its mine through the year 2017 under the current coal sales agreement with San Juan Generating Station (SJGS). Those coal sales will yield about $250 million dollars in royalty payments from the federal leases (based on the current royalty rate of 8%). One-half of this royalty is payable to the State of New Mexico under applicable federal statutes. See 30 U.S.C. Section 191.

40. San Juan argues the OCC decision contravenes the public interest on both economic and health and safety grounds. First, the coal it will be forced to bypass for safety reasons because of the wells will produce far more revenue to the State than will the gas wells, some of which may be uneconomical. Second, San Juan's expert witness, Dr. Steven L. Bessinger, Ph.D., testified at the February 10th hearing that water injected by hydraulic fracturing can effectively turn those formations into unstable mud in a short period of time, and he provided a demonstration of that at the same hearing. He also testified that the hydraulic fractures themselves could destabilize the mine roof and floor in the coal formation and the formations above and below it. The geologic formations at and immediately above the roof and at and immediately below the floor in the mine are unstable. They are brittle, consisting of water-soluble shales and mudstones. Dr. Bessinger testified that hydraulic fractures themselves could destabilize the mine roof and floor in the coal formation and the formations above and below it. These unstable conditions pose significant risks of roof and floor failure that could lead to serious consequences for workers and equipment, and could increase the potential for spontaneous combustion.

41. Dr. Bessinger testified that there is a risk of hydraulic fractures propagating in a horizontal direction because of the San Juan Underground Mine's relatively shallow depth. These fractures would pose a greater risk

to roof conditions than would vertical fractures of the type described in William P. Diamond's paper. (Richardson Ex. C-28).

42. The increased risk of roof failures from horizontal fractures increases health and safety risks to San Juan's employees and increases the risk of stranding San Juan's longwall mining system, a piece of equipment costing from 40 to 60 million dollars.

43. Use of water during hydraulic fracturing can be viewed as only a marginal additional hazard to the coal mining roof and floor stability, because most of the frac fluids are recovered immediately following fracturing. The coal also contains substantial amounts of water exceeding amounts introduced during a fracturing operation. (OCC ¶ 52)

44. San Juan suggests that any significant production interruptions could adversely affect SJGS' ability to produce electricity. The San Juan mine is the sole source of coal supply for the SJGS power plant, which produces much of the power used in New Mexico.

Public Interest Analysis – Utility Service

45. Testimony regarding the relationship between the San Juan mine and the SJGS was offered by San Juan's witness, Mr. Woomer (Record on Appeal, p. 307) and as public comment by Bill Real, Senior Vice President of Public Service Company of New Mexico ("PNM") (2-10 Tr., pp. 73-76). Mr. Real testified PNM is one of the SJGS owners and its operator. The power plant produces more than 50% of the electricity used by PNM's New Mexico customers and more than 40% of PNM's total generating capacity. The only economical supply of fuel to the power plant is from the San Juan mine, which is the sole fuel source. Any interruption in that fuel supply would create a significant and extreme hardship on PNM customers.

46. To be supportable, an administrative agency's action that affects a substantial right must be supported by some competent evidence. This is referred to as the Residuum Rule. Duke City Lumber v. New Mexico EIB, 101 N.M. 291, 681 P.2d 717, 721, *on remand* 102 N.M. 8, 690 P.2d 451, *cert. quashed* 101 N.M. 741, 688 P.2d 778 (1984). The substantial right apparently at issue with respect to the SJGS is PNM's right under its contract(s) with San Juan to receive fuel for the SJGS from the San Juan mine. It is substantial, because the mine is the only economical source of fuel and an interruption could conceivably cause a power outage to PNM's New Mexico customers. The question is, does the testimony in the record on this issue constitute competent evidence to support a finding by the Secretary that the Commission Order should be overturned, because the effect of Richardson's operations permitted under the Order will be to

interrupt the delivery of electric service to New Mexico rate payers, and this would contravene the public interest?

47. The Hearing Officer assumes, without deciding, that if the direct effect of a Commission order were to cause a power blackout to a substantial number of New Mexicans, the order would contravene the public interest. However, the Hearing Officer concludes that there is no competent evidence in the record to this effect.

48. San Juan failed to establish a cause and effect relationship between the limited additional operations Richardson will undertake under the Commission Order and the risk of an interruption in the delivery of electric power to New Mexico consumers. Considerable additional evidence would be required to do so. By way of illustration, the record is silent on the terms of the San Juan coal supply contract, on San Juan's options for supplying SJGS from its Navajo mine, on PNM's ability to purchase power from other sources in an emergency, on the costs of any of these alternatives and the effect on the public interest of incurring such costs, and not least, on PNM's independent legal obligation as a regulated utility to provide an uninterrupted supply of electricity to its customers. Courts have historically recognized public utilities operations as affected with a public interest. See Chas. Wolff Packing Co. v. Court of Industrial Relations of State, 262 U.S. 522, 534 (1923).

49. The Hearing Officer concludes that the Infill Order does not contravene the public interest with respect to its effect, if any, on the SJGS.

Public Interest Analysis – Waste of Coal

50. San Juan argued before the Commission that the Commission is required under the Oil and Gas Act, NMSA 1978, Chapter 70, Article 2 to consider the "waste" of the coal resource from its mine that will result from having to mine around Richardson's wells (Infill Order ¶ 61).

51. San Juan argues that NMSA 1978, Sections 70-2-2 and 70-2-11(A) prohibit waste and require the Commission to protect correlative rights, respectively. And that under NMSA 1978, Section 70-2-3 "waste" includes not only waste of oil and gas but also waste of other minerals.

52. The Commission concluded that the waste referred to in the Oil and Gas Act does not include coal (Infill Order ¶ 62).

53. NMSA 1978, Section 70-2-3 lists a number of items included in the definition of "waste" under the Oil and Gas Act. Despite the fact that coal is not mentioned, San Juan argues that it is included in the term "waste" because the start of the statute states, "[a]s used in this act, the term

'waste,' in addition to its ordinary meaning, shall include...". San Juan then argues that the "ordinary meaning" comes from the dictionary, which lists several definitions for waste, including defining it as a "disused part of a coal mine".

54. Next, San Juan cites Section 70-2-26 for the proposition that the Commission is obligated thereby to have due regard for the conservation of the state's oil, gas and mineral resources. The Commission concluded that this section does not apply to the Commission, because the standard cited by San Juan comes into play only upon an appeal to the Secretary. The Commission further concluded that conservation of San Juan's coal was not at issue owing to the MSHA mine safety regulations applicable to San Juan (Infill Order ¶ 64).

55. San Juan contends also that the Commission did not properly give effect to NMSA 1978, Section 70-2-12(B)(7) of the Oil and GasAct, because the Commission did not consider the possibility that Richardson's operations will threaten "injury to neighboring leases or properties". (Infill Order ¶ 63). In fact the Commission concluded the evidence did not support a finding that granting Richardson's application would harm San Juan's operations, and went on to suggest that the words "lease" and "property" in Section 70-2-12(B)(7) should have the meaning as understood in the oil and gas industry. (Infill Order, ¶ 64)

56. Well recognized rules of statutory interpretation and construction will be followed in this Recommended Decision. The "plain language" rule of statutory construction is the primary indication of legislative intent. Albuquerque v. Peoples Energy Resources, Inc., Opinion Number 2004-NMCA-084 (May 15, 2004), Bar Bulletin, July 29, 2004, Page 30. In construing the meaning of a particular statute [here, the Oil and Gas Act], the reviewing court [here, the Hearing Officer] must determine and give effect to the legislature's intent. Security Escrow Corporation and First Escrow, Inc. v. State of New Mexico Taxation and Revenue Department, 107 N.M. 540, 543, 760 P.2d 1306 (Ct.App.1988), citing State ex rel. Klineline v. Blackhurst, 106 N.M. 732, 749 P.2d 1111 (1988)

57. In determining legislative intent the reviewing official or body must "look primarily to the language of the act and the meaning of the words, and when they are free from ambiguity, we will not resort to any other means of interpretation". Security Escrow, at 543, referencing, State v. Pitts, 103 N.M. 778, 714 P.2d 582 (1986); and New Mexico Beverage Co. v. Blything, 102 N.M. 533, 697 P.2d 952 (1985).

58. In construing an act, requirements that are not in it cannot be added. Nor can language be read into it which is not there. But, the act must be read in its entirety and each part must be construed in connection with every

other part to produce a harmonious whole. State ex rel. Klineline. In this matter the word "waste" is used frequently in the Act. To say that it includes the waste of coal or other mineral resources would create unreasonable results. Among other problems, it would burden the Oil Conservation Division ("OCD") with duties to regulate coal when the mining of coal is governed by a separate act, the Surface Mining Act, NMSA 1978, Chapter 69, Article 25A.

59. The Hearing Officer concludes that the term "waste" as used in the Oil and Gas Act ("Act") does not apply to mineral estates other than potash, which is specifically noted in the Act. The introductory language of NMSA 1978, Section 70-2-3, "[a]s used in this act the term "waste", in addition to its ordinary meaning, shall include...." cannot be parsed to include the waste of coal, notwithstanding the dictionary definition San Juan cites. First, the words "as used in this act" serve to define the context within which the ordinary meaning of waste is to be determined. If we were to accept San Juan's provision, it would render the references in the Act to protecting potash deposits surplusage. Such a result is highly disfavored under rules of statutory construction. Moreover, reading key provisions of the Act together supports this conclusion. Specifically, the provisions of NMSA 1978, Section 70-2-12 enumerating the powers of the Oil Conservation Division ("Division") to make rules, regulations and orders refer to the data and records the Division is required to develop and maintain. These include detailed information about ownership of oil and gas producing properties, leases, equipment and other facilities as well as determining the limits of any area containing commercial potash deposits and updating such limits. NMSA 1978, Section 70-2-12 (B)(8) and (16). Had the legislature intended to include all mineral estates within the definition of waste, it would have empowered the Division with the power and responsibility to collect the data necessary to apply the Act to mineral estates other than potash. Likewise, the power given to the Division by NMSA 1978, Section 70-2-12 (B)(17) to regulate and prohibit when necessary oil and gas drilling and production that would unduly reduce the recovery of commercial quantities of potash underscores the same point. Namely, that had the protection of other mineral estates from waste been intended under the Act, the Division would have been given the specific authority to prevent undue reductions in their recovery. This interpretation harmonizes the provisions of the Act, in contrast to San Juan's interpretation, which creates the surplusage noted above.

60. The Commission's Infill Order ¶ 63 contains dicta that the words "leases and properties" in NMSA 1978, Section 70-2-12 (B)(7) apply solely to neighboring oil and gas leases and properties, and that it is likely these terms have the meaning as understood in the oil and gas industry. San Juan argued that the requirement in (B)(7) that the Commission's permitting orders prevent injury from wells to neighboring leases or

properties means that the Commission should have considered the possibility that Richardson's operations would threaten such injury to its coal lease.

61. As noted in paragraphs 22 and 51 above, the Commission made careful findings of fact on issues ranging from waste, injury to leases and property, economics and safety. While correct in asserting its lack of jurisdiction in particular respects, the Commission's Order concluded that the evidence before it did not support a finding that granting Richardson's application would harm San Juan's operations. San Juan introduced evidence at the administrative appeal attempting to establish costly health and safety threats to its operation from Richardson's application. For the reasons stated below in the portion of the analysis of the public interest standard examining the relationship of MSHA to these claims of San Juan, the Hearing Officer concludes that the impacts of Richardson's application on San Juan's operations have been fully considered, and that the evidence does not support a finding that Richardson's application will harm San Juan's operations. That being the case, there is no need to reach the question whether the Commission failed to properly apply NMSA 1978, Section 70-2-12 (B)(7). The Hearing Officer observes, however, that the interpretation of the Act found in paragraph 58 above appears to be equally applicable to this issue.

62. The Commission held in ¶ 64 of the Infill Order that Section 70-2-26 does not permit it to consider conservation of the state's mineral resources, because on its face Section 70-2-26 does not apply to the Commission, but rather, pertains to secretarial review of a Commission order, and, quoting ¶ 64, "[t]hat section provides that *the Secretary* (emphasis in original) 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...".

63. The Hearing Officer concludes that the Commission was indeed correct in holding that Section 70-2-26 does not apply to the Commission. The Hearing Officer finds that such a conclusion is compelled by both the language of that section and the language of the Oil and Gas Act discussed above in paragraph 59 supporting the interpretation that the operation of the Act does not extend to protecting mineral resources other than those specifically named, such as potash, except for the language in Section 70-2-26 itself. By vesting the Secretary with the right to grant a de novo hearing to consider whether an order of the Commission is in the public interest and requiring the Secretary to give due regard to the conservation of the state's mineral resources, in addition to oil and gas resources, Section 70-2-26 draws a bright line between the Commission and the Secretary. This section recognizes that the Secretary is better positioned than the Commission to consider broad policy questions attending a

determination of what constitutes the public interest in relation to the effects of a Commission order when mineral resources, any and all mineral resources in fact, are affected.

Public Interest Analysis – Mine Safety Concerns

64. San Juan argues that the potential health and safety impacts from fracturing of the coal seam caused by Richardson's additional wells and the costs of mining around them are impacts severe enough to contravene the public interest within the meaning of Section 70-2-26, thereby justifying a reversal of the Commission's Infill Order.

65. The Commission noted that the MSHA and its regulations require the use of protection pillars or other measures to protect mine worker safety. Therefore, it concluded that the conflict in this case "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". Infill Order ¶ 64. See 30 USC Section 877.

66. The Federal Mine Safety and Health Act of 1977 imposes on coal mine operators the duty to locate oil and gas wells penetrating coal beds and to establish and maintain barriers around such wells. These barriers, or pillars of coal left unmined, shall not be less than three hundred feet in diameter (unless greater or lesser barriers are required or permitted by the Secretary of Labor). 30 USC Section 877(a).

67. The Hearing Officer takes administrative notice of 30 USC Section 801 (d) and (f) and Congressional findings and declaration of purpose. Subsection (d) states, "the existence of unsafe and unhealthful conditions and practices in the Nation's coal or other mines is a serious impediment to the future growth of the coal or other mining industry and cannot be tolerated". Subsection (f) states, "the disruption of production and the loss of income to operators and miners as a result of coal or other mine accidents or occupationally caused diseases unduly impedes and burdens commerce".

68. The Hearing Officer takes administrative notice that under 30 USC Section 814 -- Citations and Orders -- a mine inspector has the authority to issue a withdrawal order to a mine operator requiring the removal from a mine area of all persons affected by a violation of any mandatory health or safety standards if the inspector also finds that the violation is also caused by a mine operator's unwarrantable failure to comply. 30 USC Section 814(d).

69. MSHA inspectors also have the authority to evacuate a coal mine if a condition presents an "imminent danger". "Imminent danger" means the

existence of any condition or practice in a coal or other mine which could reasonably be expected to cause death or serious physical harm before such condition or practice can be abated. 30 U.S.C. Section 802 (j). See also, Old Ben Coal Corp. v. Interior Bd. Of Mine Op. App., 523 F.2d 25 (7th Cir. 1975) (upholding validity of withdrawal order where inspector found imminent danger, holding that "imminent danger" is not intended to apply only to situations involving immediate danger.)

70. Mr. Jacques F. Abrahamse testified for San Juan that in the first coal mining district, which is the one in which San Juan is currently mining, in the 100 panel area, LW-101, -102 and -103, all risks have been mitigated for gas wells in that area. He also testified that San Juan has not made any proposals to MSHA to change the diameter requirements for pillars around the gas wells within San Juan's lease areas and that if San Juan wanted to request a change the proper procedure would be to submit an amendment to San Juan's ventilation plan for MSHA review. Transcript, Volume II, Pages 392-94.

71. The Hearing Officer concludes that the public interest is served by providing safe working conditions for miners San Juan employs and that MSHA is the agency best qualified to make that determination. The Commission's Order does not interfere with the MSHA requirements and, therefore, does not conflict with the public interest in safe operations.

Public Interest Analysis – Lease Terms

72. Also as noted above, Richardson asserts that the public interest cannot be contravened by the Infill Order, because its gas leases have legal priority over San Juan's coal leases, the BLM policy is to favor development of both resources, which is in the public interest, and MSHA requirements that San Juan mine around gas wells are sufficient to address San Juan's health and safety arguments.

73. The Commission held that it lacked jurisdiction to make a determination about the priority of Richardson's rights under its oil and gas leases, because the Commission's function is not to determine title to or the validity of any oil and gas lease. Infill Order ¶ 69.

74. San Juan's Coal Lease with the BLM known as the "Deep Lease" was effective on April 1, 1980. Richardson Exhibit 2. On September 10, 1998, San Juan executed and submitted to the BLM a Protocol for the Mediation of Adverse Impacts on Oil and Gas Revenues ("Protocol"). Under this Protocol San Juan agreed that "[v]alid existing rights under federal oil and gas leases . . . will be honored". San Juan committed itself to take all reasonable steps to avoid adverse impacts on oil and gas

resource production, gathering and transportation facilities, including mining around existing well bores. Richardson Exhibit A-8.

75. San Juan's Coal Lease with the BLM known as the "Deep Lease Extension" was effective on March 1, 2001. Richardson Exhibit 3. Under Special Stipulations in Section 15 of this lease, San Juan agreed that this lease was "subject to all prior existing rights including the right of oil and gas lessees & other mineral lessees and surface users". San Juan also stipulated that it has sole responsibility "to clear the coal tract of any . . . pre-existing land uses that would impede or prevent coal mining on the tract".

76. By letter dated August 31, 2001, to the BLM's Farmington Field Office (FFO), San Juan protested the issuance of Applications for Permits to Drill (APDs) to Richardson Operating Company and Dugan Production Corporation in areas where San Juan has plans to mine. San Juan requested that the BLM put stipulations on the requested APDs to prohibit the operators from hydraulically fracturing the coal seam. San Juan asserted the following safety concerns: steel casing in the basal coal seam could adversely impact the continuous mining machines; hydraulic fracturing would adversely impact roof stability; and such fracturing would increase the risk of spontaneous combustion. Richardson Exhibit A-23.

77. The FFO by letter decision of September 20, 2001 denied the protest. The FFO found that San Juan's proposed conditions would render the oil and gas leases uneconomic, also stating "this would constitute an unfair burden on the oil and gas lessees who have priority rights in developing their associated mineral resource". The FFO further concluded that in light of the language of Special Stipulation 3 of its Deep Lease Extension (See ¶ 73, *supra*.), the requested conditions were unreasonable. Richardson Exhibit A-26.

78. On October 18, 2001, San Juan appealed the FFO decision to the BLM State Director. By letter decision of December 17, 2001 the State Director essentially upheld the FFO's decision, but remanded the matter for a further examination of an environmental assessment the FFO had performed.

79. The State Director's decision held that Richardson has a prior existing right to develop coal bed methane. The analysis also cited Section 15 of the Deep Lease Extension to support its conclusion that Richardson's oil and gas leases are valid existing rights and it is San Juan's sole responsibility to remove impediments to coal mining. In addition, the Decision also concluded with respect to priority that by signing the above-referenced Protocol as well as the Deep Lease Extension San Juan agreed

to recognize the valid existing oil and gas leases' senior stature. Richardson Exhibit A-27.

80. San Juan appealed the State Director's decision to the Interior Board of Land Appeals. That case was dismissed by Order of the Administrative Law Judge on August 27, 2002, pursuant to a Stipulated Motion for Dismissal filed by San Juan and the BLM. Paragraph 5 of the Motion states that the BLM approval of the four APDs at issue establishes no significant legal precedent "because, *inter alia*, future APDs must be adjudicated on their own facts and existing and future Field Office Managers and State Directors retain their management prerogatives to make their own decisions on APDs and other issues that may be presented in the future. Moreover, BLM and the Field Solicitor regard the issues presented and resolved by the State Director's decision as being unrelated to BLM's future decisions concerning the proper administration of competing coal and oil/gas leases. Accordingly, the policies which frame those decisions will not be constrained by the outcome or language of the State Director's decision." Richardson Exhibit No. 7 filed in De Novo proceeding.

81. Richardson's oil and gas leases pre-date San Juan's coal leases. Infill Order ¶ 30.

82. The Hearing Officer finds that compliance by San Juan with 30 USC Section 877(a) constitutes a means of avoiding adverse impacts on oil and gas resource production and of clearing its coal tract of any pre-existing oil and gas land use that would impede or prevent coal mining on its coal leasehold within the meaning of the Protocol and Section 15 of it Deep Lease Extension, respectively.

83. The Hearing Officer concludes that Richardson's rights under its oil and gas leases include the right to apply to the Commission for the Infill Order issued in this case.

Public Interest Analysis – Contractual Benefits

84. In deciding whether the Infill Order contravenes the public interest within the meaning of Section 70-2-26, this decision does not attempt to define what the public interest is in all circumstances. To attempt that would be beyond this decision's scope. What this analysis does do, however, is look to case law the Hearing Officer believes is relevant to the evidence in the record in this case, because it furnishes a framework for deciding whether the public interest has been contravened. In particular, the Hearing Officer concludes that the application of New Mexico's strong public policy favoring the enforcement of valid contracts to the facts of this case is determinative of this inquiry.

85. Young & Norton v. Hinderlider, 15 N.M. 666, 110 P. 1045 (1910), involved a decision of the territorial engineer approving one of two competing permit applications to appropriate waters of the territory for an irrigation project. The territorial engineer was empowered by statute to reject an application to appropriate waters of the state "if in his opinion the approval thereof would be contrary to the public interest...". In rejecting the Hinderlider application in favor of the Young & Norton application, the engineer based his decision on the fact that there wasn't enough water to irrigate the approximately 14,000 acres contemplated by the Hinderlider application, while there was enough to irrigate the roughly 5000 acres of the Young & Norton application, and the Hinderlider project would result in a higher price of water for users. Therefore, approval of the Hinderlider application would be contrary to the public interest. The Board of Water Commissioners for the Territory reversed this decision and the District Court upheld. The Supreme Court discussed the public interest standard, set aside the District Court judgment and remanded the case to the District Court to obtain additional facts bearing on the question of public interest. In its discussion the Supreme Court clearly stated that matters that are contrary to the public interest are not limited only to cases in which a project would be a menace to the public health or safety. Nor is the public interest necessarily contravened by a project that would cost irrigators more per acre than a competing proposal. The Court made it clear that determining the public interest includes assessing the interplay of a variety of factors and their effects, including not only public health and safety and project cost to consumers, but also a project's economic viability, lest approval of a financially unsound project lead to injurious speculation and harm to the developing Territory's capital markets. Id. at 677, 678.

86. The Hearing Officer reads Hinderlider to mean that determining the public interest necessarily involves balancing competing interests, such as public health and safety and economic impacts to the parties and third parties, but in doing so, a decision maker must consider the implications of his decision on important public policies that could be directly affected.

87. New Mexico's courts have repeatedly recognized that upholding and enforcing valid contracts serve the public interest. In Coquina Oil Corp. v. Transwestern Pipeline Company, 825 F.2d 1461 (10th Cir. 1987), the U.S. District Court for the District of New Mexico granted plaintiffs' motion for a preliminary injunction enjoining defendant from not taking amounts of gas produced monthly by plaintiffs required to be taken under their contracts with defendant. Defendant opposed the motion for preliminary injunction on multiple grounds, including asserting that orders of the Federal Energy Regulatory Commission (FERC) had so reduced its market for natural gas sales as to constitute force majeure under the contracts with plaintiffs, thereby excusing defendant's performance to take

plaintiffs' gas at contract prices. One of defendant's other defenses was that injunctive relief would be contrary to the public interest because down stream customers would have to pay more for natural gas, defendant would purchase less from small independent producers and reduced sales would jeopardize defendant's business.

88. The court rejected defendant's force majeure defense, in part because the defendant was still able to perform under its contracts. Noting that force majeure only excuses a party if performance of the contract is not practicable, the court found that performance was practicable, because, while defendant might be excused from taking plaintiffs' gas, it had the alternative and ability to pay for the gas whether it took it or not. Noting that "[c]ourts rarely discharge a duty on the ground of mere loss of revenue; the proper focus in assessing impracticability is defendant's general financial health, not the losses resulting from a particular contract". [citations omitted] Id. at 6. There was evidence in the record that defendant earned substantial income despite the FERC orders. Moreover, the court found that the FERC orders did not constitute a supervening event excusing defendant's performance. That is, the FERC orders were not an unanticipated circumstance that made performance of defendant's contract obligations vitally different from what the parties should reasonably have contemplated when they entered into the contract. The court held that the FERC orders were foreseeable and that the defendant could have covered that contingency in the contract. Accordingly, the defendant was held to have assumed the risk represented by the FERC orders' effects.

89. In rejecting the defendant's argument that a preliminary injunction would contravene the public interest, the court said, "[w]hile I am concerned about harm to small independent producers, focusing on the public interest means considering whether there are policy considerations that bear on whether the order should issue. [citations omitted] Thus, enforcing plaintiffs' contracts serves the public interest even though it may harm independent producers who have voluntarily rolled back their contract prices." Id. at 8. In this case, the effect of not denying Richardson's applications by upholding the Infill Order is to require San Juan to fulfill its contractual obligations and to protect Richardson's rights as an intended beneficiary under the Protocol and Section 15 of the Deep Lease Extension.

90. New Mexico recognizes the well established rule that a third party may sue and recover upon a valid contract in which he has a beneficial interest, even if he is not explicitly designated as a beneficiary therein. Hamill v. Maryland Cas. Co., 209 F.2d 338, 340 (10th Cir. 1954). The intent of the contracting parties to benefit a third person is controlling. Intent is gathered from a construction of the contract in light of the surrounding

circumstances. Id. The New Mexico Supreme Court has held that the issue of determining whether legal liability to a third party beneficiary exists is one of contract. Permian Basin Inv. Corp. v. Lloyd, 63 N.M. 1, 7, 312 P.2d 533 (1957). The court recognized the impossibility of encompassing all third party situations in a single statement, but affirmatively approved the following statement from Corbin on Contracts, Vol. 4, 776, pp. 18, 19:

> A third party who is not a promisee and who gave no consideration has an enforceable right by reason of a contract made by two others . . .if the promised performance will be of pecuniary benefit to him and the contract is so expressed as to give the promisor reason to know that such benefit is contemplated by the promisee as one of the motivating causes of his making the contract. Id.

And, a member of a class intended to be benefited by a contractual obligation has standing to maintain a suit. Id. at 6. The court then contrasted the principle upon which third persons are denied recovery: . . "[t]he promisor should not be held liable in damages for breach of his contract with the promisee by one whose detriment by its nonperformance could not reasonably been forseen by the promisor and by one whose existence (whether specific or general) and interest in the contracted-for performance (whether contingent or direct) was not within the reasonable contemplation of the promisor when the promise was made". Id. at 7, 8.

91. Under these rules, Richardson is an intended beneficiary of the Protocol and Section 15 of the Deep Lease Extension, because (a) Richardson is within the class of oil and gas lessees to whose prior rights the Deep Lease Extension is subject; (b) Richardson's leases predate San Juan's lease; (c) San Juan's promise in the Protocol to honor the rights of valid oil and gas leases is for the pecuniary benefit of the class of which Richardson is a part; (d) such assurances were a motivating cause for the BLM to enter into the lease with San Juan, to maximize the development of both the gas and coal resources; and (e) the detriment to oil and gas lessees from San Juan's non-performance is entirely foreseeable.

92. Likewise, New Mexico courts in other contexts have upheld the right of private parties to be secure in the knowledge that their contracts will be enforced. For example, in Cafeteria Operators, L.P. v. Coronado-Santa Fe Associates, L.P. and A.P. Century II, 124 N.M. 440, 952 P.2d 435 (Ct. App. 1997) the appellate court upheld the district court's decision granting a mandatory injunction requiring the defendant landlord to demolish a building on its shopping center site that it had constructed and then leased in violation of its configuration agreement with plaintiff tenant. This breach was held to be intentional, which weighed in tenant's favor. Interestingly, the appellate court stated, "[w]e recognize that it may appear

wasteful to require demolition of the building when its benefit to Landlord and others may greatly exceed its detriment to Tenant. But nothing forbids Landlord from negotiating with Tenant to waive its right to compel removal of the building". Id. at 448.

93. In Bowen v. Carlsbad Ins. & Real Estate, Inc., 104 N.M. 514, 724 P.2d 223 (1986) the Supreme Court upheld the trial court's judgment that a restrictive covenant (a non-competition clause) in a business purchase and sale agreement was reasonable and enforceable. The court held that the restrictive covenant was not void as a restraint of trade and quoted Meissel v. Finley, 198 Va. 577, 584; 95 S.E. 2d 186, 191 (1956) as follows, "[i]t is as much a matter of public concern to see that valid engagements are observed as it is to frustrate oppressive ones". The court also cited Lovelace Clinic v. Murphy, 76 N.M. 645, 650; 417 P.2d 450, 453 (1966) in support of its holding "(public interest in enforcing contractual rights and obligations)". Id. at 517.

94. With respect to the health and safety concerns cited by San Juan, the Hearing Officer concludes that San Juan's duty to comply with the Federal Mine Safety and Health Act is *per se* in the public interest, and that actual compliance with the Act by San Juan will suffice to protect mine worker health and safety from the adverse impacts of oil and gas wells San Juan asserts. For as discussed above, the Federal Mine Safety and Health Act's mandatory requirements represent national policy which balances the economic interests of mine operators with the health and safety of mine workers in order to promote the public interest. Therefore, when San Juan entered into the Deep Lease, the Protocol and the Deep Lease Extension it knew it was and would be subject to the Federal Mine Safety and Health Act's provisions, both those empowering inspectors to evacuate a mine to avoid imminent danger as well as those provisions authorizing San Juan to request a modification in the diameter of pillars around well bores. The costs of complying with mine safety regulations are a cost of doing business. San Juan could also reasonably have anticipated when it signed its coal leases and the Protocol that a lessee under a pre-existing oil and gas lease would at some point request infill wells that would increase San Juan's cost of complying with safety rules.

95. The Hearing Officer concludes that there is competent evidence in the record by which the Commission could have found that the protections of the Protocol and of Section 15 of the Deep Lease Extension apply to Richardson's oil and gas leases, and the Hearing Officer hereby does so find. Specifically, by executing the Protocol and subsequently agreeing to the terms of Section 15, knowing that Richardson's leases predated either document, San Juan itself recognized the oil and gas leases' priority. This evidence supports both the Commission's Infill Order and the

Commission's conclusion that it lacks jurisdiction to adjudicate *sua sponte* the validity, force and effect of Richardson's oil and gas leases.

96. The Hearing Officer concludes that the effect of the Protocol San Juan signed was to acknowledge as a matter of law that Richardson's oil and gas leases were valid existing federal oil and gas rights that San Juan would have to honor, because Richardson's leases pre-dated the Protocol as a matter of record.

97. The Hearing Officer concludes that San Juan's obligations under the Protocol and Section 15 of the Deep Lease Extension (See Recommended Decision ¶s 67 and 68 above) extend to Richardson's oil and gas leases and to Richardson's rights to seek an infill order for development of the leases. Consequently, the Infill Order will not result in the mineral's waste.

98. In light of San Juan's obligations to Richardson, San Juan's legal arguments in this case, in effect, take the position that the public interest standard of Section 70-2-26 vests the Commission and the Secretary with the power to excuse San Juan from its contractual obligations. The Hearing Officer finds that such authority is in the nature of, and for purposes of this analysis may be equated with a court's equitable powers. However, under the Coquina analysis discussed above and the reasoning in the United Properties Limited case cited and discussed below, San Juan cannot meet the specific legal tests necessary to establish its right to such equitable relief in light of New Mexico's extremely strong public policy of enforcing valid contracts. Nothing in the record, for example, supports a finding that the Protocol and the terms of Section 15 fall within one of the well-defined equitable exceptions to freedom of contract, such as unconscionability, mistake, fraud or illegality. Nor is there evidence in the record that San Juan cannot perform its contract obligations, or that its general financial health is at risk from the Infill Order's effects. These conclusions are strongly reinforced by the decision of the New Mexico Court of Appeals in United Properties Limited Co. v. Walgreen Properties Inc., 2003 NMCA-180, 134 N.M. 725, 82 P.3rd 535 (2003).

99. In the United Properties Limited (hereafter "UPL") case, the issue was whether a tenant and sub-tenants ("Tenant") under a commercial lease were entitled to equitable relief from the Tenant's failure to properly give notice to the Landlord of its intent to exercise its option to renew the lease for an additional five year period. Tenant had made two million dollars in improvements to the leased property after assuming the lease. The District Court granted the equitable relief the Tenant requested. The Court of Appeals reversed the District Court and held that the lease's notice provisions must be enforced as they were written, because the notice was

quite late measured against the notice period provided for and simple neglect caused the late notice.

100. The Court of Appeals acknowledged a split of legal authority on the question whether equity will or will not relieve a lessee of the consequences of his failure to give timely notice of his exercise of an option to renew or extend a lease. However, in setting forth the rationale for its decision the court noted that it "wholeheartedly" agreed with the court's conclusions in the case of SDG Macerich Props., L.P. v. Stanek, Incorporated a/ka/ Stanek, Inc., 648 N.W. 2d 581 (Iowa 2002). The UPL court stated that it would not use equitable principles to save a party from the circumstances it created and that weighing the equities in each case where the parties bargained freely to their contract would create instability in business transactions and disregard commercial realities. Enforcing the written words of unambiguous contracts afford the greatest certainty that the intention of contracting parties will be realized and that compliance with the performance terms of contracts will occur. And finally, a court of equity is bound by a contract as the parties have made it and should be a last resort, not a first resort, to afford relief only where there is obvious fraud, real hardship, oppression, mistake or unconscionable results. Id. at p. 17. And, earlier in its decision, the UPL court noted that under the governing principles of New Mexico contract law, in the absence of mistake, fraud or illegality, a contract negotiated at arm's length is not voidable on grounds of unconscionability or oppression simply because some of its terms resulted in a hard bargain or exposed a party to substantial risk. Id. at p. 13.

101. The Hearing Officer concludes that the Infill Order is consistent with Richardson's rights as an intended beneficiary under the Protocol and Deep Lease Extension San Juan agreed to with the BLM, and that overturning the Infill Order based upon San Juan's economic impact arguments would in fact contravene the public interest in enforcing valid contracts, as discussed in detail above. Applying another prong of the Coquina analysis to the facts of this case shows that there is no evidence in the record that San Juan will be rendered incapable of complying with the MSHA regulations, despite a potentially higher cost of doing so. Nor is the Infill Order a supervening event that will excuse San Juan from its obligations under the Protocol and Section 15 of the Deep Lease Extension. It is rather an action of which San Juan assumed the risk when it executed those agreements. Finally, conceding that there may be some economic harm to the state from reduced tax revenues, or to San Juan from increased costs, the public interest is better served under these facts by denying San Juan's application to set aside the Infill Order.

102. The Hearing Officer concludes that the Infill Order does not contravene the public interest pursuant to Section 70-2-26.

103. The Hearing Officer notes that the Commission also finds support for its Infill Order in the above-cited State Director's Decision. The Hearing Officer concludes that, notwithstanding the Stipulated Dismissal of San Juan's appeal to the Interior Board of Land Appeals, the State Director's Decision remains a valid expression of how the BLM has interpreted the effects of the Protocol and the Deep Lease Extension Section 15. This Decision, then, is entitled to deference by the Commission, especially in light of the fact that the parties, issues and documents involved are essentially the same in both the OCC proceeding and San Juan's BLM appeals. The Hearing Officer reads the Stipulated Dismissal to mean that the BLM has the right to reach a different result in a future case, not that the State Director's Decision is not a valid agency interpretation of its policies in light of its approvals of both Richardson's APDs and its contracts with San Juan. There is no evidence in the record to suggest that that interpretation has been superceded or overruled. The language of the Stipulated Dismissal in fact recognizes that it may be given limited precedential value, not that it has no value. Therefore, the Commission could have taken administrative notice of and given deference to the State Director's Decision for purposes of characterizing the validity of Richardson's oil and gas leases and the duties San Juan owes to Richardson under the Protocol and Deep Lease Extension. The State Director's Decision constitutes additional competent evidence that supports the Infill Order.

104. Because there is competent evidence in the record to support the Infill Order, and because the Infill Order does not contravene the public interest for the reasons discussed, the Infill Order of the Commission should not be set aside.

San Juan's Request to Strike Portions of Infill Order ¶'s 75 and 76

105. San Juan suggests striking the Commission's comments in paragraphs 75 and 76 of its Infill Order about the parties' motivations and the consequences of the parties' actions, which San Juan considers beyond the evidence in the record and thus unsupported and beyond the Commission's jurisdiction.

106. The Hearing Officer declines to recommend striking these paragraphs in whole or in part. These are not findings of fact, but are the Commission's conclusions, though not necessary to the decision. Formal decisions almost always contain a certain amount of dicta or statements for which there is room for disagreement.

IT IS THEREFORE RECOMMENDED THAT THE FOLLOWING ORDER BE ENTERED :

1. Oil Conservation Commission Order No. R-11775-B does not contravene the public interest pursuant to NMSA 1978, Section 70-2-26. Paragraphs 1 through 7 of the actual Order shall be and hereby are affirmed.

2. San Juan's motion for mediation is hereby denied.

3. All other motions not granted in the context of the Recommended Decision are hereby denied.

RESPECTFULLY SUBMITTED at Santa Fe, New Mexico on this 30th day of September, 2004.

HEARING OFFICER

Tom Mills

Tom Mills, Deputy Secretary
Energy, Minerals and Natural Resources Department

Case No. 14191 *: Application of Redwolf Production, Inc., for Expansion of the Special Infill Well Area and for Exception to the Well Density Provisions of the Special Rules and Regulations for the Basin-Fruitland Coal Gas Pool, San Juan County, New Mexico.* Applicant seeks an order expanding the Special Infill Well Area established pursuant to Order No. R-11775 and providing for an exception to the well location provisions of the Rules and Regulations for the Basin-Fruitland Coal Gas Pool (71629) for the drilling of an original and one infill well within the SE/4 of a standard spacing and proration unit consisting of the S/2 of Section 25, Township 30 North, Range 15 West NMPM in San Juan County, New Mexico. Applicant operates the following well drilled to the Fruitland Coal Formation in the SE/4 of Section 25:

Kelly FC Well No. 1
(API No. 3004533326)
1180' FSL & 900' FEL (Unit P)

Redwolf seeks authorization to drill an additional Basin-Fruitland Coal Gas infill well at a standard location within the SE/4 of Section 25:

Kelly FC Well No. 1-H
Section 25: NE/4 SE/4 (Unit I)

The lands and wells are located approximately six miles northwest of Farmington, New Mexico.