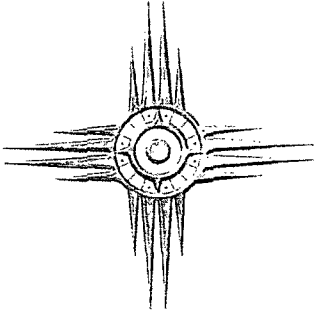


SAN JUAN

ECONOMIC

DEVELOPMENT

SERVICE



San Juan Economic Development Service

Quality Center for Business

5101 College Blvd

Farmington, NM 87402

505.566.3720 505. 566.3698 (fax) 800.854.5053

www.sanjuaneds.com sjeds@sanjuaneds.com

November 14, 2007

The Honorable Bill Richardson, Governor
State of New Mexico
State Capitol
Room 400
Santa Fe, NM 87503

COPY

Re: Pit Rule

Dear Governor Richardson:

As you know, New Mexico Oil Conservation Division (NMOCD) is conducting hearings regarding the regulation of drilling pits in New Mexico. San Juan Economic Development Service (SJEDS) believes the proposed rule if adopted and implemented will result in significant adverse economic impact on San Juan County and the State of New Mexico. SJEDS has compiled this packet of information for your use as you review the economic impact of the proposed pit rule.

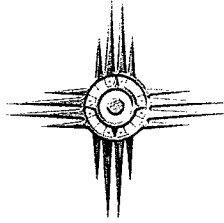
Among other items, this packet contains a case study, letters from local officials and media articles. SJEDS hopes you will find the enclosed information on this critical issue valuable. I would be happy to discuss this with you. I can be contacted at 505. 327.6807.

Respectfully,

Tommy Roberts

SJEDS Board President

Mission Statement: San Juan Economic Development Service, Inc. will lead the way to assist in the expansion, retention, creation and recruitment of economic base companies in San Juan County for the purpose of job creation.



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Joanna Prukop
Cabinet Secretary
Energy, Minerals and Natural Resources Department
1220 South St. Francis Drive
Santa Fe, NM 87505

8 October 2007

This letter is intended to serve as the comments of San Juan Economic Development Service, Inc. ("SJEDS") to the draft rule regarding oil and gas drilling pits (the "Pit Rule") recently issued by the New Mexico Oil Conservation Division ("NMOCD").

SJEDS is a New Mexico non-profit corporation whose mission is to assist in the expansion, retention, creation, and recruitment of economic base companies in San Juan County, New Mexico for the purpose of job creation. The oil and gas industry is the foundation upon which the economic vitality of San Juan County and the surrounding areas has been built and is the source of thousands of high-paying jobs. For that reason, SJEDS is extremely concerned about the potential impact on the economic well-being of San Juan County resulting from the adoption and implementation of the Pit Rule.

As a general premise, SJEDS supports the efforts of the NMOCD to regulate the oil and gas industry to mitigate adverse environmental consequences. However, such adverse environmental consequences should be demonstrable pursuant to the application of sound scientific principles as a condition to regulatory intervention. SJEDS believes that the prerequisite scientific basis has not been developed to support the adoption and implementation of the Pit Rule. In fact, the hard scientific data gathered by the Pit Rule Task Force over the past six (6) months appears to support the contention that the Pit Rule is unwarranted.

If the Pit Rule is adopted and implemented in its current form and content, the oil and gas industry in San Juan County will be saddled with huge incremental operating costs with little or no associated benefit to the environment. The incremental costs, however, may very well result in company decisions to cut back exploration and drilling programs, with a corresponding loss of high-paying jobs that are so essential to a strong economy. Such a result would be unfortunate in the context of national, state, and local interests.

Certainly, the adoption of the Pit Rule will appease those in the environmental community who are advocating a governmental policy of zero-tolerance when it comes to the impacts of oil and gas development. But the decision to adopt and implement the Pit Rule should be founded on sound science – not political considerations.

In closing, SJEDS urges the NMOCD to consider and act on the Pit Rule in the light of the scientific data that has been presented to it. If that data supports the adoption and implementation of the Pit Rule, then regulation is appropriate. If it does not, then the Pit Rule should be rejected.

Thank you for your consideration of these comments.

Respectfully submitted,

Tommy Roberts

Tommy Roberts, Board President

Carol Spencer

Dr. Carol Spencer, Vice-President

Keith Johnson

Keith Johnson, Secretary/Treasurer

Judy Reed
Judy Reed
SJEDS Executive Committee

David Velasquez
David Velasquez

Keith Johnson
Keith Johnson

cc: Mark E. Fesmire, Director, New Mexico Oil Conservation Division
Ms. Florene Davidson, New Mexico Oil Conservation Division

THE DAILY TIMES

FARMINGTON, NEW MEXICO

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DAILY TIMES EDITORIAL

New drilling pit regulations too severe for too many

New oil and gas pit rules seriously being considered in Santa Fe could mean the pits for the local energy industry, and everyone else in the state who depends on oil and gas revenues.

The New Mexico Oil Conservation Division is holding hearings that began last week on proposed regulations that drastically would change the way oil and gas producers and service companies handle drilling wastes. Should the division approve the changes — and that prospect looks likely — the new rules could lead to a severe slowdown in regional drilling because of the massive expense tied to the regulations.

Environmental protection should be of utmost importance. That is not questioned. The new pit rules, however, go too far and don't seem to be based in enough real, concrete science that proves today's method of disposing of drilling waste is inadequate.

The new pit rules, called Rule 50, would apply to temporary lined reserve pits and workover pits used by the industry during the short drilling and completion portion at a well site. These pits primarily hold drill cuttings and fluids that rise from below the surface during the process. They usually are completed within about three months and are not to be confused with the closed tanks used for produced water and other waste at long-term production pits.

The Oil Conservation Division and environmental groups are pushing hard for a closed-loop drilling system to replace these temporary lined pits, along with a requirement to haul off all drill cuttings and other waste materials from well sites to approved landfills.

Industry officials claim the new requirements could lead to an extra expense of anywhere between \$100,000 and \$300,000 per well site. Considering that the average economic benefit from each well in New Mexico is about \$1 million for the life of a well, some say the added hit to the pocketbook will tempt operators to move to other states where such rules don't exist.

The Oil Conservation Division claims it has recorded about 800 instances of ground water contamination from oil and gas operations in the last 15 years. It believes new pit rules will cut into that number dramatically.

Local oil and gas industry officials, however, say there has never been a case of ground water contamination that has affected the human population. The industry also widely believes the temporary lined pits used today are safe and pose no real threat to the environment. In addition, issues that were solved years ago are being used as support for new pit rules, industry leaders claim.

The economic benefits from oil and gas are second to none in New Mexico. About \$1.4 billion of the state's \$5.7 million general fund last year came from the oil and gas industry. Adding another layer of mammoth expense and red tape will do nothing but hurt New Mexico's economy.

The vast majority of oil and gas producers in northwest New Mexico want to do it right, and are doing just that on a daily basis. They live here, raise families here and certainly don't want to harm the environment.

Sweeping changes, as proposed by the Oil Conservation Division, should be re-evaluated and scaled down in order to not have such a severe effect on the very industry that supports so many in New Mexico. Public schools, local governments and retail businesses are among the long list of others that would feel the harsh economic blow.

The Oil Conservation Division, or, better yet, our often absent governor, should take a step back and consider the overall ramifications of these new rules. The clock is ticking. If these pit rules are approved, the new regulations would start in early 2008.

WHERE TO WRITE:

Sen. Pete V. Domenici, 328 Hart Senate Office Building, Washington, DC 20510, phone (202) 224-6621, fax: (202) 346-6720, Web site <http://domenici.senate.gov>

Sen. Jeff Bingaman, 703 Hart Senate Office Building, Washington, DC 20510-3102, Phone: (202) 224-5521, Fax: (202) 224-2852

Rep. Tom Udall, 1414 Longworth House Office Building, Washington, DC 20515 Phone: (202) 225-6190 E-Mail: Via the

official Web site at www.house.gov/tomudall Fax: (202) 226-1331, Farmington Field Office: Pete Valencia, (505) 324-1005.

Rep. Stevan Pearce, 1408 Longworth House Office Building, Washington, DC 20515 Phone (202) 225-2365.

Rep. Heather Wilson, 226 Cannon Bldg., Washington, DC 20515, Phone: (202) 225-6316, Fax: (202) 225-4975, E-mail: ask.heather@mail.house.gov

Independent Petroleum Association of New Mexico (IPANM)
Northwest New Mexico Analysis
Pit Rule Impacts

As you may be aware, the Oil Conservation Commission (OCC) consisting of Chairman Mark Fesmire, Bill Olson, & Jami Bailey, is currently hearing testimony regarding the New Mexico Oil Conservation Division's (NMOCD) application to change the rules regarding oil and gas pits in New Mexico. IPANM, the New Mexico Oil and Gas Association (NMOGA) and nearly all oil and gas operators are opposed to this new rule making endeavor. We believe the rule is unnecessary to protect the public health and the environment and that the rule will have a significant negative economic impact on the finances of government in New Mexico.

We will present several problems relating to the "science" utilized by the NMOCD, as well as a brief summary of projected economic impacts of this rule, if adopted.

Science Portion

The NMOCD rule does not distinguish between Southeast New Mexico (Oil) operations and Northwest New Mexico (Gas) operations. A one-size-fits-all rule is not practical. The drilling operations and the risks of groundwater impacts are quite different between these regions.

There are no cases of groundwater contamination relating to temporary reserve pits in the Northwest, whether lined or unlined. There are currently ten cases under investigation in the Southeast.

The NMOCD modeling utilizes Dulce, NM as representative of the precipitation, growing season, soil humidity, and other parameters that would be typical of the San Juan Basin. There are no producing oil or gas wells located within 5 miles of Dulce, NM, by contrast Farmington, NM has over one-thousand wells located within 5 miles. Dulce, NM is 1,400 feet higher in elevation than Farmington. The NMOCD had access to current climate data from four locations in Farmington, one in Aztec, and one in Lybrook, NM, but choose not to utilize these more realistic locations.

The NMOCD assumed that the liners utilized by industry always fail. The NMOCD did not utilize a bentonite clay layer in their model. Bentonite is the most common constituent of drilling mud in Northwest New Mexico. This bentonite clay layer within a temporary lined reserve pit assists in the protection of ground water, by sealing any possible leaks and adding to the integrity of the drill cuttings encapsulation.

The NMOCD utilized a 4 inch mixing zone within a fifty-foot aquifer, rather than a more realistic mixing zone. Brine water mixes quite readily with fresh water. Industry believes the mixing interval, when modeled properly, will approach the full fifty-foot aquifer height used in the model. Increasing the mixing zone height will dilute any and all contaminants that could ever migrate from a reserve pit to levels below detection.

The NMOCD is determining that the presence of a contaminant within a reserve pit, such as arsenic or lead, no matter the concentration, is of grave health concern to the public. This determination is made without a review of native background soil characteristics, which often contain higher concentrations of contaminants than what is found within reserve pits. Further, the NMOCD does not attempt to distinguish the manner in which a

contaminant may migrate, rather the NMOCD believes a contaminant's detection warrants a drastic regulatory response.

The NMOCD soil model utilizes only two foot of soil cover, rather than the four or more feet of soil cover that industry regularly uses to cover temporary reserve pits. This may not sound like much of a difference, but this difference has a dramatic impact on the NMOCD soil model. Burying cuttings in a deeper pit, lessens the probability of precipitation reaching these cuttings in New Mexico's arid climate. In fact, NMOCD's model is predicting an infiltration rate of 12.7 millimeters per year, while actual field data demonstrates only 2.5 millimeters per year of infiltration to be appropriate.

The NMOCD has arbitrarily proposed a one-hundred mile radius for the requirement that drill cuttings be hauled to a landfill, rather than disposed of safely on-site. This "dig & haul" requirement is the primary cost driver impacting industry.

Chairman Fesmire of the OCC has overruled IPANM's objection to the NMOCD's compliance with the New Mexico Small Business Regulatory Relief Act (SBRRA). The SBRRA requires rule making agencies to consider economic impacts on businesses with less than fifty-employees. The NMOCD believes it has complied with the intent of the SBRRA by supplying e-mail notification of this rule-making to the New Mexico Economic Development Department (NMEDD), two-hours following the start of the October 22nd hearing on this matter. The NMOCD has not performed any economic cost benefit analysis, nor any quantitative cost effects analysis, rather they are relying upon the economic testimony of the Oil and Gas Accountability Project (OGAP) to support implementation of this rule.

Economic Portion

In 2006, the average wage of an industry worker in New Mexico is \$ 52,468, while the average state wage was \$ 30,628 (New Mexico Dept of Labor). In San Juan County, over 9,030 people are directly employed in the oil and gas industry of a total workforce of 50,760 (New Mexico Department of Labor). This does not include trucking/transportation, nor retail establishments whose principal business is serving the oil and gas industry. IPANM estimates that thirty percent of the 9,030 industry employees will not be immediately impacted by this rule due to the specific nature of their work, but the remaining sixty percent (5,400 people) will be subject to immediate job elimination, proportionate to the reduction in drilling/workover activity. Losing these high paying positions will have an amplified effect on the entire community, including the important retail and housing sectors.

The largest operator in the San Juan Basin, ConocoPhillips, has indicated that their drilling program will essentially come to a halt, due to the lack of availability of closed loop drilling systems in Northwest New Mexico. It will take several months for these systems to become readily available. Smaller independent operators will find few of their drilling prospects meeting investment thresholds because of this rule.

IPANM estimates that the proposed rule, if enacted, will result in an immediate 75 percent reduction in drilling activity in the Northwest, with a subsequent longer term thirty percent reduction in new drilling activity once the systems become available. For

reference, the NMOCD has already documented a reduction in new applications to drill from 821 in 2006 to 561 in 2007, principally due to increased drilling costs and added regulatory burdens.

IPANM estimates that on average, in 2007, a new well in Northwest New Mexico requires a capital investment of approximately \$ 896,000. Assuming a 75 percent reduction, 350 wells will not be drilled in 2008. This reduction in activity would remove over 313 Million Dollars in private business investment in Northwest New Mexico, with a corresponding 18 million dollar impact upon gross receipts revenues. The ripple effects of this loss in base industrial revenue will have a major negative impact on the entire New Mexico economy.

Gallegos Gallup-Dakota.... Drilling Economics w/o Closed Loop as of January, 2008

Production Forecast & Economics Spreadsheet

Lease & Economic Data

| WI | NRI Oil | NRI Gas |
|---------------|---------|---------|
| Before Payout | 100.00% | 75.00% |
| After Payout | 100.00% | 75.00% |

Taxes

| Oil | Gas | Income |
|-------|-------|--------|
| 8.25% | 9.20% | 33.0% |

Product Prices

| | |
|-------------------|------------------|
| Initial Oil Price | \$ 70.00 \$/bbl |
| Initial Gas Price | \$ 5.50 \$/mmbtu |
| Gas bbl Value | 1.160 \$/bbl |
| Constant Prices | Yes (yes/no) |

Costs

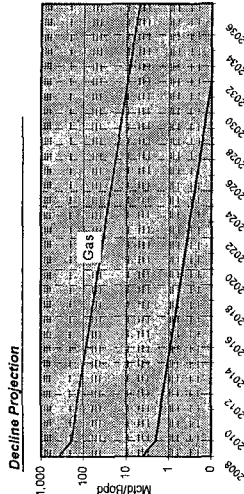
| | |
|----------------|----------------|
| Operating Cost | \$ 6.000 \$/mo |
| P&A cost | \$ 50.0 \$ |
| Salvage value | \$ 10.0 \$ |

Decline Data

| Oil | Gas |
|----------------------|--------------|
| Initial Rate | 4.0 bopd |
| 1 Yr Rate | 2.0 bopd |
| Initial Decline Rate | 69.3% per yr |
| Final Decline Rate | 13.0% per yr |
| Dogleg at | 1.0 years |
| Economic Limit | 0.4 bopd |

Recovery Data

| Oil - bbls | Gas - MMcf |
|------------|------------|
| Gross | Net |
| 5,632 | 4,224 |
| 5,632 | 4,224 |
| 5,632 | 4,224 |
| 5,632 | 4,224 |



Economic Results

| Indicators | Before Tax | After Tax |
|----------------------------|----------------|-----------|
| Payout = | 3.2 Yrs | 3.0 Yrs |
| DcfOR = | 19.1% | 19.0% |
| NPV @ 16% | \$ 66M | \$ 56M |
| Profit/Invest (\$/S) = | 0.7 | 0.6 |
| 16% Profit/Invest (\$/S) = | 0.1 | 0.1 |
| WELL LIFE = | 14.0 Years | |
| Rules of Thumb | | |
| 4-Yr Revenue Value = | \$ 140.3M | |
| Value Sloped = | \$ 18.1M | |
| Reserve Cost \$/boeg = | \$ 17.39 | |
| BOEG Ratio = | 12 : 1 mcf/bbl | |

Version 2.7.7/1/09
By: Steven S. Dunn

| Year | Oil Production | Gas Production | Oil Prices | Gas Prices | Revenue | Expenses | Net Inc | Before Tax Cash Flow | Before Tax Cash Flow |
|-----------|----------------|----------------|------------|------------|---------|----------|---------|----------------------|----------------------|
| Begin | Gross | Net | Oil Price | Gas Price | Oil Rev | Gas Rev | Net Op | Cash Flow | Cum Cash Flow |
| Rate | Prod | Prod | \$/bbl | \$/mmbtu | Rev | Rev | Income | Flow | Flow |
| bopd | stb | mcf | | | MS | MS | MS | MS | MS |
| 1 2008 | 4.0 | 1,053 | 70.00 | 5.50 | 55.3 | 452.2 | 396.4 | 859.8 | (859.8) |
| 2 2009 | 2.0 | 685 | 70.00 | 5.50 | 35.0 | 303.6 | 268.7 | 398.4 | (461.4) |
| 3 2010 | 1.8 | 501 | 70.00 | 5.50 | 31.8 | 269.5 | 237.7 | 288.7 | (272.7) |
| 4 2011 | 1.5 | 528 | 70.00 | 5.50 | 27.7 | 234.1 | 206.4 | 168.0 | (104.7) |
| 5 2012 | 1.4 | 463 | 70.00 | 5.50 | 24.3 | 206.6 | 182.3 | 137.0 | (277.3) |
| 6 2013 | 1.2 | 407 | 70.00 | 5.50 | 21.4 | 180.5 | 159.1 | 111.5 | (388.8) |
| 7 2014 | 1.0 | 357 | 70.00 | 5.50 | 18.8 | 158.5 | 139.7 | 88.1 | (476.9) |
| 8 2015 | 0.9 | 314 | 70.00 | 5.50 | 16.5 | 139.2 | 122.7 | 69.5 | (546.4) |
| 9 2016 | 0.8 | 275 | 70.00 | 5.50 | 14.5 | 122.2 | 107.7 | 52.2 | (598.7) |
| 10 2017 | 0.7 | 242 | 70.00 | 5.50 | 12.7 | 107.3 | 94.6 | 37.1 | (635.8) |
| 11 2018 | 0.6 | 212 | 70.00 | 5.50 | 11.2 | 94.2 | 83.0 | 23.8 | (659.6) |
| 12 2019 | 0.5 | 187 | 70.00 | 5.50 | 9.9 | 82.7 | 72.8 | 12.1 | (671.7) |
| 13 2020 | 0.5 | 164 | 70.00 | 5.50 | 8.6 | 72.7 | 64.1 | 1.9 | (673.8) |
| 14 2021 | 0.4 | 144 | 70.00 | 5.50 | 7.6 | 63.9 | 56.3 | 0.0 | (673.8) |
| 15 2022 | | | | | | | | | |
| 16 2023 | | | | | | | | | |
| 17 2024 | | | | | | | | | |
| 18 2025 | | | | | | | | | |
| 19 2026 | | | | | | | | | |
| 20 2027 | | | | | | | | | |
| 21 2028 | | | | | | | | | |
| 22 2029 | | | | | | | | | |
| 23 2030 | | | | | | | | | |
| 24 2031 | | | | | | | | | |
| 25 2032 | | | | | | | | | |
| 26 2033 | | | | | | | | | |
| 27 2034 | | | | | | | | | |
| 28 2035 | | | | | | | | | |
| 29 2036 | | | | | | | | | |
| 30 2037 | | | | | | | | | |
| REMAINING | | | | | | | | | |
| TOTALS | 5,632 | 4,224 | 70.00 | 5.50 | 266.1 | 2,766.0 | 1,009.9 | 859.8 | 627.4 |

Gallegos Gallup-Dakota.....Drilling Economics with Closed Loop as of January, 2008

Production Forecast & Economics Spreadsheet

| Lease & Economic Data | | | |
|-----------------------|---------|---------|---------|
| Initial Rate | WI | NRI Oil | NRI Gas |
| Before Payout | 100.00% | 75.00% | 75.00% |
| After Payout | 100.00% | 75.00% | 75.00% |

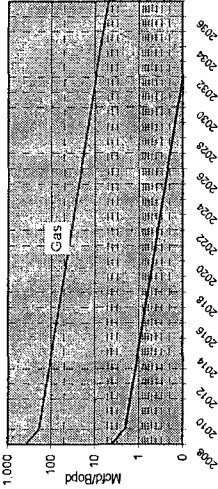
| Investments | | | |
|-------------------|--|-----------|-----------|
| Lease Bonus | | Gross | Net |
| Tangibles | | \$252.3 | \$252.3 |
| Intangibles | | \$557.5 | \$557.5 |
| Total Investments | | \$1,109.8 | \$1,109.8 |

| Decline Projection | | | |
|--------------------|-------|--------|--|
| Oil | Gas | Income | |
| 8.25% | 9.20% | 33.0% | |

| Product Prices | | | |
|-------------------|--------------|----------|--|
| Initial Oil Price | \$ 70.00 | \$/bbl | |
| Initial Gas Price | \$ 5.50 | \$/mmbtu | |
| Gas blu Value | \$ 1.50 | blu/scf | |
| Constant Prices | Yes (yes/no) | | |

| Costs | | | |
|----------------|---------|-------|--|
| Operating Cost | \$ 6.00 | \$/mo | |
| P&A cost | \$ 50.0 | \$ | |
| Salvage value | \$ 40.0 | \$ | |

| Decline Data | | | |
|----------------------|-------|--------|--------------|
| Initial Rate | 4.0 | bopd | 387 mcf/d |
| 1 Yr Rate | 2.0 | bopd | 187 mcf/d |
| Initial Decline Rate | 69.3% | per yr | 67.4% per yr |
| Final Decline Rate | 13.0% | per yr | 13.0% per yr |
| Dogleg at | 1.0 | years | 1.0 years |
| Economic Limit | 0.4 | bopd | 39 mcf/d |



| Recovery Data | | | |
|-------------------|------------|------------|-------|
| | Oil - bbls | Gas - MMcf | |
| | Gross | Net | Gross |
| | 5,632 | 4,224 | 526 |
| Cum Production | | | 384 |
| Reserves | | | 394 |
| Ultimate Recovery | 5,632 | 4,224 | 526 |

Version 2.7.71896
By Steven S. Dunn

| Year | Oil Production | | | | Gas Production | | | | Prices | | Revenue | | Expenses | | Net Inc | | Invest | | Before Tax Cash Flow | | | |
|-----------|----------------|----------------------|--------------------|--|------------------------|----------------------|--------------------|--|------------------------|--------------------------|-------------------|-------------------|---------------------|----------------------|--------------------------|-------------------------|----------------------|---------------------|----------------------|--------------------|--------------------|-------------------|
| | Begin bopd | Gross Prod stb | Net Prod stb | | Begin Rate mcf/d | Gross Prod mcf | Net Prod mcf | | Oil Price \$/Bbl | Gas Price \$/mmbtu | Oil Rev M\$ | Gas Rev M\$ | Total Rev M\$ | Prod Taxes M\$ | Operating Cost M\$ | Net Op Income M\$ | Net Invest M\$ | Cash Flow M\$ | Cash Flow M\$ | Cum Flow M\$ | Cum Flow M\$ | Disc @ 16% M\$ |
| 1 2008 | 4.0 | 1,053 | 793 | | 367 | 97,441 | 73,081 | | 70.00 | 5.50 | 55.3 | 462.2 | 517.5 | 47.1 | 72.0 | 398.4 | 1,098.8 | 389.4 | (1,109.8) | 389.4 | (1,109.8) | (1,109.8) |
| 2 2009 | 2.0 | 685 | 513 | | 187 | 54,005 | 48,003 | | 70.00 | 5.50 | 35.9 | 303.6 | 339.5 | 30.5 | 72.0 | 285.7 | | 286.7 | (474.7) | 343.5 | (766.3) | 766.3 |
| 3 2010 | 1.8 | 601 | 451 | | 164 | 56,702 | 42,152 | | 70.00 | 5.50 | 31.6 | 266.6 | 294.2 | 27.1 | 72.0 | 199.0 | | 159.0 | (275.7) | 175.9 | (580.4) | 580.4 |
| 4 2011 | 1.5 | 528 | 395 | | 144 | 49,351 | 37,013 | | 70.00 | 5.50 | 27.7 | 224.1 | 241.9 | 23.6 | 72.0 | 185.0 | | 166.0 | (103.7) | 91.7 | (371.2) | 371.2 |
| 5 2012 | 1.4 | 463 | 348 | | 127 | 43,356 | 32,501 | | 70.00 | 5.50 | 24.3 | 205.6 | 223.9 | 20.9 | 72.0 | 137.0 | | 137.0 | (137.0) | 273.3 | (303.0) | 303.0 |
| 6 2013 | 1.2 | 407 | 305 | | 111 | 38,052 | 28,539 | | 70.00 | 5.50 | 21.4 | 180.5 | 201.9 | 18.4 | 72.0 | 111.5 | | 111.5 | (111.5) | 138.8 | (452.3) | 452.3 |
| 7 2014 | 1.0 | 357 | 268 | | 98 | 33,413 | 25,060 | | 70.00 | 5.50 | 18.8 | 158.5 | 177.3 | 16.1 | 72.0 | 89.1 | | 89.1 | (89.1) | 228.0 | (315.3) | 315.3 |
| 8 2015 | 0.9 | 314 | 235 | | 86 | 29,340 | 22,005 | | 70.00 | 5.50 | 16.5 | 139.2 | 155.7 | 14.2 | 72.0 | 69.5 | | 69.5 | (69.5) | 297.4 | (212.2) | 212.2 |
| 9 2016 | 0.8 | 276 | 207 | | 75 | 25,763 | 19,323 | | 70.00 | 5.50 | 14.5 | 122.2 | 136.7 | 12.4 | 72.0 | 52.2 | | 52.2 | (52.2) | 349.7 | (193.8) | 193.8 |
| 10 2017 | 0.7 | 242 | 181 | | 66 | 22,623 | 16,967 | | 70.00 | 5.50 | 12.7 | 107.3 | 120.0 | 10.9 | 72.0 | 37.1 | | 37.1 | (37.1) | 386.8 | (8.4) | 185.4 |
| 11 2018 | 0.6 | 212 | 159 | | 58 | 19,965 | 14,889 | | 70.00 | 5.50 | 11.2 | 94.2 | 105.4 | 9.6 | 72.0 | 23.8 | | 23.8 | (23.8) | 410.6 | 4.7 | 193.7 |
| 12 2019 | 0.5 | 187 | 140 | | 51 | 17,443 | 13,092 | | 70.00 | 5.50 | 9.8 | 82.7 | 92.5 | 8.4 | 72.0 | 12.1 | | 12.1 | (12.1) | 422.7 | 2.0 | 193.7 |
| 13 2020 | 0.5 | 164 | 123 | | 46 | 15,317 | 11,488 | | 70.00 | 5.50 | 8.6 | 72.7 | 81.3 | 7.4 | 72.0 | 1.9 | | 1.9 | (1.9) | 424.6 | 0.3 | 179.4 |
| 14 2021 | 0.4 | 144 | 108 | | 39 | 13,450 | 10,087 | | 70.00 | 5.50 | 7.6 | 63.8 | 71.4 | 6.5 | 72.0 | (7.6) | | (47.1) | (47.1) | 377.3 | (56.9) | (184.3) |
| 15 2022 | | | | | | | | | | | | | | | | | | | | | | |
| 16 2023 | | | | | | | | | | | | | | | | | | | | | | |
| 17 2024 | | | | | | | | | | | | | | | | | | | | | | |
| 18 2025 | | | | | | | | | | | | | | | | | | | | | | |
| 19 2026 | | | | | | | | | | | | | | | | | | | | | | |
| 20 2027 | | | | | | | | | | | | | | | | | | | | | | |
| 21 2028 | | | | | | | | | | | | | | | | | | | | | | |
| 22 2029 | | | | | | | | | | | | | | | | | | | | | | |
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| 30 2037 | | | | | | | | | | | | | | | | | | | | | | |
| REMAINING | | | | | | | | | | | | | | | | | | | | | | |
| TOTALS | | 5,632 | 4,224 | | | 525,800 | 394,200 | | 70.00 | 5.50 | 2,657 | 2,493.3 | 2,789.0 | 253.8 | 1,008.0 | 1,672.2 | 1,498 | 377.4 | | 1,498 | (184.3) | |

6 pages

Impact of Proposed New Mexico Pit Rule

Prepared for San Juan Economic
Development Service
by Merrion Oil & Gas
San Juan Basin Case Study
Gallegos Gallup-Dakota Field

Pit Rule Impacts

- Effectively requires elimination of reserve pits for drilling
- New drilling must use closed-loop process
- Cuttings and drilling mud must be hauled and disposed of at an authorized disposal facility
- Increases cost of drilling new wells

Gallegos Gallup-Dakota Project Overview (San Juan Basin)

- One well (Nelson A2) drilled 2-years ago and producing, (type well for economics)
- 12 wells proposed with drilling permits pending
- Target intervals are Gallup and Dakota zones from ~ 4,800 ft to 6,500 ft in depth

Cost of The Closed-Loop Process

- Additional cost for closed-loop drilling, trucking, and disposal is ~\$250,000 per well
 - Closed-Loop Equipment Rental \$90,000
 - Trucking to Disposal \$70,000
 - Disposal of Mud & Cuttings \$50,000
 - Other \$40,000
- Estimated cost is for a Dakota well in the 6,000 to 7,000-foot depth range
- Closed-Loop costs are based upon actual costs incurred by Merion on three wells drilled in Farmington during September and October of 2007

Per Well Economic Summary

Gallegos Gallup-Dakota Field

| | Without | With |
|---------------------------------------|-----------|-------------|
| Drill Cost: | \$859,800 | \$1,109,800 |
| Future Cash Flow (net of Investment): | \$627,400 | \$377,400 |
| Net Present Value @ 16%: | \$65,700 | (\$184,300) |

Merion's Decision: Do not drill at this time, if ever!

State of New Mexico Loses \$5.8 Million in Royalty & Production Tax*

| | Per Well | Total for 12-Well Program |
|---|-----------|---------------------------|
| State Royalty Revenue Lost First Year (50% of Fed Royalty): | \$43,125 | \$517,500 |
| State Royalty Share Lost for Project Life: | \$232,400 | \$2,788,800 |
| Prod Tax Revenue Lost First Year: | \$47,100 | \$565,200 |
| Production Tax Revenue Lost for Project Life : | \$253,800 | \$3,045,600 |

*Production Tax includes Severance, Ad Valorem, Emergency School, and Conservation

Tony Atkinson
Chairman

Keith W. Johnson
Chairman Pro Tem

Ervin Chavez
Member

Jim Henderson
Member

GloJean Todacheene
Member



Keith A. Johns
County Executive Officer

San Juan County

100 South Oliver Drive
Aztec, New Mexico 87410-2432
Phone: (505) 334-9481 • Fax: (505) 334-3168

October 17, 2007

Joanna Prukop
Cabinet Secretary
Energy, Minerals and Natural Resources Department
1220 South St. Francis Drive
Santa Fe, NM 87505

Secretary Prukop,

Please accept this letter as formal disposition and comment from San Juan County, New Mexico, regarding the draft rule pertaining to oil and gas drilling pits (the "Pit Rule") which was recently issued by the New Mexico Oil Conservation Division (NMOCD).

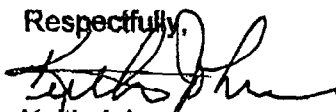
As you know San Juan County is a major economic driver to the state's operating fund as a result of the abundant resources produced from this county. The economy here is reliant on the oil and gas industry which serves as the foundation for its stability.

Although the county is supportive of the mission of the New Mexico Oil Conservation Division, we have grave concerns that the "Pit Rule" does not serve the best means for regulation of which we feel is being proposed with no scientific merit. Furthermore, the impact this proposal would have if passed, will create a devastating effect that will force the industry to incur extreme operating costs, which very well could result in the cutting back of exploration and drilling, loss of high paying jobs and revenue to the county and ultimately the state.

To provide clarity, I want to make sure that you understand that San Juan County is not favoring economic revenues over a safe environment but more so to ensure that any adoption of such a rule be of sound science and not a political agenda that environmentalists desire.

In conclusion, San Juan County Staff and its Commission, strongly urge inquiry and consideration to act on the Pit Rule based on the science related to it. Should that data support the adoption of such a rule, then we believe regulation is appropriate however, should it be unfounded then this rule should be given no consideration.

Respectfully,


Keith Johns
San Juan County CEO

October 4, 2007

Joanna Prukop
Cabinet Secretary
Energy, Minerals and Natural Resources Department
1220 South St. Francis Dr.
Santa Fe, NM 87505

Re: Comments from the City of Bloomfield to the draft rule regarding oil and gas drilling pits (the Pit Rule) recently issued by the New Mexico Oil Conservation Division (NMOCD).

Dear Madame Secretary:

The oil and gas industry has had a greater impact on the State of New Mexico than any other single industry in this state. Whether it is the number of high paying jobs or royalties and taxes that are paid to local and state government, we could not ask for a better partner. From Capital Outlay to the cities and counties, the Permanent Fund and schools all benefit from the fact that we are blessed to have this tremendous resource in New Mexico. The City of Bloomfield and San Juan County depend on the production and exploration of oil and gas to help fuel their local economies and this draft Pit Rule threatens that balance. I was a member of the Pit Rule Task Force and I am disappointed in what was produced. I believed that we would use sound scientific principles to help us come to an appropriate conclusion but that was not the case. The panel was stacked against the oil and gas industry, and to their credit they conceded in several areas to help create a win-win situation. Requiring the use of closed loop systems for drilling, and then the subsequent hauling away of the cuttings for disposal at NMOCD landfills will have a dramatic impact on the cost of drilling wells.

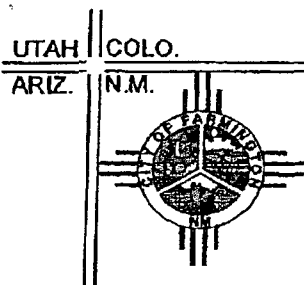
Over the last several years, due to the work of the oil and gas industry the State of New Mexico has had surplus income in their budget so that they could address much needed improvements to our infrastructure including roads, water systems and schools. At the same time many other states were

faced with large deficits in their budgets. There are two factors that are critical in this picture and they are both interrelated - production and exploration. For example: if exploration does not continue at the current or higher levels then production will begin to decrease which in turn lowers taxes and royalties that the state receives. The economies of the City of Bloomfield and San Juan County are tied to both production and exploration, and this draft of the Pit Rules threatens both. When drilling costs rise significantly, as they will with this rule, then the number of wells that are drilled each year will decrease, jobs will be lost and the production of natural gas will go down. Those that are pushing for these stringent restrictions are not using sound scientific principles as a guide but are rather of the belief that due to the higher prices that are being paid for oil and gas, the industry can afford to absorb these costs. You must remember that it wasn't but just a few short years ago that both oil and gas prices hit bottom. If these restrictions had been in place at that time, the industry and the state would have been even more impacted. Markets are cyclical and prices will most likely drop dramatically again. This draft will only punish those companies that are, and have been good neighbors. Stricter rules aren't what is needed but rather more enforcement of the current rules. The NMOCD should be given a budget that will enable them to do the job that you are trying to accomplish with this draft, and hire more employees so that they can monitor the "patch". As a City Manager and County Commissioner I represent the citizens and businesses of our city and county and part of that responsibility includes job creation and development. This rule will have a significant impact on the costs associated with drilling and in turn will hurt our economy. We also realize that these valuable resources will be gone someday and we are working to diversify our economy to help us through that transition. Thank you for your consideration.

Respectfully,

Keith Johnson
City Manager of the City of Bloomfield
San Juan County Commissioner

Cc: Director Mark Fesmire
Ms. Florene Davidson

**CITY OF FARMINGTON**

800 Municipal Drive
Farmington, NM 87401-2663
(505) 599-1103
Fax: (505) 599-8430
<http://www.fmtm.org>

November 12, 2007

The Honorable Bill Richardson, Governor
State of New Mexico
State Capitol
Santa Fe, NM 87503

Dear Governor Richardson:

The Oil and Gas industry is the most important economic engine for all of New Mexico. All communities across the state share in the revenues derived from the extraction industries. As you are well aware, the majority of these industries are located in the San Juan Basin of the Four Corners region. This area has over 22,000 wells within the basin and over 350 inside the City of Farmington. This industry is one of the most regulated in the United States. The oil and gas producers have proven to be good environmentally responsible neighbors in the Four Corners communities, especially Farmington.

It troubles me deeply that we are considering new regulations concerning the "pit rules" that would increase the cost of drilling new oil and gas wells as much as \$150,000 to \$300,000 per well. These regulations will more than likely cause the industry to decrease operations, making almost 25% to 50% of the current oil and gas drilling inventories economically unfeasible to pursue. Downturn in this industry at a critical time when energy shortages are affecting the economy of the entire country does not make economical sense.

This industry provides over \$2.8 billion dollars in taxes and royalties to the State of New Mexico's treasury; that equates to over 35% of needed revenues that can only be replaced by raising property and gross receipt taxes on our citizens.

The environment has always been important to those of us who live, work and raise our families in the City of Farmington. That includes the members of our community that work in the oil and gas business. This industry has been regulated and has managed well drilling with a minimum of invasiveness on our citizens and the environment.

Governor, as Mayor of the City of Farmington and for the sake of economic stability in times of uncertainty, I urge you to ask the NMOCDD to abandon the effort to implement these new "pit rules". These regulations can only serve to hurt our communities.

Sincerely,

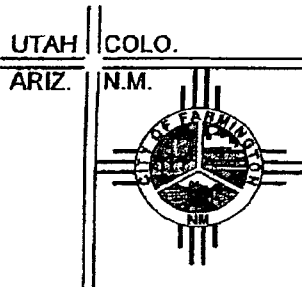
William E. Standlee, Mayor
City of Farmington

WES/lmb

xc: Senator Bill Sharer
Senator Steve Neville
Representative Tom Taylor

Representative James Strickler
Representative Paul Bandy

OFFICE of the MAYOR

**CITY OF FARMINGTON**

800 Municipal Drive
Farmington, NM 87401-2663
(505) 599-1103
Fax: (505) 599-8430
<http://www.fintn.org>

November 12, 2007

Joanna Prukop, Cabinet Secretary
Energy, Minerals and Natural Resources Department
1220 South St. Francis Dr
Santa Fe, NM 87505

Dear Secretary Prukop:

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As Mayor of the City of Farmington and for the sake of economic stability in times of uncertainty, I urge the NMOCD to abandon the effort to implement these new "pit rules". These regulations can only serve to hurt our communities.

Sincerely,

William E. Standley, Mayor
City of Farmington

WES/lmb

xc: Senator Bill Sharer
Senator Steve Neville
Representative Tom Taylor

Representative James Strickler
Representative Paul Bandy

OFFICE of the MAYOR

LOCAL/REGION

THURSDAY
October 11, 2007

FARMINGTON • AZTEC • BLOOMFIELD • SHIPROCK

Eric Fisher, managing editor, (505) 564-4620

Economic development group concerned about oil rule

— By Cornelia de Bruin —
The Daily Times

SAN JUAN COUNTY — San Juan Economic Development Service is on the record as being concerned about the ripple effects of the "pit rule," a proposed regulation, on the local economy.

The so-called pit rule, recently issued by New Mexico Oil Conservation Division, would require the oil and gas industry to change the way it traditionally has used drill pits. The process to change the rules applicable to oil- and gas-field pits began in 2006. A hearing on the proposed rule is slated for late this month.

Drill pits are open, lined pits into which the material that is brought to the surface during the

drilling process used for natural gas wells is placed. They generally are used up to a month.

The proposed regulation would require oil and gas companies to cover the open pits and install a closed-loop system — essentially putting the drilling-related material into a tank.

Speaking from its vantage point, that of an economic development group, San Juan Economic Development Service on Wednesday morning approved sending a position letter drafted by its board president, Tommy Roberts, regarding the "pit rule" to Energy, Minerals and Natural Resources Department Cabinet Secretary Joanna Prukop and New Mexico Oil Conservation Division Director Mark E. Fesmire.

"If the Pit Rule is adopted and

result in company decisions to cut back exploration and drilling programs, with a corresponding loss of high-paying jobs that are so essential to a strong economy."

The loss, it continued, would be "unfortunate" to national, state and local interests."

San Juan Economic Development Service, locally known as SJEDS, is a nonprofit corporation that helps with "the expansion, retention, creation, and recruitment of economic base companies ... for the purpose of job creation in San Juan County."

The group also takes issue with adoption of the "pit rule" without its being "founded on sound science — not political considerations."

"The adoption of the Pit Rule

will appease those in the environmental community who are advocating a governmental policy of zero-tolerance when it comes to the impacts of oil and gas development," the letter states.

Speaking on behalf of Prukop, Jody Porter, public information officer for Energy, Minerals and Natural Resources, said the state's Oil Conservation Division, "is certainly sensitive" to the issues raised by SJEDS.

"We will be holding a hearing Oct. 22, and continuing it to Nov. 5, and the group can voice its statements at the meeting," Porter said. "We will consider all the evidence."

Cornelia de Bruin:

cdebruin@daily-times.com

FOR MORE INFORMATION ABOUT THE PIT RULE:

Google the New Mexico Oil Conservation Division and follow the prompts to: OCD Online, Imaging, Case File, No. 14015.

implemented in its current form and content, the oil and gas industry in San Juan County will be saddled with huge incremental operating costs with little or no associated benefit to the environment," the letter states.

Estimates of the costs range from \$50,000 to \$100,000 per pit site.

The letter added that the incremental costs "... may very well

OGAP's use of pit data is misleading DT 10-29-07

Environmental groups are fond of citing certain data in support of their demands that closed-loop drilling systems be mandated by regulation in New Mexico.

In 2005, one of those groups, Oil & Gas Accountability Project (OGAP), with offices in Durango, Colo., approached the Farmington City Council, of which I was a member, and submitted a demand that the city of Farmington revise its oil and gas regulations to require the use of closed-loop drilling systems in lieu of open and lined drilling pits.

In support of its demand, OGAP referred to thousands of documented cases of soil and ground water contamination from "oil and gas" pits in New Mexico, hundreds of which it alleged to be located in San Juan County.

Discussion of the OGAP demand was scheduled as an agenda item for a regular City Council meeting. OGAP did not have a representative present at that meeting, but a handful of supporters of closed-loop drilling systems were in attendance, as was the District Supervisor of the Aztec office of the New Mexico Oil Conservation Division (NMOCD).

Having some knowledge and experience in the oil and gas industry, I noted that (a) there are two basic kinds of "oil and gas" pits — drilling pits and production pits, (b) closed-loop drilling systems are designed to replace drilling pits — not production pits, and (c) production pits were not germane to the discussion since the NMOCD had previously regulated their use to

the satisfaction of both industry and environmental groups.

I then asked if anyone in the audience knew whether any of the "hundreds" of documented San Juan County cases pertained to contamination of ground water from the contents of drilling pits. The only response was from the NMOCD representative who said he was not aware of any documented cases of drilling pit contamination of ground water in San Juan County.

I asked that anyone having such documentation, including OGAP, provide it to the City Council. To my knowledge, there was never a response to my request. Based on the response from the NMOCD representative and the lack of response from anyone else who supported the use of closed loop systems, I inferred that the documented San Juan County cases were attributable to production pits and concluded that the City Council

had been provided insufficient information upon which to justify regulation that would expose industry to millions of dollars in incremental operating costs.

More recently — in an Oct. 21, 2007, letter to the editor — Bruce Baizel, Staff Attorney for OGAP, arguing in support of closed-loop drilling systems, pointed to data released in 2005 by the NMOCD that documents 95 cases of ground water contamination from "oil and gas" pits in San Juan County.

Having had some prior experience with OGAP and its use of this kind of pit data, I wondered how many of the 95 documented

cases of contamination were attributable to drilling pits, rather than production pits.

I called Wayne Price, Chief of the Environmental Bureau of the NMOCD, and asked if he would send me the documentation that Baizel said had been released by the NMOCD in 2005. Price said he could not give me that data because it was confidential pursuant to an attorney-client privilege. I wondered how Baizel was aware of the documentation if it was subject to an attorney-client privilege, but I did not pursue that issue with Price. Instead, I asked Price how many of the 95 San Juan County cases pertain to ground water contamination from drilling pits. He would not answer that question, but did state that he could say that there are not 95 cases of ground water contamination from drilling pits in San Juan County.

To see if I could get him to further elaborate, I asserted that there is no documentation of even one case of ground water contamination from drilling pits in San Juan County — an area where oil and gas drilling operations have been ongoing for more than 70 years.

Price did not challenge my assertion. Instead, he responded that the NMOCD had documentation of ground water contamination from drilling pits located in Southeast New Mexico and that it could take 100 years for ground water contamination to be detected.

From that response, I can only assume that my assertion was correct — there is no documentation of ground water contamination from drilling pits in San Juan County — and that the cases cited by and relied upon by OGAP involved production pits.

In pointing out the misleading use by OGAP and others of "oil and gas" pit data in the context of claims of groundwater contamination in San Juan County

and the demand for closed-loop drilling systems, I do not ignore the fact that the contents of drilling pits have come into contact with soil and that livestock occasionally find access to drilling pits and are harmed.

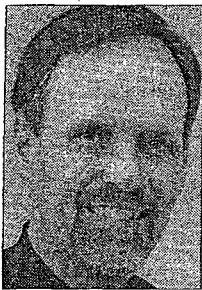
Whether soil contact results in soil contamination is a hotly debated question, but if it is established by the application of sound scientific data and principles that soil is contaminated by contact with the contents of drilling pits, there are remedies available that are far more reasonable than an industry wide requirement for use of closed-loop drilling systems.

Likewise, the potential for harm to animals can be addressed with requirements for adequate fencing, with strong penalties for violations and fair compensation for losses.

But, from the perspective of OGAP and others, the debate about closed-loop drilling systems has very little to do with documented evidence, practical solutions, or economic considerations. These folks expect to be protected, no matter how remote the likelihood of harm or how costly it is to prevent the very remote from actually occurring.

Mr. Baizel sums up the OGAP philosophy very succinctly when he presumes to tell industry operators that they will actually save money if they use closed-loop drilling systems and, even if they don't save money, they can afford the cost. Notwithstanding the OGAP philosophy, I am hopeful that most people in our community would expect and demand that governmental regulation of any industry be based on hard facts and sound science — not conjecture.

Tommy Roberts, an attorney and a former member of the Farmington City Council, is a resident of Farmington.



**TOMMY
ROBERTS**

San Juan Voices

www.daily-times.com

FARMINGTON NEW MEXICO

DAILY TIMES

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Supporters rally behind new oil, gas rules

— By Cornelia de Bruin —
The Daily Times

FARMINGTON — Timed to the presentation of opening arguments for and against changing some of the rules that govern New Mexico's oil and gas producers, a group of environmental organizations has released its stand on the issue.

The citizens' groups, ranchers and landowners include the Oil and Gas Accountability Project, San Juan Citizens Alliance, Chris Velasquez, a Blanco

rancher, and Pat Wise, city manager of Lovington.

They are calling on state officials to prohibit the open waste pits they say are now used on most oil and gas drilling sites and to require operators to dispose of pit waste at permitted waste facilities.

The state's Oil Conservation Division released its proposal to change Rule 50, also known as the Pit Rule. If the division decides after hearings scheduled Nov. 5 in Santa Fe to change the existing rule, oil and gas producers would be required to

change their drilling practices and temporarily store well drilling byproducts in closed-loop containers. Opening arguments on Rule 50 started Monday in Santa Fe.

The containers are similar to tanks. They would hold rock cuttings and the slurry mixture drillers use as they grind through hundreds of feet of earth to reach their target — natural gas and oil reservoirs. After the well is drilled, the changed regulation would mandate that the material be hauled to OCD-approved

landfills or landfills approved to take hazardous materials.

"It's time that the oil and gas industry takes responsibility to prevent pit pollution and dispose of their waste properly like everyone else," said Bruce Baizel, staff attorney for the Oil & Gas Accountability Project and Pit Rule Task Force member.

The groups contend in an Oct. 19 press release that unlined or poorly lined o

See **Oil & Gas Rules A6.**

Oct 23, 07

Oil & Gas Rules

(Continued from Page A1)

and gas pits, and buried pit waste, "have threatened New Mexico's water, soil, and residents for years."

They cite nearly 7,000 incidents of soil and water contamination.

"In 2005, the New Mexico Oil Conservation Division released data showing that close to 400 incidents of ground water contamination had been documented from oil and gas pits," the press release states. "Most recently, as part of the Pit Rule Task Force process, the OCD released pit-sampling data that showed carcinogens present in all the samples and heavy metals in two-thirds of the pit samples."

Among the ingredients found are benzene, toluene, xylene, arsenic, lead, mercury and barium.

Baizel said the groups' concerns are two-fold: animal access to the pits during the drilling process, and companies' burial of the material.

"They bury this stuff without marking the sites," Baizel said. "The concern is that if a rancher disturbs the area, he comes in contact with the carcinogens."

Blanco rancher Chris Velasquez said he had 20 cattle walk into an unfenced pit in 2001.

"Not only am I losing cattle ... the contaminants sterilize the soil and move around with the rains," he said.

Independent producers in San Juan County don't think the proposed pit rules are based on sound science. Rather, several producers say that presidential politics is part of the package. They also say the rules could add up to \$170,000 to the cost of drilling each well — a financial factor that may limit the number of wells drilled here.

New Mexico Oil and Gas

Association President Bob Gallagher said late last week the proposed regulations could result in a \$700 million negative hit to the state's oil and gas industry.

"The proposed rule brings environmental, public health and taxpayer benefit to all New Mexicans by requiring closed loop systems rather than pits in some areas, banning unlined pits and requiring surface owner consent before waste can be buried on site," Baizel said. "We need this stronger rule ... no other industry gets to leave their waste for others to take care of, and this rule prevents that."

Baizel said the pit waste burial portion of upcoming pit rule discussions is expected to be "among the most contentious issues" at the pit hearing.

The new regulations, if approved by the state, could begin in early 2008.

More arguments and supporting testimony are scheduled to begin Nov. 5 in Santa Fe. They will be held in Porter Hall, 1220 South St. Francis Drive. Contact the Oil Conservation Division at (505) 476-3458 for more information.

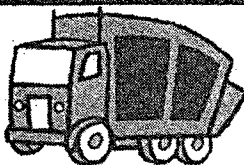
Cornelia de Bruin:
cdebruin@daily-times.com

Dumpster Weekend

Saturday & Sunday
October 27 & 28
8 a.m. - 3 p.m.



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No Refrigerators
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No liquids of any kind
No Pyracantha or Russian Olive



Information: 599-1426



Oil, gas rules hearings begin next Monday in Santa Fe

*Plenty on the line
as opposing sides
argue points*

— By Cornelia de Bruin —
The Daily Times

SAN JUAN COUNTY — Representatives of the energy, economic and environmental communities are polishing their legal arguments as they ready themselves for two weeks of hearings that begin Nov. 5 in Santa Fe.

The hearings could affect the state's oil and gas operations in a financially substantial way — a way that has the allegiance of various environmental groups. At the table will be representatives of the state's Oil Conservation Division, the entity proposing the changes, environmental groups, which support the change, and local producers.

"The discussion process used to be more cooperative," Thomas E. Mullins, principal/engineering manager of Synergy Operating, LLC, said. "Now it's 'stakeholder' meetings. What they're doing is taking a stake and driving it into the heart of the industry."

Mullins is also vice president of the Independent Petroleum Association of New Mexico.

The proposal

Pit rules — specifically a proposed change in the New Mexico Energy, Minerals and Natural Resources department's Rule 50 — are regulations governing the state's massive oil and gas industry. If the Oil Conservation Commission votes to change Rule 50, other regulatory measures also will be changed.

The proposed change, put forth earlier this year by the department's Oil Conservation Division, would mandate that oil and gas producers replace the pits they now use to hold drilling by-products with closed-loop systems similar to tanks.

The proposal also would require producers to remove, in most cases, the by-products to a storage facility after a well is drilled. Producers claim the overall expense would be at least \$100,000 per well site.

Producers could not bury the material on site, the present practice, but would store it in an approved facility. Some exceptions are allowed, but David

Regulations

(Continued from Page A1)

said one of the main reasons for the proposed rule changes is to contain the material in a permanent disposal facility to lessen pollution statewide.

Drilling by-products can contain benzene, toluene, ethyl benzene and xylene — industrial pollutants harmful to the environment.

"The position of the division is that the regulations are necessary for environmental protection," Brooks said.

During his opening arguments last week in Santa Fe, Brooks said OCD wants to protect New Mexico and its residents from the waste by putting it in a centralized facility rather than dumping it at drill sites "like lumps in tapioca."

OCD began keeping a record of drilling spills in the 1980s, logging about 1,900 of them statewide since then. The division's records show that about half the spills polluted ground water across the state. About 550 of the spill sites remain under mediation. Approximately half — 250 — have been cleaned up.

"We want the industry to realize that it is much cheaper to control the problem than to clean it up," Mark Fesmire, director of Oil Conservation Division, said. "We want to prevent contamination and provide a well-regulated facility to put the stuff in."

Fesmire could not break down his data to determine which spills occurred in San Juan County.

Mullins, however, takes issue with Fesmire's ground water pollution data.

"The facts do not support the added regulation. There have been spills here, but they have never contaminated the ground water," Mullins said.

He has downloaded OCD's two-year-old spill data — the most current information available — which supports his assertion. Mullins would like to go toe-to-toe with Fesmire, he said, and grill him about why the division is going into a hearing with old data and whether oil and gas

BURYING BY-PRODUCTS

In some cases drilling by-products that are now stored in on-site pits at drill sites could be buried in San Juan County. Attorney David Brooks, who represents the state's Oil Conservation Division, said that this area is more than 100 miles from an OCD-approved drill waste storage landfill.

Although three landfills are

approved to take local industrial waste, the agreement allowing that is due to expire in the spring. If the local sites cannot be used, local companies cannot take the waste to Colorado's two landfills and the waste content falls within OCD parameters governing total petroleum hydrocarbon content, it could be buried in a lined trench.

industry improvements are kept out of the spotlight. Many of the issues on which proponents of pit rules focus are legacy issues and therefore not pertinent to the present situation, Mullins said.

"We as an industry have been quiet too long," Mullins said. "It's been a challenge to get equal time."

The effect on consumers

Independent oil and gas producers in the San Juan Basin counter that the proposed changes are unnecessary and will cost them money they will, in turn, pass on to their customers.

"There are a lot of unknowns. I've seen both sides of the arguments," T. Greg Merriion, president of Merriion Oil & Gas Corp., said.

Merriion operates three sites within Farmington city limits that use the closed-loop system the pit rules would mandate. Drill site limitations made the systems necessary, he said.

"They definitely cost more," Merriion said. "I'm still incurring costs from hauling the mud and cuttings away."

Although Merriion is still tallying up his drilling expenses, he maintains that the closed system "is more expensive."

"A lot of people say they

don't care (about the higher price) if it's when the environment needs protection," he said.

Merriion maintains that many drilling situations don't need a closed-loop system to protect the environment and that drilling situations can vary from site to site.

What's not needed, nor an option with the proposed Rule 50, is a cookie-cutter type approach.

"This will affect a number of projects," he said. "The investment to drill after these are implemented will be greater and it will have a negative impact."

Both short- and long-term effects will be felt, he added.

"In the short term fewer wells will be drilled, but in the long term there will not be as much supply and there will be an increase in demand," Merriion said. "It's supply and demand, and it means higher prices to the consumer."

Local producers John Byrom, president of the Independent Petroleum Association of New Mexico, and Thomas Dugan, president of Dugan Production Corp., also plan to drill fewer wells.

How will the environment fare?

"Communities faced with oil and gas issues are faced with a 21st-century problem," said Eric

Jantz, New Mexico Environmental Law Center attorney. "The chemicals used in drilling and its solvents have changed, and the pits use old technology."

Jantz will represent the environmental interests that want the state's pit rules changed. He plans to present an analysis of the chemicals that go into drilling pits.

Included are toluene and xylene, both neurotoxins, Jantz said, along with ethyl benzene, a carcinogen, and heavy metals such as mercury, lead, cadmium and chromium.

"The chemical ingredients of the fracturing fluid ('frac' is an oil and gas industry term that refers to treating the producing formation in an attempt to improve production) are not known because they are proprietary," Jantz said.

If the proposed regulations pass, Jantz said San Juan County can "count on a cleaner, healthier environment ... a lot less pollution."

"The industry takes the standard line that there will be a huge economic effect," he said. "I doubt it."

After testimony is taken during the hearings and the proceedings adjourn, commissioners will discuss, and rule on, the proposal in open session.

"That could be mid-November, or possibly after Thanksgiving," Brooks said. "The rules will take effect after they are published in the New Mexico Registry, and that can take from 30 to 90 days."

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The Four Corners
Information Leader

TUESDAY

November 6, 2007

FARMINGTON



PIT RULES

(Continued from Page A1)

awful drastic," said Dana McGarth, who runs a small firm in Farmington that helps get natural gas wells ready for production. He told the commission the new rule could deter new drilling, costing jobs and harming the economy.

No one knows exactly how many pits there are in New Mexico, where according to the OCD more than 90,000 oil and gas wells have been drilled during the past century or so and about 55,000 currently are producing. Pits are dug to hold the fluids and solids that are the byproducts of well drilling, and to dispose of waste from production. Fesmire says in the past 15 years, the OCD has recorded nearly 800 instances of ground water contamination from oil and gas operations, roughly half of those due to pits. The pro-

— By Deborah Baker —
The Associated Press

SANTA FE — Mark Fesmire remembers when, as a young engineer reading a new oil well for production in southeastern New Mexico, he was told by his boss to get rid of a pit full of salty waste water by ripping the liner and letting the stuff soak into the ground.

While it broke no rules, "That's haunted me ever since," Fesmire said. "That

was wrong." Two decades later, the state Oil Conservation Division that Fesmire heads is proposing a new, tougher rule for oil and gas pits that has drawn vehement objections from the industry.

A hearing that could last into next week resumed Monday before the Oil Conservation Commission, which has the final say.

Environmental groups and some ranchers and city officials contend that

in the budget year that ended June 30, according to recent revenue figures. That means about one of every four dollars in the state's \$5.7 billion general fund last year was attributable to oil and gas.

"We don't need to shoot the cash cow," said Rep. Candy Spence Ezzell of Roswell, a rancher, farmer and independent oil producer.

Lawmakers also objected that the OCD was overreaching, putting the industry on what GOP Whip Dan Foley of Roswell called "a path to destruction."

The proposed rule requires for the first time that all pits be lined according to certain specifications. It places extensive restrictions on where pits may be placed. Most importantly, there could be no temporary or permanent pits in places where the ground water

is less than 50 feet below the bottom of the pit.

Operators instead would have to use a so-called closed-loop drilling system, a series of storage tanks that separates liquids and solids, with waste trucked off for disposal.

"We don't need to shoot the cash cow."

REP. CANDY SPENCE EZZELL, Roswell

And, perhaps the most controversial change, the rules severely curtail the permanent, onsite disposal of pit waste, which has been the industry norm. Instead, waste would have to be hauled to OCD-approved disposal facilities, unless they're more than 100 miles away.

Even if pits are lined, OCD contends, onsite disposal means

contamination — including carcinogens and heavy metals — from unfined or poorly lined pits threatens water quality and the health of New Mexico's people, livestock and wildlife.

The industry says OCD has been swayed by those advocates into proposing a set of regulations that are not based on science and will punish the industry — and, ultimately, a state economy that depends on it.

"It's overzealous," said Bob Gallagher,

pit waste eventually will contaminate ground water.

"We just need to put this waste in a centralized landfill, where we have some control over it," Wayne Price, OCD's Environmental Bureau chief, testified Monday.

Environmental groups applaud that proposed change, saying waste disposal should be concentrated rather than sprinkled throughout the state such as "lumps of tapoca" in mini-dumps.

Gallagher says the "dig and haul" requirement, which he estimated would affect about 95 percent of operations, is arbitrary and would be too expensive.

There are four disposal sites in southeastern New Mexico that would be authorized to take such pit waste. There is none in the northwest — the

president of the New Mexico Oil and Gas Association. "It provides no real additional environmental benefits, and it's arbitrary."

Gallagher estimates the proposed changes could mean an additional cost of \$200,000 at each well site, driving operators to neighboring oil- and gas-producing states such as Texas and Colorado.

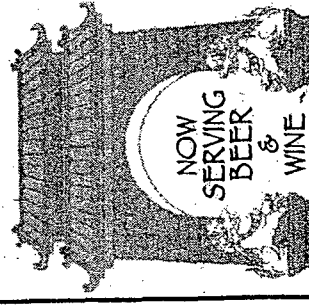
"It seems to me the changes ... at

See Pit Rules A7.

closest is near Durango, Colo — but Price said the new rule could encourage the establishment of a commercial landfill for such waste in the northwes

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Environmentalists distort the record

It is unfortunate that the citizens of New Mexico continue to be lambasted with misinformation regarding oil and natural gas pits by organizations such as OGAP, the San Juan Citizen's Alliance, Citizens for Clean Air and Water, and a few well-intentioned ranchers. Oil and gas pits of all types have been heavily regulated for many years, and these regulations have served the state well in protecting the land, air and water. In fact, many regulations can be overkill.

As a New Mexican and a local independent oil and gas producer, I take pride in supplying needed fuels in an environmentally sound manner to allow transportation, commerce, warmth and electricity to flow not only to New Mexicans, but also to almost 10 percent of the citizens of the United States. Our industry's tax revenue effectively funds more than 50 percent of our state's general fund.

Existing NMOC rules and regulations require metal/fiberglass tankage with secondary containment for produced fluids such as condensate, produced water and oil. These long-term production pits are different from the temporary lined reserve pits and workover

pits utilized by our industry during the short drilling and completion phases of operation.

Opponents to our industry continue to distort the facts as they attempt to make "legacy issues" — problems that no longer exist — appear to be current hazards due to under-regulation.

There are distinct differences between the uses of pits within our industry. In the San Juan Basin most wells are drilled in less than two weeks, with the temporary lined

"reserve" pit closed out in under 90 days. Lined reserve pits are used to hold the drill cuttings that are returned to the surface by the drilling mud. Reserve pits also allow for the final storage of excess cement that is used to protect the ground water after it is circulated properly to the surface.

Following the drilling activity, gravity allows solids to settle to the bottom of the pit, and any remaining liquids are removed and properly disposed of or recycled under existing regulations. The remaining solids, including the drill cuttings and cement, are buried onsite with the surface revegetated to a condition that offers better forage for livestock, deer and elk.



THOMAS E. MULLINS

San Juan Voices

These temporary lined reserve and workover pits don't photograph well during use, but until recently, being unattractive didn't qualify for your elimination. Our industry believes that this safe, economical and efficient method of handling drilling "cuttings" should be allowed to continue.

The debate and testimony being waged in Santa Fe in the coming weeks will center around whether the added de facto requirements of closed-loop drilling, removal of temporary pit liners and the hauling of all cuttings and cement to a dedicated landfill are warranted for the protection of ground water resources and the environment.

For more than 60 years, in the San Juan Basin of Northwest New Mexico, more than 35,000 wells have been drilled and worked over using reserve and workover pits without record of ground water contamination. This is an unfortunate fact that has yet to be refuted, although there remains a significant effort to identify instances of damage to justify added regulation.

Environmental organizations continue to take information on industry supplied Material Safety Data Sheets (MSDS) and mischaracterize the hazards of handling concentrated bulk products to create fear and loathing of our activities in the public arena. I continue to watch in trepidation as,

throughout the Rocky Mountains, these East Coast-funded organizations present a diatribe of catastrophe to local communities in order to scare them into opposing whatever industry is their current target.

The average citizen is busy daily using soap, shampoo, fertilizer and other general household products containing chemicals with known carcinogens that can injure if the concentrations are high enough. Remember, the next time you are cooking with flour, that this is an inhalation hazard that could kill you!

Wells drilled in the San Juan Basin use green materials such as fresh water, bentonite clay, wood chips, cedar fiber, paper and lime as their primary constituents. Minor concentrations of salts, such as table salt, (sodium chloride), and calcium chloride, are used to stabilize the mud and improve cement bonding characteristics.

When you hear these anti-industry groups say "... industry can afford to do it right," please know that industry continues to do it right.

The superior question remains: Where is the benefit? Regarding this proposed pit rule, the answer is simple. There isn't any.

Thomas E. Mullins, a resident of Farmington, is engineering manager for Synergy Operating, LLC

THE DAILY TIMES

FARMINGTON NEW MEXICO

Help avert proposed Pit regulations

Staff Writer

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Editor:

Overregulation hurts everyone. The proposed new Pit Rules would render up to 50 percent of state oil and gas drilling inventories uneconomic, and seriously damage our local economy. This entire fuss is over the disposal of drilling fluids, which in our area are natural or biodegradable. The proposed regulation is tantamount to requiring that a builder put four roofs on every house, when one is sufficient.

San Juan Basin is the largest producing natural gas field in the United States. We supply vital, clean-burning, natural gas as the fuel of choice for America. Area producers already face drilling inflation: The cost of materials, labor, and services has nearly doubled over the past few years. Superfluous regulatory requirements only add insult to injury.

As oil and gas companies lose revenue, they will take investment dollars elsewhere, moving to friendlier states or overseas. The resultant lack of new drilling here will have a domino effect on service companies first, but layoffs in all sectors would be inevitable. Many of us remember the industry layoffs of 1987, 1996 and 2000.

The oil and gas industry provides over \$2.8 billion dollars (FY 2006) to the state's treasury in taxes and royalties. This amounts to 35 percent of our total budget. Education takes up to 60 percent of that budget, so who will suffer? Yet, an economic

impact study of the proposed rules has not been conducted. Go figure.

As a freshman legislator, and 30-year veteran in the oil and gas industry, I believe the new Pit Rules are poorly thought out, threatening to our state economy, and of little or no environmental merit. Their implementation will pressure legislators to compensate for lost revenue by raising income, property, and gross receipts taxes. We don't want that, and neither do you. The NMOCD was given authority to adopt reasonable rules, not a license to put a crucial industry out of business.

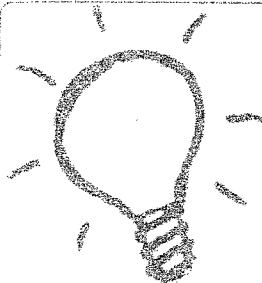
I urge all concerned citizens, oil and gas employees, educators, local politicians, service industries and businesses to call or fax Governor Richardson (State Capitol, Suite 400, Santa Fe, N.M. 87501, fax (505) 476-2200), and the Energy and Natural Resources Cabinet Secretary, Joanna Prukop (1220 S. St. Francis Drive, Santa Fe, N.M. 87505, fax (505) 476-3462). Ask them to stop these arbitrary and capricious rules. Time is short. The hearing commenced Monday.

JAMES STRICKLER

State Rep., District No. 2

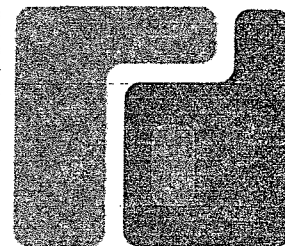
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