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William F. Carr

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February 20, 2003

HAND DELIVERED

The Honorable Tom Mills
Deputy Secretary
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Office of the Secretary
Resources Department
Energy, Minerals & Natural

FEB 20 2003

Received

Re: **New Mexico Oil Conservation Commission Case 12888, Order R-11775-B;
Appeal of San Juan Coal Company to the Secretary of Energy, Minerals
and Natural Resources**

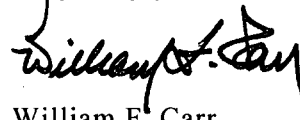
Dear Secretary Mills:

On behalf of Richardson Operating Company and in accordance with your direction at the conclusion of the hearing held on February 10, 2003 in the above-referenced case, please find enclosed Richardson's Proposed Findings of Fact and Conclusions of Law.

In this proceeding the Secretary is only required to determine if Oil Conservation Commission Order No. R-11775-B contravenes the public interest. The Richardson Findings of Fact and Conclusions of Law support this Order and a determination that it does not contravene the public interest.

However, if the Secretary believes the public interest has been contravened, a decision must be rendered that contain sufficient particularity to explain the rejection of the Commission's Order and the Richardson Findings of Fact and Conclusions of Law thereby enabling the Commission to amend its order to conform to your decision.

Very truly yours,



William F. Carr



W. Thomas Kellahin

ATTORNEYS FOR RICHARDSON
OPERATING COMPANY

**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.**

• Received

FEB 20 2003

• Energy, Minerals & Natural
Resources Department
• Office of the Secretary

**OIL CONSERVATION COMMISSION CASE NO.
12734 (De Novo), ORDER R-11775-B.
(Request for de novo review by the Secretary of the
Energy, Minerals and Natural Resources Department)**

**RICHARDSON OPERATING COMPANY'S
PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW.**

Pursuant to the February 10, 2003 request of the Deputy Secretary of the New Mexico Department of Energy, Minerals and Natural Resources, Richardson Operating Company ("Richardson") hereby submits its proposed Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

JURISDICTION OF THE SECRETARY:

1. The power of the Secretary to review Oil Conservation Commission Order No. R-11775-B to determine if it contravenes the public interest is authorized and limited by statute. NMSA 1978, § 70-2-26 (1995 Repl.)
2. The Secretary's jurisdiction in this case is limited by statutory terms and conditions and by the regulatory scheme applicable to the development of these resources. In reviewing this decision of the Commission, the Secretary must respect the jurisdictions of other state and federal agencies with responsibility for the management and development of these resources.
3. The governing section of the New Mexico Oil and Gas Act provides that the Secretary may hold a public hearing to determine whether, **under the circumstances, this order** of the Commission contravenes the public interest. § 70-2-26 (emphasis supplied).

THE LANDS:

4. This case involves an application for the creation of 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.
5. Eighty-five percent (85%) of the land in the "infill area" is federal land.
6. The Bureau of Land Management ("BLM") is the federal agency responsible for the management of oil, gas and coal on federal lands.
7. There has been no formal delegation of this management responsibility from the BLM to the state.
8. San Juan Coal Company ("SJCC") has previously presented the priority, safety, and economic issues it raises in this case to the BLM and the Oil Conservation Division. On four occasions, the BLM, the Oil Conservation Division and the Oil Conservation Commission have ruled against SJCC on these issues.
9. Where there is competing mineral development between owners of gas leases and coal leases, it is the policy of the BLM that both resources should be produced "to optimize the recovery of both resources." (Record on Appeal at 779.)
10. Since the February 10, 2003 hearing, the BLM has written to advise the Commission that it supports infill development of the Basin-Fruitland Coal Gas Pool and to encourage the recompletion of wells to avoid additional surface disturbance of these lands. The BLM's February 11, 2003 letter is incorporated into these Findings of Fact and Conclusions of Law and is attached hereto as Exhibit A.

MINERAL LEASES:

11. Richardson and Dugan Production Company ("Dugan") are the lessees of the oil and gas rights in the subject area. The oil and gas leases pre-date and have priority over the coal leases.
12. As a condition precedent to the issuance of the Federal Coal Lease for the Deep Mine Extension, SJCC agreed that the oil and gas leases had senior stature to their coal leases. (Record on Appeal at 830)
13. The Federal Coal lease to the deep mine extension held by SJCC contains a special stipulation recognizing the oil and gas lessee's "prior existing right" to produce the gas. (Record on Appeal at 736)
14. The State of New Mexico Coal leases provide for insitu coal gasification in order to remove coal but provide "such gasification shall not disturb or diminish commercial quantities of coalbed methane gas" (Record on Appeal at 721.)

15. SJCC has been and is continuing to vent to the atmosphere, and thereby waste, natural gas that it does not own.
16. After the natural gas is produced from these leased lands, coal reserves remain and can be mined; whereas after the coal is removed, the gas is also gone.

THE WELLS:

17. 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 operated by Richardson.
18. The Commission order allows Richardson to drill two additional wells penetrating the Fruitland Coal in the infill area and to recompleting thirteen (13) additional wells in this area. No new Richardson well will be drilled in a mine district on State of New Mexico lands.

RICHARDSON APPLICATION:

19. The BLM requested that Richardson and Dugan expedite recovery of the coalbed methane gas prior to the mining of the coal by SJCC. Since then, Richardson has attempted to comply with this request but has faced vigorous opposition by SJCC at every turn.
20. With this application Richardson seeks authorization to accelerate gas production prior to the time the coal from which the gas is produced is removed through mining.
21. Approval of this application authorized Richardson to develop this acreage under the identical rules that apply to the development of Fruitland Coalbed Methane Gas in other similar portions of this reservoir.

THE HEARING:

22. The entire record from the October 29, 30 and 31, 2002 Commission hearing on the Richardson application was incorporated by reference into the record of this hearing.
23. During three days of hearing held October 29, 30 and 31, 2002, and at the February 10, 2003 hearing before the secretary, the parties presented evidence on the nature of this reservoir and made various comparisons of the value of this coal and this coalbed methane gas.

COMMISSION ORDER NO. R-1775-B:

24. The Commission entered Order No. R-11775-B granting the application of Richardson and found that the proposed infill wells were needed to efficiently and economically produce the CBM underlying this acreage.
25. This is all Order No. R- 11775-B decides. Therefore, this is the issue for the Secretary review to determine if this order contravenes the public interest.

FEBRUARY 5, 2003 LETTER FROM SJCC:

26. On February 5, 2003, SJCC wrote to Richardson and advised that it was concerned about encountering more gas in this reservoir than it had anticipated and that it therefore needed to drill wells in the coal to extract the gas from this formation prior to mining the coal.
27. SJCC stated in its February 5, 2003 letter that it “plans to conduct test de-gassing activities in advance of mining” by using “relatively new technologies” that have not been attempted in the basin.
28. SJCC stated in its February 5, 2003 letter that it was “planning to test a horizontal in-seam drilling technology” or other technologies such as “vertical to horizontal drilling” to de-gas the coal prior to mining.

SJCC’s letter of February 5, 2003 is incorporated into these Findings of Fact and Conclusions of Law and attached hereto as Exhibit B.

REVIEW BY THE SECRETARY:

29. SJCC presented testimony in opposition to Richardson’s application before the Oil Conservation Division, the Commission and the Secretary. It seeks an order from the Secretary preventing further infill development in this portion of the pool. In essence, San Juan seeks an order that would shut down this development while at the same time it acknowledges that removal of the CBM gas is needed prior to mining. As an alternative remedy SJCC has also suggested that the Secretary refer this dispute to non-binding mediation.
30. In summary, the evidence in this case establishes that:
 - A. Richardson’s oil and gas leases pre-date the coal leases,
 - B. San Juan has agreed that the oil and gas leases in the infill area are superior to their coal leases;
 - C. Both the natural gas and the coal resources have value;

- D. The BLM encourages its lessees to accelerate development of the CBM in advance of mining to ensure recovery of methane that otherwise would be lost, and reduce the safety threat of methane degassing during mining operations (Record on Appeal at 1267.);
- E. The parties agree that additional wells need to be drilled in the coal to remove the natural gas prior to mining the coal.

CONCLUSIONS OF LAW

1. The power of the Secretary to review Oil Conservation Commission Order No. R-11775-B to determine if it contravenes the public interest is authorized and limited by statute. NMSA 1978, § 70-2-26 (1995 Repl.)
2. The Secretary's jurisdiction in this case is limited by statutory terms and conditions and by the regulatory scheme applicable to the development of these resources. In reviewing this decision of the Commission, the Secretary must respect the jurisdictions of other state and federal agencies with responsibility for the management and development of these resources.
3. The governing section of the New Mexico Oil and Gas Act provides that the Secretary may hold a public hearing to determine whether, under the circumstances, this order of the Commission contravenes the public interest. § 70-2-26 (emphasis supplied).
4. The Oil Conservation Commission has special expertise and competence to decide technical matters concerning the development of oil and natural gas. The Secretary should respect the technical competence of the Commission on technical issues and not allow this review to become a forum for the supplementation of the record below and to then re-determine issues fully presented to the petroleum engineers and geologists that serve as members of the Commission.
5. While this case concerns the development of coalbed methane gas and coal development, the underlying and controlling issues involve mine safety matters governed by the federal Mine Safety and Health Act ("MSHA") and regulations promulgated thereunder. The administration of these regulations has not been delegated to the State of New Mexico and the Commission correctly determined that these issues should be presented to MSHA.
6. The Secretary cannot alter the terms, special stipulations and conditions of the relevant oil and gas and coal leases and related contracts, nor issue orders affecting federal lands that are inconsistent with stated federal policy governing these lands.
7. Richardson and Dugan are the lessees of the oil and gas rights in the infill area. SJCC is the lessee of state and federal coal rights but does not own the oil and gas rights.

8. Richardson's oil and gas leases predate and are superior to the coal leases of San Juan Coal Company.
9. Federal coal leases are subject to the superior oil and gas leases covering these lands.
10. The federal government's policy for the development of these competing gas and coal resources is that both resources should be developed.
11. The state coal lease was issued subsequent to the state oil and gas lease covering the state lands in the infill area. Under the terms of the lease, the coal lessees may not degas the formation in order to remove coal if such degasification disturbs or diminishes commercial quantities of coalbed methane gas.
12. San Juan's venting of natural gas as part of its coal mining efforts causes waste and contravenes the public interest.
13. The parties agree that additional wells must be drilled to remove the coalbed methane gas from the Fruitland coal seam prior to mining the coal. (Record of Appeal at 785 and 801.)
14. The Commission order holds that additional drilling is needed to produce the coalbed methane gas from the coal and further holds that the drilling proposed by Richardson will be efficient and economic.
15. Both the statements of the parties and the order of the Commission are consistent with each other for all now agree that wells are needed to extract the gas from the coal in the infill area prior to mining the coal. (SJCC Exhibit 69, February 10, 2003.)
16. If SJCC drills wells in the infill area, these wells are subject to the jurisdiction of the Commission and would have to be justified and determined to be necessary, efficient and economic. See, NMSA 1978, § 69-3-7.
17. If it is in the public interest for SJCC to drill and produce gas it does not own, it is in the public interest for Richardson to drill and produce gas it owns.
18. SJCC's argument regarding economics of the resources becomes academic to the extent that both resources are produced.
19. The public interest must be defined in terms that are broader than just the corporate profit and economic interests of SJCC and PNM. (*Young & Norton v. Hinderlider*, 15.N.M.666, 110 p. 1045 (1915).
20. The order of the Commission allows the owner of the gas to produce the gas in a manner that is needed, and is efficient and economic.

21. The Commission's order which authorizes the drilling and completion of infill wells in the infill area will result in gas being removed from the coal prior to coal mining in an efficient and economic manner and does not contravene the public interest.
22. At the request of SJCC the Secretary has held a public hearing to determine if an order of the Oil Conservation Commission contravenes the public interest. Although SJCC now suggests that the Secretary should submit this dispute to non-binding mediation, that action is beyond and inconsistent with the provisions of the statute under which this matter has been called before the Secretary.
22. Having called this matter to public hearing the Secretary now concludes that the Commission's Order does not contravene the public interest.
23. The motion of San Juan Coal Company for a Stay of Commission Order No. R-11775-B is hereby denied.
24. The motion for clarification of Richardson Operating Company is hereby denied.

Respectfully submitted,

KELLAHIN & KELLAHIN

By: 

W. Thomas Kellahin
117 North Guadalupe
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Fax No. 505 982-2047

HOLLAND & HART LLP

By: 

William F. Carr
Robert J. Sutphin, Jr.
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CERTIFICATE OF SERVICE

I certify that on February 20, 2003 I served a copy of the foregoing document to the following by

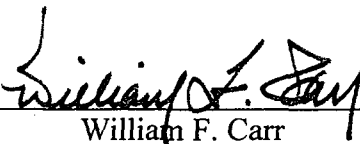
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U.S. Mail, postage prepaid
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William F. Carr



United States Department of the Interior

BUREAU OF LAND MANAGEMENT

Farmington Field Office
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IN REPLY REFER TO:
3160 (07100)

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FEB 13 2003

HOLLAND & HART LLP

FEB 11

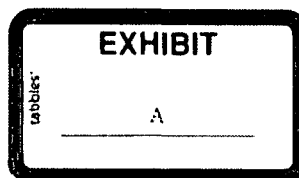
CERTIFIED—RETURN RECEIPT REQUESTED
7160 3901 9842 1254 8364

Ms. Florene Davidson, Commission Secretary
New Mexico Oil Conservation Division
1120 S. St. Francis Drive
Santa Fe, NM 87505

Re: Bureau of Land Management, Farmington Field Office
Position concerning increased well density in the
Fruitland Coal within the "High Productivity Area"
Standard Gas Proration Unit (320 acres)
New Mexico portion of the San Juan Basin

On October 15, 2002 the New Mexico Oil Conservation Division issued a Fruitland Coal infill order (Case No. 12888, Order No. R-8768-C) allowing 160 acre spacing for all areas except the 'High Productivity' portion of the basin also referred to as the "Fairway". The Division Order states "A preponderance of the evidence [submitted] establishes that current 320-acre spacing is adequate in the High Productivity Area." The Order further declares that "Based on the relative lack of direct evidence of the potential effects from infill drilling within the High Productivity Area, it would not be prudent for the Division to amend the pool rules to provide for increased density within the High Productivity Area at this time. The more prudent course of action would be to refer the matter of infill drilling within the High Productivity Area back to the Committee for further study." The Bureau of Land Management (BLM) realizes that in certain areas of the fairway the existing well spacing is adequately draining the Fruitland Coal reservoir. The BLM also acknowledges that portions of the fairway probably require additional drilling to optimally recover the gas resource. Consequently, the BLM concurs with the order but would entertain additional forthcoming technical data that would support infill drilling in the Fruitland Fairway. The Federal lands in this area have high aesthetic appeal and are prime areas for wildlife habitat. Merely rate acceleration of gas production at the expense of additional surface disturbance is difficult to justify to the multiple users of the public lands.

Within the "High Productivity Area", the BLM reserves the right to request technical data from operators especially if the Bureau suspects that rate acceleration alone is involved in the new drill and/or additional surface disturbance is required. These data may include, but are not limited to, geologic cross-sections, reservoir isopachs, reservoir simulations and other pertinent information.



The BLM supports the orderly and efficient exploration, development and production of oil and gas on Federal and Indian lands. The BLM is responsible for managing public lands for multiple use and maximizing the resource values for the American people.

In summary, the BLM is in support of the increased well density in the Fruitland Coal formation. We encourage the development of the Fruitland Coal Formation by means of re-completions in existing wellbores, commingling and drilling from existing well pads. This type of development will minimize surface disturbances, decrease development costs and maximize utilization of existing wellbores.

Sincerely,

/s/ Steve Henke

Steve Henke
Field Manager

cc:

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San Juan Coal Company



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February 5, 2003

Richardson Operating Company
1700 Lincoln, Suit 1700
Denver CO 80203

Dear Mr. Richardson,

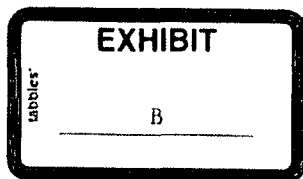
San Juan Coal Company Gas Recovery Proposal

As you are aware, the BLM and the New Mexico State Land Office have leased overlapping resources (coal & coal-bed methane) to separate parties in the San Juan Coal Company "SJCC" coal lease area. SJCC has been developing its San Juan Underground mine for the past several years. Through those efforts SJCC continues to learn about conditions in the mine and the characteristics of the coal formation and the associated coal bed methane.

In order to conduct its mining operations safely, SJCC is required to maintain good air quality at all work sites in the mine, and has designed a mine ventilation system for that purpose and to properly and safely vent gasses liberated during mining.

The amount of gas in the current mining area to date is low enough to be adequately managed with the existing mine ventilation system. However, if areas are encountered that have a high enough gas content, SJCC may be unable to remove all of the gas given the maximum capability of the mine ventilation system as designed. If such areas are encountered, additional de-gassing techniques may need to be employed. To investigate the potential of de-gassing techniques, SJCC plans to conduct test de-gassing activities in advance of mining. Since relatively new technologies will be used, and this is the first time this has been attempted in this basin, a number of de-gassing technologies may be tested and utilized depending upon their economic and safety effectiveness. Initially we are planning to test a horizontal in-seam drilling technology. Other technologies, such as vertical to horizontal drilling, may be evaluated for economic and technical viability in the future.

To the extent that SJCC determines that it is safe, economic, and practicable for mining purposes to conduct de-gassing activities, and if any gas is collected and delivered to the surface by SJCC, SJCC would like to make that gas available for your gathering and disposition. While SJCC cannot commit at this time to the location(s) where such gas may be available, or to the quality and quantity of such gas, SJCC stands prepared to work with you to attempt to resolve any technical, regulatory, and operational issues encountered in gathering this gas.



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which is headquartered in Australia
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Melbourne Victoria 3000 Australia
ABN 49 004 028 077
Registered in Australia

SJCC also is investigating another potential source of gas. To understand this source some background information may be helpful. The longwall mining method utilized by SJCC recovers large blocks (panels) of coal. After the coal is removed, the material above the removed coal breaks up and caves into the void area creating a "gob" zone. The panel is then isolated from the rest of the mine so the oxygen content of the atmosphere in the panel can be reduced to eliminate the possibility of heating, combustion, or explosions. Nitrogen may be injected initially to reduce safety risk. Some gas liberated from the gob zone or lower horizons may be collected in gob vent bore holes. The gob vent bore holes will be managed so that the oxygen deficient atmosphere is not compromised. Due to density segregation, it is conceivable that the gas obtained from the gob vent bore holes may be primarily methane.

SJCC would like to make available to you any gas that is generated from the gob vent bore holes that can be gathered without compromising the sealed panel atmosphere, and without affecting other safety considerations. While SJCC can not commit to the quantity, quality (an increased nitrogen content may exist), or timing of any gob vent bore hole gas, SJCC is prepared to work to resolve any technical, regulatory, and operational problems that may be encountered in gathering any gas generated at the gob vent bore holes.

SJCC is making this proposal with the hope that it may provide a path to allowing improved recovery of the resources in question and provide a positive step in resolving all issues, while permitting SJCC to mine coal and meet its long term contract obligations. SJCC understands from previous conversations that you may prefer a buyout to an on-going relationship for simultaneous mineral development. SJCC is prepared to discuss reasonable buy out arrangements as well.

Please contact me if there are any questions or to initiate discussions on these matters. San Juan Coal Company is very interested in resolving this conflict in a mutually agreeable manner.

Yours sincerely,

Evan Jones
Vice President, San Juan Coal Company

Cc: Steve Henke BLM – Farmington Field Office
Carston Goff Deputy State Director BLM NM State Office
Arthur Arguedas Department of Interior Solicitor
Lori Wrotenbery Chairman, State of New Mexico Oil Conservation Commission
Jenifer Prokup Secretary, NM Energy, Minerals, and Natural Resources Department
Patrick Lyons Commissioner, NM State Land Office



February 20, 2003

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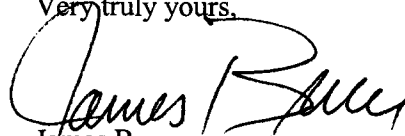
The Honorable Thomas Mills
Deputy Secretary
NM Energy, Minerals and Natural Resources Dept.
1220 S. St. Francis Dr.
Santa Fe, NM 87505-4000

Re: *De Novo* Review by Secretary of OCC Case No. 12734 (*de novo*);
Proposed Findings and Conclusions

Dear Secretary Mills:

San Juan Coal Company submits the enclosed Proposed Findings of Fact and
Conclusions of Law, as you directed during the hearing held on February 10, 2003.

Very truly yours,



James Bruce
Larry P. Ausherman

LPA:tc

Enclosure

cc: William Carr
W. Thomas Kellahin
Carol Leach

Modrall Sperling
Roehl Harris & Sisk P.A.

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**STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT**

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EMNRD-LEGAL

**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.**

**De Novo Review
By the Secretary
Case No. 12734 (De Novo)**

CERTIFICATE OF SERVICE

I hereby certify that I hand-delivered to Thomas Mills, Tom Kellahin, and William Carr a copy of San Juan Coal Company's Findings and Conclusions of the Secretary of the Energy, Minerals and Natural Resources Department, this 20th day of February, 2003.

By: _____

James Bruce

**STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT**

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FEB 21 2003

EMNRD-LEGAL

**IN THE MATTER OF THE APPLICATION OF
RICHARDSON OPERATING COMPANY TO
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POOL AS PROVIDED BY RULE 4 OF THE
SPECIAL RULES FOR THIS POOL,
SAN JUAN COUNTY, NEW MEXICO.**

**De Novo Review
By the Secretary
Case No. 12734 (De Novo)**

**FINDINGS AND CONCLUSIONS OF THE SECRETARY OF THE ENERGY,
MINERALS AND NATURAL RESOURCES DEPARTMENT
(PROPOSED BY SAN JUAN COAL COMPANY)**

BY THE SECRETARY:

THIS MATTER came before the Secretary of the New Mexico Energy, Minerals and Natural Resources Department ("Secretary") for evidentiary hearing conducted by Thomas C. Mills, Deputy Secretary, on February 10, 2003 at Santa Fe, New Mexico. This hearing was requested by San Juan Coal Company ("San Juan") pursuant to NMSA 1978, § 70-2-26 and granted by the Secretary in her Order of January 29, 2003. The hearing concerned review by the Secretary under § 70-2-26 of the December 19, 2002 Order of the Oil Conservation Commission, Order No. R-11775-B, ("Commission's Order") granting the September 11, 2001 Application of Richardson Operating Company ("Richardson") to Establish a Special Infill Well Area ("Infill Application"), which is opposed by San Juan. The Secretary, having considered the evidence, testimony, and statements presented at the February 10, 2003 hearing and the record before the

Commission below, which was incorporated in its entirety, on this _____ day of _____, 2003,

FINDS AND CONCLUDES:

PROCEDURE

1. By decision of December 19, 2002, the Oil Conservation Commission ("Commission") granted Richardson's Infill Application, and the Commission denied San Juan's application for rehearing on January 23, 2003 by failure to act. San Juan requested review by the Secretary pursuant to San Juan's application for review, which was served on counsel on January 23, 2003, and filed on January 24, 2003. The Secretary, by Order of January 29, 2003, granted hearing to review the Commission's Order of December 19, 2002 .

2. San Juan asserts in this proceeding that the Commission's Order and its associated denial of rehearing contravenes the public interest. This proceeding is to determine whether the public interest has been contravened, giving due regard to the conservation of the state's oil, gas and mineral resources.

3. The Secretary has jurisdiction over the subject matter and over the two parties to this proceeding, San Juan and Richardson. No other person or entity applied for party status, and there are no other parties.

4. The parties had adequate notice of the hearing and the issues to be considered, and hearing was held on February 10, 2003, in accordance with NMSA 1978, § 70-2-26 within twenty days of the January 23, 2003, denial of rehearing by the Commission. 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. February 10, 2003 Hearing Transcript ("Feb. 10 Tr."), 7.¹

5. 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, and the pleadings and correspondence submitted to and from the Department in this proceeding.

THE LEASES AND THE INFILL APPLICATION

6. Richardson seeks an Order creating a special infill area within the Basin-Fruitland Coal (Gas) Pool comprised of the following area (the "Infill Area"):

Township 29 North, Range 14 West, N.M.P.M.
Sections 4-6: All

Township 29 North, Range 15 West, N.M.P.M.
Section 1: All

Township 30 North, Range 14 West, N.M.P.M.
Section 16: All
Sections 19-21: All
Sections 28-33: All

Township 30 North, Range 15 West, N.M.P.M.
Section 36: All

Richardson owns interests in oil and gas leases in a portion of the Infill Area.

7. San Juan owns two state and two federal leases as described on San Juan Coal Co. Exs. 2 through 5. In particular, San Juan holds a federal coal lease (the "Deep Lease", San Juan Coal Co. Ex. 2) covering the following lands:

¹Citations in this filing are to the February 10 hearing transcript and OCC Transcript. We understand that Page 1 of the OCC Transcript is the Record on Appeal, p. 38. San Juan's counsel received a draft index to the Record on Appeal at 1:30 p.m. on Thursday, February 20, 2003, and will coordinate with other counsel to insure the Record on Appeal is complete.

Township 30 North, Range 15 West, N.M.P.M.

Section 13: S $\frac{1}{2}$
Section 14: S $\frac{1}{2}$
Sections 23-26: All
Section 35: Lots 1-4, N $\frac{1}{2}$, and N $\frac{1}{2}$ S $\frac{1}{2}$ (All)

8. San Juan holds a state coal lease (San Juan Coal Co. Ex. 5) covering the following lands:

Township 30 North, Range 15 West, N.M.P.M.

Section 36: Lots 1-4, N $\frac{1}{2}$, and N $\frac{1}{2}$ S $\frac{1}{2}$ (All)

9. San Juan also holds a federal coal lease (the "Deep Lease Extension", San Juan Coal Co. Ex. 3) covering the following lands:

Township 30 North, Range 14 West, N.M.P.M.

Sections 17-20: All
Section 29: All
Section 30: All
Section 31: Lots 1-4, N $\frac{1}{2}$, and N $\frac{1}{2}$ S $\frac{1}{2}$ (All)

10. San Juan owns a state coal lease (San Juan Coal Co. Ex. 4) covering the following lands:

Township 30 North, Range 14 West, N.M.P.M.

Section 32: Lots 1-4, N $\frac{1}{2}$, and N $\frac{1}{2}$ S $\frac{1}{2}$ (All)

San Juan operates an active coal mine, the San Juan Underground Mine, on its four leases.

11. San Juan has also expressed interest in the "Twin Peaks" area, generally to the east of the San Juan Underground Mine, but San Juan currently holds no coal leases in that Twin Peaks area. (See OCC Transcript ("OCC Tr."), 270-73.)

12. The Basin-Fruitland Coal (Gas) 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.

13. The Pool is also governed by the “Special Rules and Regulations for the Basin-Fruitland Coal (Gas) Pool” established in Order No. R-8768 (and amended in Orders Nos. 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 ft. to the outer boundary of the unit nor closer than 10 ft. 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. The Oil Conservation Division has recently enacted amendments to the Pool rules in Order No. R-8768-C, which is on appeal *de novo* before the Commission. The amendments described in Order No. R-8768-C permit one infill well to be drilled (or recompleted) within certain spacing units, but that Order expressly exempts the area encompassed by Richardson’s application.

14. There are approximately 60 existing or planned wells in the Deep Lease and Deep Lease Extension. Approximately half of these are “deep” wells, completed in formations below the base of the Pictured Cliffs formation. These wells are not fractured in the coal, and thus are not harmful to the coal formation and pose a lesser threat to mining. In addition, these deeper wells are either plugged and abandoned, or are marginally productive. Thus, San Juan will likely be able to mill out the casing and mine through these wells when the longwall miner approaches them.

15. The kinds of wells of concern in this case are Fruitland Coal wells and Pictured Cliffs wells. The Commission’s Order allows two Fruitland Coal wells per half section (four per section), and current Commission rules allow four Pictured Cliffs wells

per section. Richardson proposes (1) three new Fruitland Coal wells in San Juan's Mine Districts, (2) five Fruitland Coal recompletions in San Juan's Mine Districts, and (3) three additional new wells or recompletions in the Deep Lease Extension. Moreover, Dugan Production Corp. has proposed additional wells in the Deep Lease Extension. (See Richardson Ex. A-1.)

16. The Pictured Cliffs and Fruitland Coal formations can be developed independently of each other, resulting in eight Pictured Cliffs and Fruitland Coal wells per section. (See Public Comment Ex. 1 (Letter of Dugan Production Corp. to the Secretary.)) At this time, there are only four Pictured Cliffs/Fruitland Coal wells per section. (See Richardson Ex. A-1.) Thus, there is a potential for four additional wells per section, contrary to Richardson's statement that the hearing only concerns one or two wells. This number of wells will have a severe effect on San Juan's Underground Mine.

17. Richardson has apparently drilled a new well in Section 19, T.9 N. [sic], R.14 W. that it represents is not an infill well. (Richardson Surreply of January 28, 2003.) San Juan disputes that it is not an infill well. (February 5, 2003 letter of Larry Ausherman to Carol Leach.) That well was drilled on the South ½ of Section 19, and therefore that well is an infill well.

18. The Commission's Order contravenes the public interest in granting the Infill Application. The Infill Application should be denied, and the Commission is ordered to enter an Order in accordance with these Findings and Conclusions denying Richardson's Infill Application.

THE SAN JUAN UNDERGROUND MINE

19. San Juan has operated surface coal mines in the Farmington, New Mexico area for decades, and in October of 2002, it began underground longwall mining at the San Juan Underground Mine. The San Juan Underground Mine will replace the existing surface mines as the sole source supply for the San Juan Generating Station ("SJGS"). San Juan will use primarily a longwall mining system to mine coal. The longwall mining system is an enormous piece of equipment (1000 feet long), which mines a "panel" of coal 1000 feet wide, 13 feet thick, and up to almost 2 miles long. (OCC Tr., Testimony of Lynn Woomer; Feb. 10 Tr. 88-89, San Juan Coal Company Exs. 12 and 15.)

20. The San Juan Underground Mine involves an initial capital investment of approximately \$150 million, with additional investments planned over time. San Juan plans to employ over 300 people in the Underground Mine and associated operations when in full production, with an annual payroll of about \$33 million. (See San Juan Coal Co. Ex. 8.)

21. San Juan plans to extract over 100 million tons of coal from the Underground Mine through the year 2017 under the current coal sales agreement with SJGS. Those coal sales will yield about \$250 million in royalty from the federal leases (based on the current underground 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. § 191. In addition, coal production from the two state coal leases is expected to generate an additional \$25 million in royalty revenue to the New Mexico Commissioner of Public Lands or the State Land Office. Preserving these benefits is in the public interest. (See San Juan Coal Co. Ex. 9 and testimony of Lynn Woomer, OCC Tr. 270-273; Feb, 10 Tr.,

73-76, Statement of Mr. William Real, Senior Vice President, Public Service Company of New Mexico.) There is also the possibility of coal mining beyond 2017, especially in the “Twin Peaks” area immediately east of the existing coal leases, which could result in additional coal royalty.

22. Generally, the San Juan Underground Mine is designed so that mining occurs in a sequence that begins in the west of the San Juan coal lease area, and generally proceeds east. The economic viability of the Underground Mine depends on the systematic, uninterrupted development of the coal reserve pursuant to a mine plan approved by the Mining and Minerals Division of this Department in 1999. (See OCC Tr. 273-84; San Juan Coal Co. Exs. 7 and 10; Feb. 10 Tr. 84-88, 96-100.)

PROTECTION OF THE PUBLIC INTEREST

23. Under NMSA 1978, §70-2-26, Secretarial review is available “to determine whether an order or decision issued by the commission contravenes the public interest.” The Oil and Gas Act does not define the term “public interest.” However, both § 70-2-26 and applicable case law provide ample guidance to determine whether the Commission’s Order contravenes the public interest. Based on the record in this proceeding, three factors are particularly material.

24. First, Section 70-2-26 specifically provides that in considering the public interest, the Secretary should exercise “due regard for the conservation of the state’s oil, gas, and mineral resources.” NMSA 1978, § 70-2-26 (emphasis added). In conducting the present review of the Commission’s Order, the jurisdiction of the Secretary clearly extends beyond oil and gas to other mineral resources. And, the Secretary’s jurisdiction permits consideration (or due regard) not just of mineral resources owned by the State,

but of all mineral resources in New Mexico. Coal is a mineral resource, and the coal resource at San Juan Underground Mine is valuable, with its royalty stream and other economic and employment benefits far exceeding the value and royalty of the gas resource found within the San Juan Underground Mine area.

25. Second, in addition to giving due regard to the conservation of all mineral resources, the public interest clearly includes the economic interests of the public. The public has strong economic interests in the generation of benefits in the form of royalty, taxes, and employment from the production of minerals. The Commission's Order contravenes this economic interest because it favors production of the far less valuable resource (coal bed methane ("CBM")) at the expense of a far more valuable, proven reserve (coal). As a result, the public would be deprived of significant economic benefits as described in San Juan Coal Co. Ex. 13 under the Commission's Order. (See also OCC Tr. 270-73.)

26. Third, in addition to giving due regard to all mineral resources and economic interests, the public interest includes protection of health and safety. The Commission's Order is contrary to health and safety considerations because drilling and recompletion and fracturing of the additional infill wells and the associated fracturing of the coal and adjoining strata create conditions in the mine that threaten the safety of the miners, the mine, and possibly even other CBM wells in the event of fire caused by spontaneous combustion.

27. In its Order, the Commission determined that consideration of the public interest is beyond the scope of its jurisdiction under the New Mexico Oil and Gas Act. Commission's Order, ¶ 64. The Commission also expressly refused to give "due regard"

for conservation of coal and determined that it lacks jurisdiction to consider the waste of coal. Commissioner's Order, ¶¶ 62 and 64. It should have considered the public interest, conservation of all mineral resources, and waste of coal. By so limiting its consideration in this case, the Commission also did not adequately discharge its responsibility to consider the factors that NMSA 1978, § 70-2-17(B) requires it to consider. The Commission did not bring its expertise to bear on all the considerations that it must pursuant to § 70-2-17(B) and pursuant to the public interest analysis of § 70-2-26.

28. In the wake of the Commission's decision not to consider the public interest, or waste or conservation of coal, it necessarily falls to the Secretary to give due regard to the conservation of all mineral resources in the public interest.

CONFLICT BETWEEN COAL AND CBM DEVELOPMENT

29. San Juan has valid concerns about the compatibility of the development of CBM by Richardson in advance of San Juan's development of the coal itself. As Lynn Woormer explained, San Juan initially thought that a good solution to the conflict between coal and gas development was for gas development to occur ahead of mining. However, upon further study, San Juan concluded that CBM wells and associated fracturing of the coal by Richardson's hydraulic fracturing process associated with those wells in advance of mining raised serious safety concerns, if pursued. (OCC Tr. 317-18; 361-73; San Juan Coal Co. Exs. 16-18.)

30. Many of these safety concerns stem from instability in the geologic formations at and immediately above the roof and at and immediately below the floor in the San Juan Underground Mine. San Juan did not fully appreciate the full ramifications of this instability until it gained experience in working underground in this local area.

The formations are brittle, consist of water-soluble shales and mudstones, and even in their natural state, are relatively unstable. They can become more unstable through hydraulic fracturing. Dr. Steven L. Bessinger, Ph.D., testified that water injected by hydraulic fracturing can effectively turn those mudstones into an unstable mud in a short period of time, and he provided an effective demonstration of that at the February 10 hearing. (Feb. 10 Tr. 103-07, 115.) Dr. Bessinger also testified that the hydraulic fractures themselves could destabilize mine roof and floor in the coal formation and the formations above and below it. (Feb. 10 Tr. 106-08.) These unstable roof and floor conditions, exacerbated by hydraulic fracturing, pose significant risks of roof and floor failure that could lead to serious consequences for underground workers and equipment, and these conditions also increase the potential for catastrophic spontaneous combustion events. (Feb. 10 Tr., 101-20.)

31. Dr. Bessinger established that the risk that hydraulic fracturing activities would create unstable roof and floor conditions is particularly pronounced because, owing to the relatively shallow depth of the coal at San Juan Underground Mine, hydraulic fractures at the San Juan mine would likely propagate in a horizontal, not vertical, direction. Id. These horizontal fractures create a broader and more deleterious effect on the roof conditions for underground mining than would vertical fractures of the type described in the paper of William Diamond (Richardson Ex. C-28). Dr. Bessinger's testimony demonstrates that the paper by Mr. Diamond deals primarily with vertical fractures, a common result of the hydraulic fracturing of deeper coal formations. (Feb. 10 Tr. 116-18.) Given the importance of local or specific geologic conditions, the Diamond paper does not provide substantial basis for questioning San Juan's concerns

about instability in roof and floor conditions at San Juan Mine created by hydraulic fractures. (Feb. 10 Tr. 116-19.)

32. Granting the Infill Application without prohibiting the use of hydro-fracture completion techniques would allow Richardson to fracture the coal, giving rise to roof instability as described by Dr. Bessinger. Commission's Order, ¶ 38.

33. The increased risk of roof failures increases the health and safety risks to San Juan's employees and also increases the risk of a catastrophic event that could bury or strand San Juan's longwall mining system. This could result in the need to abandon all or part of the longwall mining system, costing in the range of \$40 million to \$60 million, and could jeopardize the continuous coal supply to the San Juan Generating Station. (Feb. 10 Tr. 112-15.)

34. Fractures in the coal seam and mine roof that can give rise to safety and operational concerns are permanent, and would remain even if the well bore itself is plugged and abandoned. (Feb. 10 Tr. 120-22; San Juan Coal Ex. 64.)

35. In addition to hydraulic fracturing, another problem for coal development caused by gas operations is the existence of steel well casings in the coal seam. The federal Mine Safety and Health Administration ("MSHA") regulations require that before mining operations can approach to within 150 or 300 feet of an active well bore (300 or 600 ft. in diameter, depending upon interpretation of MSHA regulations), the well bore must be plugged and abandoned according to MSHA requirements. (Feb. 10 Tr. 120-22; see also OCC Tr. 283-96; San Juan Coal Co. Exs. 13, 66.)

36. Upon approaching an active well bore that has **not** been completed and fractured in the coal seam, San Juan is faced with two general alternatives – to bypass the

active well bore according to MSHA requirements or to enter into a buyout arrangement with the well's operator. The buyout agreement could take several forms. If San Juan is able to reach a buyout agreement, it can plug and abandon the well and mine through the area, avoiding the need to bypass that coal. If San Juan is unable to reach a buyout agreement, it must bypass and leave unmined a substantial block of coal. (See Id.; see Feb. 10 Tr. 122-24.)

37. Upon approaching a well **that has been fractured in the coal**, San Juan's buyout or bypass alternatives are more complicated than its alternatives upon encountering a well that has not been fractured in the coal. (See Feb. 10 Tr. 121-23; San Juan Coal Co. Ex. 64.) When encountering an area that has been fractured, unstable roof conditions created by the fractures may limit San Juan's ability to mine through the area because of concerns about roof falls, even if it could negotiate a buyout. See Id.

38. To date, Richardson's and San Juan's negotiations for buyout or accommodation have not succeeded. Allowing additional infill wells will increase the number of wells that San Juan must bypass if it fails to reach a buyout agreement. The Commission's Order allowing an increase in the number of wells contravenes the public interest because: (1) it does not give due regard for the conservation of the coal resource (by requiring great quantities of coal to be bypassed); (2) it is against the public interest in regard to health and safety considerations by creating unsafe conditions for underground workers; and (3) it is against the public's economic interest because it results in the loss of coal royalty far in excess of the value of the gas royalty associated with the well to be bypassed.

39. If the coal surrounding a single well bore must be bypassed by the longwall mining system, San Juan estimates the amount of coal left unmined is approximately 1,000 ft. long and either 300 ft. or 600 ft. wide, depending upon interpretation of MSHA rules. At 600 ft. wide, the coal block contains approximately 330,000 tons of coal, and at a royalty rate of 8%, the royalty value alone is \$800,000. At 300 ft. wide, the value is half of that. (See San Juan Coal Co. Ex. 13.) However, regardless of the dimension of any individual block of bypassed coal, if there are too many well bores in a longwall panel, it could cause portions of a coal panel or an entire coal panel (10,000 ft. x 1000 ft. x 13 ft.) to be bypassed, with an attendant potential royalty loss for an entire panel of over \$13 million. Id. This loss of royalty and coal is not in the public interest, and it is exacerbated by the economic loss caused by the down time of the longwall mining system while moving around a well or wells. See Feb. 10 Tr. 121-25.) Dr. Bessinger testified that in addition to waste of coal, gas development and infill wells could otherwise impede mining operations, causing increased costs and delays in mining that could lead to interruption of coal supply. (Feb. 10 Tr. 120-25.) These events could lead to higher costs and a less secure supply of electricity for PNM's customers – a result that is not in the public interest. (Feb. 10 Tr. 73-76.)

40. The contravention of the public interest is exacerbated by the economic loss caused by the down time of the longwall mining system while moving around a well or wells. (Feb. 10 Tr. 125.)

41. The Commission's discussion in ¶ 24 of its Order of the relationship between this case and MSHA regulations is misplaced. First, the conservation of the state's mineral resources is not addressed by MSHA regulations; those regulations

address safety, not conservation, and require that the coal around active oil and gas wells be bypassed. See 30 C.F.R. § 75.1700; Feb. 10 Tr. 120-21. This bypass may serve MSHA's safety requirements, but it does not conserve coal. Indeed, it wastes coal. This Department in this proceeding does not need to engage in regulation of mine safety. MSHA's charge to do so does not overlap or conflict with our responsibility to determine whether infill wells should be allowed.

42. Contrary to Commission Order, ¶ 64, the conflict here is "between oil and gas producers and coal miners." It is not a conflict between "San Juan's obligation to its workers under the Act and MSHA regulations and its plan of operations." Id. The MSHA regulations may address certain safety matters, but those regulations only apply when a well is drilled. If additional infill wells are not allowed, San Juan does not have to bypass valuable coal reserves in pursuing the development of the coal.

43. The maximum coal and gas resource recovery can be achieved utilizing gas recovery methods that do not have negative impacts on mining as described by Dr. Bessinger. Utilizing conventional gas wells with hydraulic fracturing in and around the coal seam significantly increases the probability that coal will be lost.

PUBLIC INTEREST MEDIATION:²

44. Although bypass of coal is not in the public interest, an amicable resolution of this coal versus CBM conflict in the form of a buyout or accommodation arrangement of a form acceptable to both parties is in the public interest.

²This section is proposed as a separate element that could be adopted independent of the rest of San Juan's proposed findings and conclusions, as an initial Order of the Secretary to promote the public interest.

45. Accordingly, the Secretary finds and concludes that the public interest would be best served by a facilitated or mediated settlement of the dispute, and orders the parties to participate in non-binding mediated settlement negotiation, using a neutral third-party mediator to assist the negotiation. The parties have ten days to agree upon a mediator. In the event the parties fail to agree, then the Deputy Secretary shall select a mediator for the parties. The parties shall have 60 days from the date of this Order to complete a mediation session, and shall provide a joint report to the Deputy Secretary concerning the status of the mediation and whether more time would be productive to reaching an amicable resolution. The fundamental goal of the mediation is to arrive at a fair market value of Richardson's CBM gas resource within the San Juan Underground Mine (and the value of associated undepreciated equipment that cannot be used in other operations) and ultimately a buyout based on that value. Pending the mediation, this Order stays the effectiveness of the Commission's Order.

46. In the event an agreement is not reached, the Secretary retains jurisdiction to issue a final decision on the merits of this proceeding. The Secretary has authority to Order this mediation in furtherance of her enumerated powers under NMSA 1978, § 70-2-26. See Public Service Company v. New Mexico v. New Mexico Environmental Improvement Board, 89 N.M. 223, 227, 549 P.2d 638, (Ct. App. 1976) ("The authority granted to an administrative agency should be construed so as to permit the fullest accomplishment of the legislative interest or policy.").

47. That this mediation order is in the "public interest," and within the Secretary's authority under Order under § 70-2-26, is consistent with the BLM Instructional Memorandum No. 2000-081, Richardson Ex. A-14, which promotes

accommodation as its preferred method for resolving conflicts that arise between competing oil and gas and coal lessees.

RECOVERY OF GAS BEFORE, DURING AND AFTER MINING

48. San Juan is developing a pilot project to drill horizontal bore holes into the face of its target coal seam (the “8 Seam”) running parallel with the coal seam to drain methane in advance of coal mining. San Juan has the right to vent gas in its mining operations. The project is described in the letter to Richardson, which is San Juan Coal Co. Ex. 69. The letter does not state that commercial quantities of gas exist or will be recovered. However, it does provide that if gas is collected and if it is safe, economic, and practicable, San Juan would like to make that gas available for Richardson’s gathering and distribution.

49. The horizontal bore holes that San Juan plans to drill as described in San Juan Ex. 69 could be thousands of feet long running through the coal and would expose thousands of feet of coal surface area as compared to the intersection of approximately 13+ feet in the 8 Seam in a conventional CBM drilling and completion technique. Dr. Bessinger testified that the boreholes would not be fractured in the coal and so would not pose the problems for mining that conventional CBM wells pose. The degassing would meet MSHA safety regulations and avoid spontaneous combustion.

(Feb. 10 Tr. 134-136.)

50. After the longwall miner mines through an area of the mine, a rubble of coal and other rocks is left behind in what is known as “gob.” Dr. Bessinger explained that it may be possible to produce commercial gas from gob vent boreholes and that mining of coal leaves behind gas in the gob. Feb. 10 Tr. 139-141.

51. Using the horizontal bore holes and producing methane using this technique as San Juan proposes in its letter to Richardson (San Juan Ex. 69) may permit production of CBM in advance of mining if economic, and it would not require that coal be bypassed under applicable MSHA regulations. This method may allow the production of both resources and is in the public interest because: (1) it gives due regard for all mineral resources; (2) it enhances economic recovery; and (3) enhances safety by allowing gas to be produced without fractures and other problems associated with CBM wells. Conversely, the Commission's Order which allows the gas production from conventional fractured core bed methane wells to proceed at the expense of the coal reserve allows the production of only one resource, and the less valuable one at that, and therefore contravenes the public interest. Even if development of both resources were not feasible, development of the more valuable coal resource in favor of the less valuable gas would be in the public interest.

NMSA 1978, SECTION 70-2-17(B): ECONOMIC WASTE

52. The Commission's Order contravenes the public interest because the Commission failed to discharge its obligation to ascertain whether drilling infill wells would be economic and efficient, considering "economic loss caused by the drilling of unnecessary wells ... prevention of waste [and] the avoidance of the augmentation of risks arising from the drilling of an excessive number of wells." See NMSA 1978, § 70-2-17(B). Uneconomic and inefficient infill wells are particularly in contravention of the public interest in this circumstance because they damage the more valuable coal resources, which the Commission failed to consider.

53. The public interest is contravened by the Commission's Order because the Commission abdicated to Richardson its statutorily defined responsibilities when it stated: "If Richardson is willing to accept the risk, the application should be approved." Commission's Order, ¶ 22. This abdication is particularly apparent when the Commission also found that "Richardson has overestimated the amount of gas present within the application area..." Commission's Order, ¶ 22.

54. The desorption data presented by San Juan, and not considered by the Commission, corroborates substantial evidence presented to the Commission that the CBM reserves in the San Juan Underground Mine area are not economic, and that at the very least are vastly less valuable than the coal in the 8 Seam which San Juan seeks to develop. (See, OCC Tr. 454-55, 460-64, 540-65; Feb. 10 Tr., 179-90; testimony of Dan Paul Smith; San Juan Coal Co. Exs. 44, 50-60, 74.)

55. Even if there may be evidence in the record to suggest that some CBM wells may be economic, the evidence also demonstrates that the CBM development drilling and completion activity will have a dramatic and detrimental effect on San Juan's ability to mine and deliver coal safely, efficiently, and continuously to the San Juan Generating Station. There are other methods to recover CBM that are not destructive to the coal seam.

56. The practice of operators in this area is to perforate and fracture the Pictured Cliffs formation immediately below the Fruitland Coal. (Richardson Ex. B-2.) The testimony shows that the Pictured Cliffs formation itself is marginal. (Testimony of Dan Paul Smith, Feb. 10 Tr., 177-78.) In addition, although ostensibly Pictured Cliffs wells, these wells at the top of the Pictured Cliffs are actually producing from the

Fruitland Coal formation. (Testimony of Paul Bertoglio, OCC Tr., 531-67.) Therefore, through his existing Pictured Cliffs wells Richardson already has the infill relief he has requested.

57. The Fruitland Coal wells in this area have lives of 5-20 years, and over that time a better than average coal gas well will produce approximately \$125,000.000 in royalty. (Testimony of Dan Paul Smith, Feb. 10 Tr., 188-189.) This is vastly less than the royalty of \$800,000 producible from one 600 x 1,000 foot block of bypassed coal or more, if multiple blocks of coal, parts of coal panels, or entire coal panels are bypassed. (San Juan Coal Co., Ex. 13.)

BLM PROCEEDINGS AND THE PRIORITY OF LEASE RIGHTS

58. It is not the function of the Secretary or the Commission to determine the priority of the various coal and gas leases implicated here, interpret leases, or address other such matters that are more properly before the BLM or the Commissioner of Public Lands. See Commission's Order, ¶ 69. This Order does not do so. Moreover, the BLM has not decided the issue presented in this proceeding—whether Richardson's Infill Application should be granted.

59. The Secretary lacks jurisdiction to resolve issues in this proceeding that require the presence of other persons or entities not participating in this matter. Specifically, the United States and the New Mexico Commissioner of Public Lands are not parties to this proceeding. The fact that those entities are parties to the coal and oil and gas leases at issue here provides additional reason that the Secretary will not engage in any interpretation of those leases. It would be improper to decide issues concerning

which of the competing resource development interests or leases may have priority over the other. See Commission's Order, ¶ 69.

60. The Secretary does not reach Richardson's argument that San Juan has breached a contract, in the form of the Protocol that is part of the 1998 Farmington Resource Management Plan Amendment. The Secretary notes, however, that there is no evidence in the record that the United States or the BLM has made such an assertion, and there is no evidence that San Juan does not stand by the commitments described in its Protocol.

61. The BLM is the land management agency with jurisdiction over coal and oil and gas leasing of the lands subject to San Juan's federal coal leases and Richardson's federal oil and gas leases. On the other hand, this Department, through the Oil Conservation Division (and upon review to the Oil Conservation Commission and the Secretary) is the agency with jurisdiction over questions of well spacing generally, and specifically, whether the infill well application should be granted. This Department's jurisdiction in this regard extends to federal, state and fee lands. Richardson has recognized the jurisdiction of this Department to determine whether infill wells should be allowed on federal, state, and fee lands; Richardson itself invoked this jurisdiction when it filed the Infill Application, which covers substantial acreages of federal lands.

62. The Commission's comments on the motivation of the parties before it or the consequences of the parties' actions beyond the evidence presented in the record are unsupported. In ¶ 75 and ¶ 76, the Commission's Order includes statements that extend well beyond the jurisdiction of the Commission and should be stricken.

WASTE OF COAL

63. The Commission's Order contravenes the public interest because it considered only the potential waste of CBM, and failed to consider the waste of coal that would result from its Order and the actions of oil and gas producers pursuant to that Order.

64. Under the Oil and Gas Act, "waste" is defined to include not only waste of oil and gas but also waste of other minerals. The Order determines that "waste" protected by the Oil and Gas Act is defined in terms of "crude petroleum oil or natural gas," not coal. Order, ¶ 62. This conclusion disregards the actual language of the Oil and Gas Act. Waste is defined at NMSA 1978, § 70-2-3, and the Commission did not apply a critical part of that definition. Paragraph 62 of the Order states that this definition of waste "refers to waste as it is 'generally understood in the oil and gas business'". However, the Commission did not address or recognize that the definitions of waste in §70-2-3 all include the first line of the statute, and that line states: "As used in this act, the term 'waste,' in addition to its ordinary meaning shall include:" (Emphasis added.) As San Juan has pointed out to the Commission, the ordinary meaning of waste in Webster's Dictionary specifically includes a "disused part of a coal mine." Webster's Third New International Dictionary (1981 Ed.). The Commission's Order and its erroneous interpretation of the term "waste" contravene the public interest. If the legislature had intended to limit the definition of waste to oil and gas it would have more clearly done so, as it did, for example, in the Oil and Gas Act's definition of "correlative rights" in the NMSA 1978 § 70-2-33.H.

PREVENTION OF INJURY TO NEIGHBORING PROPERTIES

65. Under NMSA 1978 § 70-2-12.B(7), the division is authorized to “require wells to be drilled, operated and produced in such manner as to prevent injury to neighboring leases or properties.” Fracturing of wells will cause serious injury to the coal resource resulting in roof instability and increasing the risk of spontaneous combustion. The coal bed and the gas within it are neighboring estates, as has been recognized in Amoco Production Company v. Southern Ute Indian Tribe, 526 US 865, 879, 119 S.Ct. 1719, 1727 (1999). The Commission’s Order contravenes the public interest because it encourages damage of the coal.

PREVENTION OF FIRES

66. Under NMSA 1978 § 70-2-12.B(5), the division is authorized to make orders to “prevent fires.” San Juan raises serious safety concerns regarding the effect of additional well bores in its coal seam and associated fracturing on the safety of the Underground Mine. A fire at the mine could lead to the loss of life and the loss of all or part of the San Juan Underground Mine and its associated coal reserves.

67. The Commission’s Order contravenes the public interest insofar as it did not find that granting the Infill Application would threaten “injury to neighboring leases or properties” under NMSA 1978, § 70-2-12(B)(7); it encourages damage to the coal.

IT IS THEREFORE ORDERED THAT:

Alternative 1³.

Richardson and San Juan are ordered to participate in non-binding mediated settlement negotiation, using a neutral third-party mediator to assist the negotiation. The

³ San Juan presents two alternative Orders. The first incorporates its proposal for mediation. The second does not.

parties have ten days to agree upon a mediator. In the event the parties fail to agree, then the Deputy Secretary shall select a mediator for the parties. The parties shall have sixty days from the date of this Order to complete a mediation session, and shall provide a joint report to the Deputy Secretary concerning the status of the mediation and whether more time would be productive to reaching an amicable resolution. The fundamental goal of the mediation is to arrive at a fair market value of Richardson's CBM gas resource within the San Juan Underground Mine (and the value of associated undepreciated equipment that cannot be used in other operations) and ultimately a buyout based on that value. Pending the mediation, this Order stays the effectiveness of the Commission's Order, and Richardson may not drill, fracture, or recomplete infill wells in the infill area.

Alternative 2.

Granting the Infill Application contravenes the public interest, and the Infill Application should be denied. The Commission is directed to modify the Commission's Order to comply with this Order and these Findings and Conclusions.

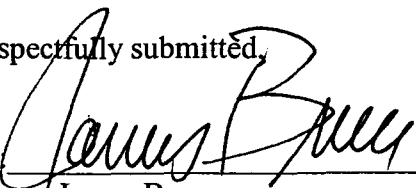
Done at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO, DEPARTMENT
OF ENERGY, MINERALS AND NATURAL
RESOURCES

By: _____
Joanna Prukop, Secretary

Respectfully submitted,

By


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and

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