

April 8, 2015

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VIA E-MAIL

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RE: Raton Basin Coalbed Methane Operations / Surface Discharge Permits

Dear Ms. Jackson and Mr. Pfaltzgraff:

During our meeting on March 26, 2015 with Dr. Wolk, Martha Rudolph, you, XTO Energy Inc. (“XTO”) and Pioneer Natural Resources USA, Inc., (“Pioneer”) (collectively, the “Companies”) the Companies pleaded for the status quo – continuing to operate and discharge produced water. We emphatically stated that if the effluent limits in the current permits became effective on July 1, 2015 that the Companies would be required to shut down operations. Dr. Wolk committed that XTO and Pioneer would not be forced to shut down operations, saying “that’s not going to happen.” Now, what we feared has come to be – to avoid operating in violation of the permit limits (and the law), the Companies will be forced to close CBM production in the Raton Basin before July 1, 2015.

At the March 26 meeting, we presented a proposal to CDPHE to address the outstanding issues, which had three key elements: (1) extend the July 1, 2015 compliance schedules in the permits; (2) agree to withhold a decision on to-be-filed requests for re-consideration of the Division’s Denial Orders regarding the existing appeals until facilitated discussions are completed; and (3) engage in a facilitated conversation with the Companies. The Companies proposed that the parties identify a mutually-acceptable facilitator to assist in resolving these

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issues. The Companies suggested Barbara Biggs as a possible facilitator. Ms. Biggs worked with Metro Reclamation District on several permit renewals and new permits, and as a current Water Quality Control Commissioner, Ms. Biggs is very familiar with the permitting process and the technical issues at hand. The Division rejected the Companies' proposal and suggested facilitator "because of conflict issues" with little explanation.

The Division's counter-proposal (as outlined in Ms. Jackson's April 1 e-mail) would require the Companies to withdraw the existing appeals before the Division would even engage in a facilitated discussion. This counter-proposal is unreasonable. The Division's unwillingness to consider, in good faith, an extension of the July 1, 2015 deadline means that the unattainable discharge limits will become effective. Extending the deadlines for those July 1, 2015 permit limits would have allowed the produced water to continue to be legally discharged and given time for the Division to develop new discharge limits that protect the downstream water quality and are attainable by the Companies. Such a resolution would be truly a win for Las Animas landowners & communities, the Companies and, we presume, the State. We recite the Division's comments in their posted counter-proposal below, and our response:

Division's Counter-Proposal: *The [Division] has considered your clients['] request that the Division engage in a facilitated dialogue regarding Pioneer's and XTO's draft renewal permits (Colorado Discharge Permit Nos. CO 0047767, CO 0047776, CO 0048003, CO 0048054 and CO 0048062) that are not final and currently out for public comment. As you are aware, the Division engaged in dialogue with XTO and Pioneer for months on these permits leading up to publication of the draft renewal permits for public comment. The Division continues to be committed to resolving any outstanding issues or misunderstandings regarding the renewal permits. The Division will agree to participate in a facilitated discussion with Pioneer and XTO on the following conditions, which the Division hopes will be mutually agreeable to Pioneer and XTO.*

RESPONSE: You state that "the Division engaged in dialogue with XTO and Pioneer for months on these permits leading up to publication of the draft renewal permits." The majority of conversations between the Division, XTO, and Pioneer occurred in 2012, 2013 and early 2014. During those conversations, the Companies received confirmation that EC and SAR approaches proposed by the Companies would be acceptable. The Companies were surprised when the permit modifications for EC and SAR were issued in February 2014 based upon different assumptions that did not use the science and calculations that had been developed and tested for these constituents. Comments were submitted, but ignored by the Division. Although XTO and Pioneer anticipated compliance, there was more variability in monthly data than the previous quarterly data set would have predicted. Please note that sodium laboratory analyses using EPA methods have a 20% (+/-) and that almost all effluent samples that exceeded the discharge limits were within 20% or less of the discharge limit. Notwithstanding that the reported values were within the margin of error of the test, XTO and Pioneer immediately notified the Enforcement Section of their compliance difficulties. Each company offered a series of actions to evaluate SAR measurements, compliance and treatment alternatives which were accepted by the

Enforcement Section. Further, the Enforcement Section advised that since EC and SAR were new limits, the Companies were entitled to compliance schedules in their permits. A compliance schedule would keep the discharge limits as “report only,” while compliance options were explored and evaluated. However when compliance schedules were then requested for EC and SAR, they were denied by the Permits Section.¹

Whole Effluent Toxicity (WET) testing is conducted with invertebrate and macroinvertebrate lab species to determine the effect of the discharge on toxicity to representative aquatic life. After a meeting with EPA headquarters (“EPA”), EPA Region 8 (Denver), EPA Office of Research, and the Division, the Companies were advised to develop a WET testing program that would test and protect aquatic life where they live and reproduce – at the confluences of the tributaries and the Purgatoire River. After considerable study and expense, the Companies proposed WET testing at the confluences. The last conversation regarding WET testing occurred with the Division in 2012. At that time, the Companies understood that they were on the same page as the Division regarding WET testing and that the Companies’ proposal for WET testing was acceptable. In the draft renewal permits, without any notice from EPA or the Division indicating a change of opinion or the reasons therefor, the Division proposed new WET limit to be imposed upstream of the Purgatoire River; in some cases several miles upstream of the River. The proposal for WET testing developed with EPA and the Division was completely rejected by the Division in the draft renewal permits without any prior notice or discussion with the Companies, despite numerous opportunities to do so.

Conversations with the Division regarding EC and SAR occurred at a frenzied pace immediately prior to the draft renewal permits’ issuance. Frequently, the Division had a new concept for EC and SAR, which they wanted to test with the Companies. There was no agreement that the last minute proposals from the Division were scientifically based or attainable.

When iron was discussed, the Division told us “oh, you will not have any problems.” But when we asked whether there would be 2-year antidegradation based limits, the Division said yes, but conveniently failed to bring those numbers to the meeting. As such, the Companies had no prior knowledge of the 2-year antidegradation based limits that the Division included in the draft renewal permits.

Division’s Counter-Proposal: *From the Division’s perspective, the purpose of the facilitated discussion is to create a productive space to discuss and hopefully resolve or narrow outstanding issues associated with Pioneer’s and XTO’s draft permits. For the Division to participate, the facilitated discussion must be a non-binding process.*

¹ This is a chronic problem with the Division; one section recommends actions be taken by another section. That section then disagrees. It is a game where each section tries to avoid work by passing it on to another section without any regard for what happens when the new section also prefers to pass.

It is the Division's understanding that Pioneer's and XTO's remaining issues relate to the draft effluent limitations for total recoverable iron, electrical conductivity/sodium adsorption ratio ("EC/SAR"), and whole effluent toxicity ("WET"), so it is the Division's position that the facilitated discussion should be limited to these topics.

RESPONSE: While the major issues are the proposed limits applied for iron (TR), EC, SAR and WET testing, where those limits are applied is also problematic. Because the flow calculations are incorrect, discharge limits are included for outfalls that have little or no effect on water quality. This is particularly critical because there are no agricultural diversions upstream, so the proposed EC and SAR limits are premised on the water from the outfalls reaching the Purgatoire and then flowing to an agricultural diversion that may be several miles from the outfall. Aquatic life does not thrive and reproduce in the tributaries. As such, chronic WET testing is not appropriate at these outfall locations but rather at the confluence of the tributaries.

Division's Counter-Proposal: *Given that the draft permits demonstrate the Division's position on the draft effluent limitations for total recoverable iron, EC/SAR, and WET the Division would like Pioneer and XTO to agree to provide a written explanation of its position and alternative approach no later than 1 week prior to the facilitated discussion.*

RESPONSE: Please see the comments submitted by Pioneer and XTO, respectively on the draft renewal permits submitted April 6, 2015. As detailed further in the April 6, 2015 comments, the Companies discussed these topics with the Division on numerous occasions. Among others, *see, e.g.*, presentation re: Five Point Plan to Dr. Urbina, CDPHE Executive Director (May 2012); Letter from R. Sandquist to P. Pfaltzgraff, WQCD, re: Importance of Permit Compliance (Jan. 13, 2014); email from K. Morgan, WQCD, to XTO re: WQCD-XTO 6/25/14 meeting follow-up (June 26, 2014); e-mail from R. Sandquist to K. Morgan and C. Pickens, WQCD, and A. Urdiales, EPA, re: XTO Energy, Inc./SAR Permit Limits (July 24, 2014); e-mail from R. Sandquist to K. Morgan, WQCD, re: SAR Issues: Pioneer Natural Resources/ Meeting with WQCD Enforcement Section (Aug. 6, 2014). Although permit modifications to address these issues were submitted in **December 2013** (WET and iron) and **August 2014** (EC and SAR), no official reply was received from the Division until **February 6, 2015**, some 14 months later (WET and iron); 6 months later (EC and SAR). The Companies would be pleased to resubmit this information.

Division's Counter-Proposal: *To accommodate the facilitated discussion the Division will extend the public comment period for the five draft permits for forty-five days (45) days, with the option to extend an additional thirty (30) days. The extended public comment period will end May 6, 2015. Because this facilitated discussion will generate substantive comments, the Division will incorporate the information generated during the facilitated discussion into the administrative record for the draft permits and will consider the information along with all other public comments, including an additional written comments Pioneer and XTO may submit.*

RESPONSE: The Division's offer to extend the public comment period, while appreciated, came much too late in the process. When the Companies' offer of a facilitated discussion was responded to by the Division seven days after it was presented to the Division, the deadline for public comments on the draft permits was only a few days away. The Companies could not risk delaying their comments while also considering the Division's counter-proposal regarding a facilitated discussion. This is especially true given the Division's refusal to extend the compliance deadlines for WET, iron, and EC/SAR under the current permits, despite the fact that the Division refused to consider XTO and Pioneer's requests for modification of those deadlines and instead insisted on considering compliance schedules for WET, iron, and EC/SAR within the renewal permit process only. Additionally, the counter-offer to extend the public comment period would not address—and could, in fact, exacerbate—the Companies' concerns regarding the permit limits that take effect in July 2015.

Division's Counter-Proposal: *Finally, the remaining issues on the draft permits are technical. Division believes that better progress will be made by technical staff focusing on the technical issues without attorneys present. Therefore, the Division's preference is to limit the facilitated discussion to technical staff. Any legal issues that arise during this facilitated discussion can be tabled for discussion between counsel. We also believe that the discussion would benefit by having a representative from EPA participate to provide EPA's perspective on the issues.*

RESPONSE: The issues facing the Companies are not purely technical issues, rather the technical, legal and policy issues are intertwined. Further, the Companies believe that a facilitated discussion would be more productive if all necessary parties are present for the discussion and additional follow-up to address purely "legal" questions would not then be necessary. If a representative from EPA will "be present," then the Companies request that representatives from Las Animas County and landowners also "be present."

ROLE OF THE FACILITATOR

Division's Counter-Proposal: *The role of the facilitator will be to foster open dialogue, organize the discussion, keep the conversations on topic, and help clarify points so they are understood. The facilitator will remain neutral and will not propose independent opinions or otherwise direct the outcome or information generated. Again, as stated above, the facilitator is not an arbiter, mediator, or any type of legal or quasi-legal fact finder or decision maker; therefore, the facilitator will not have any role in determining the final decision. The authority for any final decision on these permits rests with the Division, and will be included in the final permits.*

RESPONSE: The Division counter-proposes that if XTO and Pioneer forego all legal remedies and subject themselves to potential enforcement actions and penalties, that the Division will agree to engage in a substantive discussion of the issues with them. As

Colorado taxpayers, residents and businesses operating in Colorado, we always thought that our government, and its agencies, had an unspoken commitment to speak with us and not demand that its citizens give up fundamental legal rights as a precondition to those communications. Instead of agreeing to our proposed facilitated conversation with a technically-grounded facilitator, the Division has counter-proposed that the facilitator have no role, no comment, no advice – essentially, the facilitator would be neutered. Even though not binding, a benefit of facilitated communications is a facilitator that can note the points of agreement, disagreement and offer thoughts on ways to bring the parties closer to resolution. The facilitation needs to be a real discussion that promotes dynamic discussion and development of creative solutions to resolve points of difference.

Division's Counter-Proposal: *The Division considered Pioneer and XTO's suggestion of Barbara Biggs to serve as the facilitator. The Division cannot agree to use a current commissioner as the facilitator because of conflicts issues. Alternatively, the Division suggests that Will Allison, Air Quality Control Division Director, serve as the facilitator. Mr. Allison has extensive regulatory and legal experience, including knowledge of the water quality control permitting process. Additionally, given that Mr. Allison is a CDPHE employee there would be no cost for either party to have Mr. Allison act as the facilitator. Should Pioneer and/or XTO disagree to Mr. Allison acting as the facilitator, the Division would recommend Lisa Carlson serve as the facilitator. Ms. Carlson is the current facilitator for the Colorado Water Quality Forum, and so she is well versed in Colorado water quality issues including permitting. However, the Division has no funding source to pay for Ms. Carlson so the companies will need to pay her fees.*

RESPONSE: We are familiar with Mr. Allison and his credentials and experience, and have the utmost respect for him. However, because the Companies' CBM operations also require air quality permits, utilizing Mr. Allison as a facilitator would be a conflict of interest. We are also familiar with Ms. Carlson. She has "hosted" the Water Quality Forum for several years. Rarely do issues related to permit terms, enforcement and development of discharge limits occur before the Forum and, as such, we do not believe Ms. Carlson would be an appropriate facilitator. This is probably due to the difference of opinion regarding the role of the "facilitator." We envision a facilitator that understands the technical issues presented, directs conversations, makes suitable inquiries, identifies points of agreement and disagreement – all to reach resolution. We do not believe these skills are necessary for, or have been exhibited by, the Water Quality Forum facilitator.

ADDITIONAL TERMS

Division's Counter-Proposal: *Finally, in exchange for the Division agreeing to participate in the facilitated discussion, we ask that Pioneer and XTO agree that the companies will not pursue reconsideration of, or an appeal of the Division's denial of the companies' Notice of Appeal, Request for Administrative Hearing, and Request for Stay. Pioneer and XTO will retain the ability to appeal the final permits.*

RESPONSE: XTO and Pioneer will not pursue reconsideration or an appeal of the Division's March 19 Denial Order as it relates to the draft renewal permits. XTO and Pioneer acknowledge that the March 19 Denial Order unequivocally states that the draft permits and the fact sheets accompanying them are not final and that they are therefore not final agency actions subject to administrative appeal. XTO and Pioneer reserve their right to appeal the renewal permits after they become final.

This said, the Division's position with regard to extensions of the compliance schedules for WET, iron and EC/SAR under the current permits—which remain in effect until the renewal permits are final and any appeal regarding those permits is adjudicated—is untenable. XTO and Pioneer believe that the Division is estopped—based on specific representations from the Division that it would consider Pioneer and XTO's earlier requests for permit modifications in a timely fashion during the permit renewal process—from asserting that the time for requesting a stay of these compliance deadlines is passed. Absent an agreement from the Division to either grant a stay of those deadlines upon a timely-submitted request for administrative reconsideration or to extend those deadlines sufficiently to allow for issuance and potential appeal of the renewal permits, XTO and Pioneer are being forced by the Division to file for judicial review of the denial of the stays in order to preserve their rights.

REQUEST FOR STAY AND REQUEST FOR AN EXTENSION OF PERMIT REQUIREMENTS

Division's Counter-Proposal: *In your email dated March 30, 2015 you stated that you are expecting follow-up on "actions to stay portions of the administrative processes and appeals, and extend the existing permit requirements scheduled to become effective July 2015." As stated in the Division's March 19, 2015 denials, the Division does not have the authority to stay XTO's and Pioneer's current permit terms because the deadline to request a stay has passed. The Division's authority to issue a stay is limited to respond to requests for stays that are made within the statutory timeframe after final action by the Division. In this case the request is either well beyond that statutory timeframe for prior permit actions, or before final agency action on the current draft renewal permits.*

Additionally, the Division will not modify the administratively extended permits, which will result in the compliance schedules expiring and the underlying limits becoming effective in July. The Division understands that the companies are concerned about their ability to meet the terms and conditions in the current permits beginning in July. For this reason we recognize the need to move quickly to schedule and complete the facilitated discussion. We also recognize that having new permits in place by July may still be difficult. We believe there may be an option that may be available that we could pursue should we find that additional time is needed to issue the final permits. We can explore that option with you at the appropriate time.

RESPONSE: Our request to stay portions of the administrative process was to put them "on hold" during a period for the facilitated conversation. By staying the administrative

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and judicial processes, neither party would abandon its legal rights. We outlined in our discussion on March 26th how these items would be placed "on hold" by our proposal. If the Division accepted reconsideration of the Denial Orders then the appeal deadline would be tolled during the reconsideration (which could match the time of the facilitated conversations). The permit comment period could have been extended.

Most importantly, the Companies requested as the first step that the Division extend the deadline in the current permits from July 1, 2015 to October 2017. In its response, the Division has refused to undertake actions "to hold" the current process for appeal; and denied extensions of the July 1, 2015 deadlines even though it is recognized that meeting those dates "may be difficult." The Division has refused this request in spite of express statements from the Division that the July 1, 2015 deadline was (when adopted) far enough in the future to justify the Division's refusal to consider XTO and Pioneer's requests to modify the current permits and to address the issues of WET, iron and EC/SAR exclusively through the permit renewal process.

Our request was that the Division issue modifications to the current permit limits for boron, EC, SAR, WET and iron limits that would become effective on July 1, 2015. The Division has the authority to modify permits, even while on administrative extension. (*See memo attached.*)

During our conversation prior to this email, you commented that the Division could use its enforcement discretion when the Companies exceeded the permit limits after July 1, 2015. As I noted, this does not protect the Companies from enforcement by EPA or citizen suits. And, the Companies would risk knowing violations, which could be criminal. For those reasons, enforcement discretion is not an acceptable alternative. If there are other "options" that would not put the Companies in the above-described "no win" situations, we would welcome hearing those suggestions.

Sincerely,



Ronda L. Sandquist

cc: Ms. Martha Rudolph
Dr. Larry Wolk

Attachment

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