

## Litigation Update

YOUR MONTHLY LINK to THE SECTION of LITIGATION

### HOT TOPICS

#### **Colorado Decision to Shut Down Coal Bed Methane Production?**

*By Katherine W. Wittenberg and Susan L. Aldridge*

In a July 2007 decision, a judge in a southwestern Colorado water court issued an order that could slow coal-bed methane (CBM) production and lead to delayed or derailed CBM production in the Rocky Mountain region. The opinion, from the district court for the Seventh Water Division of Colorado, concludes that the diversion of ground water during CBM extraction requires a well permit and augmentation plan. Although CBM drilling could increase America's self reliance with regard to energy, this decision could prompt oil and gas companies that also produce CBM to question the worth of continued CBM production in Colorado or any other state that follows its lead.

#### **CBM production**

Methane is the primary component of natural gas; CBM is simply methane found in coal seams. Extraction of CBM involves pumping water out of the coal seams to reduce the reservoir pressure, which permits the recovery of the gas. The water brought to the surface and then reinjected to the subsurface is an unavoidable byproduct of the CBM recovery process. Often the water removed during CBM production cannot be used beneficially for irrigation or consumption due to high saline content.

#### **Why is CBM being produced now?**

Exploration and production of natural gas accords with current National Energy Policy, which calls for federal agencies to develop a national energy policy to help the private sector, and even state and local governments, "promote dependable, affordable, and environmentally sound production and distribution of energy for the future." Due to its availability, the presence of an existing market delivery infrastructure, and the environmental advantages of clean-burning gas, natural gas is an important part of the national energy supply.

#### **Conflict between CMB production and a state's water rights system**

Water rights in Colorado, like those in other Western states, depend on the "prior appropriation" doctrine, namely that the first in time to appropriate the water has the first priority for its use. Thus, in Colorado, if an established water supply is not physically and economically feasible for a new project, the new project may obtain a junior water supply from wells or through stream diversions by "augmenting" or increasing the water supply in the stream through a court-approved plan of augmentation. With this background, the recent water court decision becomes very interesting, even to those outside the jurisdiction of this Colorado district.

#### **Water court decision: Vance v. Simpson**

In November 2005, two ranchers in southwest Colorado filed a declaratory relief action seeking a determination that ground water diverted in the process of extracting CBM is tributary to surface streams and thus part of the "waters of the state" thereby requiring CBM producers to comply with state water laws. The state water laws at issue are the Water Right Determination and Administration Act of 1969 (1969 Water Act) and the Colorado Ground Water Management Act (Ground Water Act), which would require, according to plaintiffs, well permits and augmentation plans when ground water is diverted

during the course of CBM development.

Although the suit was directed against the state functionaries (state engineers) responsible for administering water rights, BP America (which has wells in the area) intervened, supporting the state engineers' position that the Colorado Oil and Gas Conservation Commission (COGCC) has the exclusive authority to regulate oil and gas wells within the state.

### **Legal arguments and the decision**

The parties agreed that the issues raised by plaintiffs' lawsuit were legal ones, subject to summary judgment. In the decision, the court first concluded that the diversion or production of water in the course of CBM development is subject to the state water laws, and that the COGCC does not have the exclusive authority to regulate oil and gas wells, as well as their exploration and production waste. Thus, CBM production is subject to state water laws; specifically the 1969 Water Act and the Ground Water Act.

The court found that although the Colorado Oil and Gas Conservation Act clearly has jurisdiction to regulate all oil and gas operations, and may permit and regulate oil and gas wells, there is nothing in the act that excludes application of the 1969 Water Act with respect to diversion of water that is in or tributary to natural surface streams. Instead, the court concluded, the COGCC has authority to regulate disposal only of produced water. However, the 1969 Water Act provides the framework to implement the right to divert unappropriated stream and tributary ground waters of the state to beneficial uses.

### **Appropriation of water**

The court next examined whether the diversion of water in connection with CBM production is an appropriation of water and concluded that the pumping of water during CBM production is an application of state water for beneficial use within the meaning of the 1969 Water Act.

BP America, relying on *Santa Fe Trial Ranches Property Owners Ass'n. v. Simpson*, 990 P.2d 46 (Colo. 1999), argued that mere diversion of water does not constitute a water right if it is not beneficially used because actual beneficial use provides the basis, measure, and limit of an appropriation. Because the ground water is withdrawn initially as a byproduct of the process, BP argued, such water is a byproduct of the operation. Therefore, it is not applied to beneficial use.

According to the court, "appropriation is the application of a specified portion of the waters of the state to a beneficial use pursuant to the procedures prescribed by Colorado law." The fact that the diversion of water is inadvertent does not mean that an appropriation has not occurred. The court ultimately concluded that what constitutes beneficial use depends on specific circumstances of the case. But in evaluating whether the water has been put to a "beneficial use," the phrase should be interpreted broadly.

### **Ground Water Act**

The court next concluded that a CBM drilling operation that removes ground water does not constitute a "well" under the Ground Water Act, relying on the act's definition of a well as any structure or device used for the purpose or with the effect of obtaining ground water for beneficial use from an aquifer. The court disregarded arguments that the water produced in the drilling operation is not the object, and instead contended that the effect of the drilling operation is to obtain ground water from the aquifer. The court thusly rejected the argument that a structure diverting water without applying it to a beneficial use is clearly not a water well for purposes of the statute and permitting requirements.

### **State engineer's construction of the statute**

The court concluded that because the statute is silent on whether a court should defer to the state engineer with respect to interpretation of a statute, the agency position is not entitled to deference. Moreover, the court held that the state engineer had wrongly interpreted the statute, and the court's deference in the face of "statutory language . . . so clear as to compel [a] contrary result" would be inappropriate.

In so ruling, the court rejected BP America's concern that the CBM industry has consistently relied on the state's express and long-standing position that CBM wells are subject to comprehensive permitting by the COGCC and other state and federal agencies—but not subject to regulation and permit requirements under the state water laws. The court also disregarded BP America's point regarding inconsistent treatment across state lines or in other areas of the state (e.g., no

well permits are required for CBM production in New Mexico or other, nontributary areas in Colorado).

### **Evidence regarding non-tributariness**

Finally, the court disregarded evidence regarding whether the water was non-tributary and determined that the proper forum to present evidence of non-tributariness is before the state engineer in the context of a permit application or in the context of a water right application.

### **Significance of the decision**

"Colorado water law emphasizes 'the adjudication and administration of decreed water rights in order of their priority' while 'maximizing the use of Colorado's limited water supply for as many decreed uses as possible,' consistent with the state's obligations vis-à-vis other states." *Empire Lodge Homeowners' Ass'n v. Moyer*, 39 P.3d 1139, 1150 (Colo. 2001). If this new water court decision is followed by other courts, drilling difficulties for CBM producers could involve more than simply the challenging logistics of extracting the gas.

### **Post Script**

The state and local functionaries involved in the *Vance* lawsuit have filed motions that could delay the effect of the Water Court decision. On July 17, the state engineer and Water Division engineer sought clarification and modification of the court's order, along with a motion to stay enforcement of the judgment. BP America joined in these motions. The state engineers have also expressed their intent to appeal the decision.

The state officials argued that while the summary judgment motions on which the court based its order addressed only the issue of "whether the State Engineer has jurisdiction over the produced water that is a by-product of oil and gas drilling, specifically [CBM] drilling," the court's order granted plaintiffs all "the relief requested in the [*Vance*] Complaint, as amended," thereby awarding plaintiffs relief beyond that sought in their summary judgment motion. The state officials also expressed their intent to appeal the court's order, noting repercussions that may result from the court's order. According to the state officials, the Water Court's decision: reverses the official policy and legal position held by the State of Colorado and the Engineers for several decades; is inconsistent with laws of neighboring New Mexico where part of the San Juan Basin is located; would require a major change in Colorado oil and gas operators' business practices; would require an overhaul of the well permitting obligations of the state, resulting in a flood of new applicants that would overwhelm resources; and would curtail the operations and income of local business related to CBM production, thereby depleting tax revenue to local communities. According to state officials, the orderly and predictable administration of water resources requires the Colorado Supreme Court to resolve this difficult issue.

BP America points out that although CBM producers in the state are not bound by the water court decision, BP America's opportunity to relitigate the question will be restricted by the res judicata or stare decisis effect of the court's order. BP America also intends to appeal the decision and argues that a stay of the order pending appeal is necessary to avoid adverse effects on natural gas production in the area.

---

Authors Katherine W. Wittenberg and Susan L. Aldridge are Members of Beatty & Wozniak, P.C., a Denver based law firm focused on energy and natural resources law.

### **Call for authors! Have a hot topic of interest to our readers? Want to write about it?**

Editors Daniel S. Wittenberg and Michael D. Yablonski welcome your input for future issues of Hot Topics. Please [contact them](#) for further information.