Committee on Resources

Subcommittee on Energy & Mineral Resources

Witness Statement

HEARING BEFORE THE
COMMITTEE ON RESOURCES
Subcommittee on Energy and Minerals
U.S. HOUSE OF REPRESENTATIVES
With respect to HR 4297
Powder River Basin Resource Development Act of 2000
JULY 20, 2000
STATEMENT OF
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I. INTRODUCTION

HR 4297 has been introduced to attempt to resolve conflicts between coal producers and producers of coalbed methane ("CBM") in portions of the Powder River Basin ("PRB"). Effectively, HR 4297 grants coal producers the right to condemn, vent and waste CBM and to deduct the costs of condemnation from payments of their federal coal royalties. Certain oil and gas associations, including the Independent Petroleum Association of Mountain States ("IPAMS"), oppose HR 4297 as drafted. This testimony is offered on behalf of RIM Operating, Inc. and its affiliates ("RIM"), which holds leasehold and operating rights to CBM in the PRB, and on behalf of IPAMS, a non-partisan association representing nearly 1,000 independent oil and natural gas producers, supply companies, bankers and industry consultants in a thirteen state Rocky Mountain region, including the State of Wyoming. IPAMS represents those companies producing the majority of CBM in the Powder River Basin.

RIM and IPAMS recognize and greatly appreciate Representative Cubin's longstanding support of the energy industry. But, as promoted by certain interested parties, HR 4297 itself is ill conceived and counterproductive.

IPAMS and RIM support the BLM's newly implemented formal policy for resolving this type of conflict, IM No. 2000, and believes it should be given the chance to work before congress intervenes and enacts sweeping legislation.

HR 4297 encourages the condemnation, venting and waste of CBM into our atmosphere at taxpayer expense, rather than promoting the cooperative production and recovery of all valuable energy resources. HR 4297 delegates the sovereign's power of condemnation to private coal companies, including in particular

a huge multinational corporation based in England, and allows that power and federal funds to be used to terminate vested senior property rights held by smaller domestic oil and gas companies. The bill erodes the sanctity of private property and the certainty of rights that have allowed parties to invest with security in the development of our country's natural resources and sets a dangerous precedent for management of our public lands and resources.

HR 4297 unnecessarily involves the Federal government, Federal legislation and Federal subsidies in what is essentially a private and local dispute that can readily and equitably be resolved through private agreement, as many similar conflicts have routinely been resolved in the past. Without the inducement of the "better deal" that certain coal companies hope to obtain through HR 4297 at taxpayer expense, outstanding conflicts in the PRB could quickly be resolved through private negotiation and agreement, with no delays whatsoever to coal operations. Such agreements can provide for the cooperative recovery of coal and CBM and have already been successfully negotiated and implemented in the PRB.

HR 4297 is a bad bill for the environment and for the prudent stewardship of our non-renewable natural resources. The bill encourages the condemnation and venting into the atmosphere of substantial amounts of methane, one of the most potent greenhouse gases. The detrimental effects of this venting on the environment are not fully understood. At the same time, the bill allows large volumes of CBM to be lost and wasted forever, rather than captured and put to beneficial use as a clean burning fuel. In order to meet the dramatically increasing demand for natural gas in the United States, we need to develop policies that encourage the recovery of this valuable non-renewable resource, not enact legislation that results in its irrevocable loss for all generations.

HR 4297 is also a bad bill for the Federal budget. Not only will Federal royalties on coal be reduced to reimburse coal companies for amounts paid to condemn CBM, but no royalties or taxes will be paid on the CBM that is condemned and vented rather than produced.

If, notwithstanding the serious policy issues outlined above, Congress is intent on enacting condemnation legislation, HR 4297 nevertheless contains serious flaws and inequities. HR 4297 does not provide full or fair compensation to CBM lessees for the loss of their resource. The bill requires that compensation be paid for only a small portion of the CBM that will actually be lost and wasted as a result of coal mining. HR 4297 is convoluted, difficult to understand and embodies certain other procedural and constitutional shortcomings. Even more disturbingly, HR 4297 has been promoted based upon certain distortions and misrepresentations, particularly regarding the purported need for condemnation legislation.

RIM and IPAMS welcome this opportunity to set the record straight. RIM and IPAMS believe that HR 4297 must be taken off the "fast track" and that certain facets and implications of the bill, including those discussed below in this testimony, must be carefully considered.

II. BACKGROUND

The conflict between coal and CBM operators in the PRB has focused upon an area of Campbell County, Wyoming covered by the Hilight oil and gas field (the "Hilight Field")[(1)]. In order to understand the present conflict, it is essential to understand recent events relating to the Hilight Field and the manner in which conflicts have been successfully resolved to date.

The Hilight Field has been producing oil and gas, primarily from deep formations, for several decades. In the past six years, production of gas from the Hilight Field has increased approximately four-fold and

numerous wells that were previously shut-in have been returned to production. This increase in production is attributable partially to secondary recovery of deep gas and partially to the development of CBM, which has become highly attractive and valuable due to the recent construction and commissioning of pipelines and gas gathering facilities.

The oil and gas unit at the southern end of the Hilight Field is known as the South Hilight Unit (the "SHU"). RIM holds leasehold and operating rights to CBM in the SHU, primarily under senior Federal oil and gas leases dating back to the 1960s. M&K Oil Company ("M&K") holds leasehold and operating rights to the deep oil and gas within the SHU under the same leases.

Two major coal companies, Arch Coal Company and its affiliates ("Arch") and Kennecott Energy Company and its affiliates ("Kennecott") have surface coal mines in the area. Arch's Black Thunder Mine has been approaching the SHU from the south and Kennecott's Jacobs Ranch Mine has been approaching the SHU from the southeast.

The potential conflict between the oil and gas operators and the coal operators came to a head in connection with the issuance of the Thundercloud Federal Coal Lease (WYW 136458, referred to hereinafter as the "Thundercloud Coal Lease") effective as of January 1, 1999. The Thundercloud Coal Lease covers lands within and immediately adjacent to the SHU, including substantial acreage covered by RIM's and M&K's senior oil and gas leases. The Thundercloud Coal Lease itself was issued to Arch, but on April 29, 1999, the Bureau of Land Management ("BLM") approved an assignment of a portion of the Thundercloud Coal Lease to Kennecott.[(2)]

RIM was understandably quite concerned about the issuance of the Thundercloud Coal Lease. Surface coal mining within the SHU would cause the irretrievable venting and waste of the CBM resource. Coal mining destroys the reservoir in which the CBM resides and directly vents CBM into the atmosphere. Moreover, the exposure of the coal seam causes a drop in reservoir pressure. This acts like a hole in a tire, and CBM from throughout the area will flow through the porous coal structure to the mine face and be lost through venting. RIM has provided to the BLM a rigorous study which establishes that, even prior to the initiation of mining on the Thundercloud Coal Lease, the Jacobs Ranch and Black Thunder Mines were causing the drainage, venting and loss of in excess of 500 million cubic feet of CBM from the SHU per year.[(3)] This study was accepted and approved by the BLM.[(4)] Surface coal mining on the Thundercloud Coal Lease would permanently and irrevocably devastate both the CBM resource within the SHU and RIM's vested senior leasehold rights.

The potential conflict between CBM and coal was well anticipated in the administrative process leading up to the issuance of the Thundercloud Coal Lease. The Environmental Impact Statement for the Thundercloud Coal Lease (the "EIS") repeatedly notes that surface coal mining would result in the irretrievable loss of CBM and Appendix H to the EIS estimates that the Thundercloud Tract contains between 1.7 and 5 billion cubic feet of CBM. Both the EIS[(5)] and the Record of Decision dated July 15, 1998 authorizing the Thundercloud Coal Lease (the "ROD")[(6)] explained that this conflict would be handled by a lease stipulation (the "Senior Rights Stipulation"), which expressly prohibits the approval of coal mining operations that unreasonably interfere with orderly development and production under senior oil and gas leases. In accordance with well established policies and regulations of the Department of the Interior and fundamental tenets of property law, the ROD also explained that the conflicts that would inevitably ensue between the senior oil and gas lessees and the junior coal lessees would be resolved in favor of the senior lessees in accordance with the "first in time, first in right" principle.[(7)] Accordingly, the coal lessees clearly understood

that they would take their rights under the Thundercloud Coal Lease subject to the senior oil and gas leases and with an obligation not to interfere with the oil and gas lessees' pre-existing right to fully develop and produce their resource.

The Senior Rights Stipulation was duly included in the Thundercloud Coal Lease and the BLM assured RIM that "these stipulations are all that's necessary to ensure that the 'first in time, first in right' policy can be implemented if conflicts arise between oil and gas and coal on the Thundercloud tract."(8)

Following the issuance of the Thundercloud Coal Lease, the BLM and the State of Wyoming encouraged negotiations to resolve operational conflicts on the Thundercloud Tract. In April 1999, at the suggestion of the Powder River Basin Regional Coal Team, the BLM convened a federally supervised mediation involving coal companies (including Arch and Kennecott), oil and gas producers (including RIM and M&K), the State of Wyoming and Federal agencies (including the BLM and the Minerals Management Service). At the Federal mediation, the BLM re-emphasized that intractable conflicts would be resolved by the BLM on the basis of the "first in time, first in right" doctrine, but urged the parties to negotiate consensual agreements that would: (i) allow surface coal mine operations to proceed; (ii) encourage the cooperative and contemporaneous production of both coal and oil and gas; and (iii) fairly compensate the senior oil and gas lessees for resources unavoidably lost due to the advancing coal mines. While productive discussions were held between certain parties, the mediation did not immediately result in any agreements.

On May 21, 1999, the BLM sent representatives of Arch, Kennecott, RIM and M&K a letter indicating that the BLM would not, at least for the time being, approve any APD permits (for CBM or oil and gas drilling) or R2P2 permits (for surface coal mining operations) on the Thundercloud Tract.(9) Confronted with this obstacle to their respective operations on the Thundercloud Tract, Arch and RIM entered into focused negotiations and, three months later, entered into a Joint Development Agreement dated September 1, 1999 (the "JDA"). Kennecott declined to enter into such negotiations.

The JDA demonstrates clearly both that coal companies in the PRB do not need the right of condemnation and that consensual agreements can provide a vastly superior resolution. The JDA was accomplished through creative and good faith negotiations between Arch and RIM, with significant support, involvement and encouragement from the State of Wyoming and the BLM. While the JDA may not represent an ideal outcome for either Arch or RIM, and while some degree of necessity and urgency may have been required to bring the parties together and get the deal done, it is nevertheless an essentially fair and equitable compromise and results in the cooperative production of both coal and oil and gas.

Following the execution of the JDA, each of Arch, RIM, the State of Wyoming and the BLM entered into a Memorandum of Understanding (the "MOU") which formally acknowledges, supports and blesses the JDA. In the MOU, the State and the BLM acknowledged and confirmed the "appropriateness of the arrangements and agreements between Arch and RIM." In cover letters, the BLM acknowledged its participation in the mediation process and stated its belief that "this agreement is a reasonable attempt to optimize production of both resources from the Thundercloud lease"(10) and the State of Wyoming commented that it "has supported the process, believes that the agreement is a rational solution to the conflict and is willing to be a signatory to the agreement."(11)

In contrast to HR 4297, which encourages the condemnation, venting and waste of CBM so that coal can be produced, the JDA encourages the cooperative production of both of these non-renewable energy resources. Under the JDA, Arch (which is the junior lessee) is allowed to pursue its surface coal mining operations without interference, restriction or delay and RIM is encouraged to drill and operate CBM wells in advance

of the coal mine. The parties work closely together to coordinate their respective operations and use of surface facilities (which cooperation cannot effectively be mandated by Federal legislation). When the face of Arch's coal mine comes within a critical distance of a CBM well, RIM is required to curtail production and abandon the well. In consideration, Arch compensates RIM for the loss of remaining production.

Both Arch and RIM have recognized that the value of RIM's CBM wells will be dramatically impacted by the approach of Arch's surface coal mine. As a surface coal mine approaches a CBM well, reservoir pressure is reduced and CBM throughout the area is drawn to the mine face and vented into the atmosphere. By the time that the coal mine arrives, a CBM well will be rendered virtually worthless. Accordingly, the JDA values lost production by reference to a model CBM well for the area, with stated characteristics of quantity and life of production. This model reflects an estimate of the producing characteristics of a local CBM well unaffected by surface coal mining operations. Under the JDA, the amount of production lost from a CBM well at the end of its fourth year, for example, is established by determining the amount of production remaining in the model well after year four. The value of that lost production is then reduced to present value by application of a discount rate.

The JDA has obvious benefits for all parties concerned. Although it is the junior lessee that took its coal lease subject to the obligation not to interfere with the operations or resources of the senior oil and gas lessees, Arch obtained the right to advance its surface coal mine without restriction, delay or limitation. RIM is allowed to drill CBM wells and to produce as much CBM as possible in advance of the coal mine and is compensated for CBM resources that are unavoidably lost. The State and Federal governments receive prompt and full payment of royalties and taxes on the expedited production of the entire coal resource, on the portion of the CBM resource that is actually produced by RIM and on payments made by Arch to RIM for CBM that cannot be recovered from wells that must be abandoned. The government and its resources are not tied up in a cumbersome and inappropriate condemnation scheme and the coal and oil and gas operators work together in a cooperative, rather than an adversarial, relationship. Most importantly, the JDA encourages the production and recovery of both coal and CBM and minimizes the waste and venting into the atmosphere of non-renewable energy resources.

While a consensual approach such as the JDA has myriad and obvious benefits, coal companies will not be motivated to enter into such arrangements if they are afforded the right of condemnation at taxpayer expense. As profit motivated businesses, coal companies would certainly prefer to condemn the CBM resource at taxpayer expense than to make payments under a joint development agreement.

RIM also entered into a Joint Development Agreement with an affiliate of Kennecott on July 7, 2000, allowing both companies to conduct their respective operations on 157 acres in the Powder River Basin in Wyoming. RIM holds rights to develop coalbed methane (CBM) in the area pursuant to senior federal oil and gas leases dating from the 1960s. Jacobs Ranch acquired a junior federal coal lease covering the subject land in 1999. The Joint Development Agreement will allow coal mining operations to proceed throughout the conflict acreage without interference or delay and, at the same time, will allow existing CBM wells to produce up until the last possible date.

In order to try to establish a need for condemnation legislation, where none exists, the proponents of HR 4297 have resorted to attacking and misrepresenting the JDA. They allege that Arch was forced to enter into the JDA under duress and that it must pay RIM a "multiplier" of the fair market value of the CBM resource. These are quite simply fabrications and distortions. Consider, in particular, the following facts:

1. In entering into the JDA, Arch was no more under duress than was RIM. Both parties needed to

enter into the JDA in order to obtain permits to operate within the Thundercloud Tract. RIM would have preferred to produce the CBM resource without interference or to receive more adequate compensation for its losses. Neither Arch nor RIM was entirely pleased with the result, but the compromise that was ultimately struck was fair and appropriate;

2. Under the JDA, Arch does not pay for the full value of the existing CBM resource, as would be required in connection with condemnation. Once Arch's coal highwall comes within a critical distance of a CBM well and the well is shut-in, Arch is obligated to compensate RIM only for the loss of remaining production. Arch pays nothing for the value of CBM that can be recovered by RIM in advance of the surface coal mining operation;

3. The amount and value of lost CBM production is determined by reference to a model well for the area. This model well was proposed by Arch, not by RIM, and was based on a BLM study of actual production from 85 CBM wells operating nearby in the PRB;

4. The value of lost production from a CBM well is reduced to present value prior to payment to RIM at an extremely high discount rate. The applicable discount rate is defined as nine percentage points above the "Ask Yield" for U.S. treasury notes with a maturity of ten years. At present, this discount rate is approximately 17% per year;

5. In order for any compensation to be payable to RIM for the loss of a CBM well, the well must be drilled prior to January 1, 2002. Otherwise, Arch pays RIM nothing at all for the loss of a CBM well; and

6. The BLM and the State of Wyoming encouraged and supported the JDA and executed the MOU which affirmatively blesses it.

Based upon these facts and provisions, as well as others, it should be clear that the JDA does not require Arch to pay more than the fair market value of the CBM resource. In fact, RIM receives significantly less than the fair market value of the resource. As the actions and concurrence of Arch, the BLM and the State of Wyoming suggest, the JDA presents a viable, balanced and equitable mechanism to resolve disputes between coal and CBM operators in the PRB. Kennecott has merely chosen to pursue publicly funded condemnation under HR 4297 because it provides a better economic deal for Kennecott.

Many of the conflicts that have arisen to date between coal and oil and gas producers in the PRB have already been resolved by consensual agreement. In addition to the JDA between Arch and RIM in the South Hilight Unit, Arch and RIM have reached a contractual settlement in the Jayson Unit, at the northern end of the Hilight Field. We have also reached agreement with Kennecott on the Assigned Lands in the South Hilight Unit. We also understand that Kennecott and M&K reached a tentative settlement regarding their conflict over deep oil and gas in the South Hilight Unit. Contractual solutions have worked and are working in the PRB. Once the disincentive of HR 4297 is removed, there is every reason to believe that the few outstanding conflicts remaining will also be resolved contractually. There is simply no need for intervention by Congress or the enactment of Federal condemnation legislation.

III. MAJOR PROBLEMS WITH HR 4297

A. Federal Condemnation Legislation Is Unnecessary and Inappropriate; It Discourages Both the Resolution of Conflicts by Private Agreements and the Cooperative Development of Coal and CBM.

Federal condemnation legislation is not needed in order to resolve conflicts between coal and oil and gas operators in the PRB. The BLM and the State of Wyoming have existing and prospective policies to address these conflicts.(12) These policies have been carefully developed over a number of years and give appropriate and constitutionally required consideration to issues such as the protection of vested property rights. Under the system that has evolved, junior lessees take their leases subject to the express obligation not to interfere unreasonably with orderly development and production under senior leases for other resources.

In situations where the junior lessee controls the more valuable resource and cannot effectively operate without unduly interfering with the resources or operations of a vested senior lessee, the parties have customarily and routinely entered into agreements whereby the junior lessee buys-out the senior lessee or the parties otherwise agree upon mutually satisfactory arrangements for joint development of their respective resources. This system, in which conflicts are ultimately resolved by private agreement, has worked well over the years in several different locations and in connection with conflicts between various resources. In fact, this system has already worked effectively to resolve conflicts between coal and oil and gas operators in the PRB.

HR 4297 discourages both the resolution of conflicts by private agreement and the cooperative development of coal and CBM. Private agreements, such as the JDA between Arch and RIM, allow surface coal mining operations to proceed without delay or interference, encourage the production and recovery of CBM in advance of coal mining and provide for the payment of appropriate compensation for resources that are unavoidably lost. There are obvious benefits for all parties involved. However, if coal companies are afforded the right to condemn the CBM resource at taxpayer expense, they will not be motivated to enter into such arrangements.

HR 4297 unnecessarily involves the Federal government, Federal legislation and Federal subsidies in what is essentially a private and local dispute that can readily and equitably be resolved through private agreement, as many similar conflicts have routinely been resolved in the past. Without the inducement of the "better deal" that certain coal companies hope to obtain through HR 4297 at taxpayer expense, outstanding conflicts in the PRB would quickly be resolved through private negotiation and agreement, with no delays whatsoever to coal operations and without the use of Federal funds. Such agreements can provide for the cooperative recovery of coal and CBM.

B. Granting Coal Companies the Right of Condemnation Is Inconsistent With the Sanctity and Priority of Private Property Rights on Which our System is Based and Sets a Dangerous and Inappropriate Precedent.

HR 4297 delegates the sovereign's power of condemnation to private coal companies, including a huge multinational corporation based in England, and allows that power and Federal funds to be used to terminate vested senior property rights held by smaller domestic oil and gas companies. The bill erodes the sanctity of private property and the certainty of rights that have allowed parties to invest with security in the development of our country's natural resources.

HR 4297 also sets a dangerous precedent for the manner in which we manage our public lands and resources. If coal companies are granted the right of condemnation in the PRB, a strong argument can and will be made that other conflicts between competing mineral developers (and, for that matter, conflicts between other competing land uses and values) should be resolved in the same way. In a system that relies

on condemnation to resolve conflicts, rather than the priority of property rights, the big and politically powerful will always prevail over smaller interests. Moreover, because of the insecurity and uncertainty inherent in such a system, few will be willing to invest in the development of our natural resources. Our traditional system, based on the sanctity and priority of property rights, has worked well and does not need to be replaced by a condemnation system.

Implementation of a condemnation solution is a radical and global fix to what is essentially the local problem of a foreign-owned coal company. That company has available to it a more appropriate contractual solution, which has already been embraced by a major coal company, the BLM and the State of Wyoming. The right of condemnation must only be granted to private companies in exceedingly rare and unique circumstances and where absolutely required by a compelling public interest. As discussed throughout this testimony, coal companies simply do not need the right to condemn CBM in the PRB.

C. HR 4297 Will Encourage the Venting of Methane, a Potent Greenhouse Gas, Into the Environment.

HR 4297 encourages coal producers to condemn and vent CBM into the atmosphere at taxpayer expense. There will be no incentive for coal companies to enter into joint development agreements for the cooperative development and recovery of CBM in advance of coal mining. Coalbed methane is one of the most potent greenhouse gases and contributes significantly to global warming when released into the atmosphere. It has been estimated, on behalf of the United States Department of Energy, that methane is 56 times more detrimental to the environment (in terms of global warming potential) than CO_2.(13) It has also been estimated, in a study approved by the BLM, that the Jacobs Ranch and Black Thunder Mines alone are venting 2.3 million cubic feet of CBM per day.(14) While the environmental effects of this venting are not yet fully understood, it is clearly unwise to encourage such emissions through the enactment of Federal legislation.

D. HR 4297 Will Encourage the Waste of CBM, A Clean-burning and Non-Renewable Energy Resource.

When captured and put to beneficial use, CBM is one of the cleanest burning fuel resources. HR 4297 encourages large volumes of this non-renewable energy resource to be condemned, lost and wasted forever.

In a recent study entitled "Meeting the Challenges of the Nation's Growing Natural Gas Demand," dated December 25, 1999, the National Petroleum Council estimated that, while the United States currently produces only 22 trillion cubic feet of natural gas annually, by the year 2015 the anticipated demand will reach 31 trillion cubic feet. In order to meet this growing demand, production of natural gas must be dramatically increased.

CBM resources, especially in the Rocky Mountain region, represent a significant portion of our nation's known and potential gas resources. The Gas Research Institute estimates that the amount of CBM gas in place in the PRB is 39 trillion cubic feet, of which 9.4 trillion cubic feet is recoverable. The Gas Research Institute further estimates that, if properly developed, this resource could yield $5.3 billion in production taxes and royalties alone. A substantial investment has already been made in the development of CBM in the PRB. The Wyoming Independent Producers Association estimates that Wyoming CBM developers have invested approximately $290 million to date in drilling and completion costs and another $400 million in lease acquisitions (60% Federal, 35% fee and 5% State). Within the next year, another $295 million will be invested in pipelines and compression stations. When the Fort Union and Thunder Creek Pipelines are operating at their maximum capacity of 1 billion cubic feet per day, which is five times greater than the rate at which they are currently operating, the State of Wyoming and producing counties can expect

approximately $380,000 per day in tax revenues and royalties at today's natural gas price. But the realization of these benefits is dependent upon the implementation of policies and practices that encourage and allow the production of the CBM resource.

In keeping with fundamental notions of good stewardship of our country's non-renewable natural resources, and in order to meet the dramatically increasing demand for natural gas in the United States, we need to develop policies that encourage the recovery of this valuable and clean-burning energy resource, not enact legislation that results in its irrevocable loss for all generations.

E. Pursuant to HR 4297, Federal Funds Are Used to Condemn CBM On Behalf of Coal Producers; Royalties and Taxes on CBM Are Also Lost.

HR 4297 provides that amounts paid by coal companies to condemn CBM may be recovered by deductions from their Federal coal production royalties. Effectively, the taxpayers will be paying condemnation awards on behalf of the coal companies. Additionally, both the State and Federal governments are forced to forego the collection of production royalties and taxes on CBM that is condemned rather than produced. RIM estimates that, for the 5,200 acres covered by the JDA between Arch and RIM, the cumulative cost to the Federal government of HR 4297 would have been $22.6 million. This area is less than one fifth of one percent of the total acreage covered by HR 4297.

In contrast, pursuant to cooperative development agreements such as the JDA between Arch and RIM, the State and Federal governments receive prompt and full payment of royalties and taxes on the production of the entire coal resource, on the portion of the CBM resource that is actually produced in advance of the coal mine and on payments made to the CBM operator for CBM that cannot be recovered from wells that must be abandoned.

It defies understanding as to why the Federal government should incur these significant fiscal costs in order to assist a huge and foreign-owned multinational corporation to condemn senior oil and gas resources, which would otherwise have been produced and generated significant royalty and tax income to the United States.

F. HR 4297 Does Not Provide Full or Fair Compensation to CBM Lessees for the Loss of Their Resource; The Bill Requires That Compensation Be Paid For Only a Small Portion of the CBM That Will Actually Be Lost and Wasted As a Result of Coal Mining.

HR 4297 requires coal companies only to compensate oil and gas lessees for CBM originally underlying and lost from the specific acreage to be mined. However, as discussed previously, surface coal mining will cause the loss of CBM from a much larger area. RIM has conducted a drainage study which establishes that CBM in the Hilight Field will flow several miles to the exposed face of a coal highwall and be vented into the atmosphere[(15)]. This study has been approved by the BLM.[(16)] CBM lessees must be compensated for all CBM that will be lost and wasted as a result of coal mining on their property, not just the portion of the resource that was originally situated beneath the acreage actually mined. When dealing with a gas in a porous structure, there is no rational basis for distinguishing between lost gas that was originally situated beneath the acreage actually mined and lost gas originally situated beneath adjacent acreage. This would be akin to putting a hole in a tire and then disclaiming responsibility for the loss of air from portions of the tire that are not directly beneath the hole. HR 4297 needs to account for the huge volume of CBM that will be lost through drainage and venting.

This problem is compounded by the fact that HR 4297 allows coal operators to condemn small portions of oil and gas leases in sequential steps, and as needed for their operations, rather than requiring the condemnation of the entire area in one proceeding. This will dramatically reduce the compensation payable for lost CBM. As the coal operator mines one portion of an oil and gas lease, CBM will be drained and vented from the other portions. Then, when the coal operator condemns the next portion of the lease, the CBM resource will be valued at a significantly lower level due to losses of CBM caused by coal mining. In this manner, coal operators will pay for lost production from a CBM well only when their coal mine has come close to the well and destroyed its remaining value. Oil and gas lessees will receive cents on the dollar for the loss of their CBM resource.

The proponents of HR 4297 argue that the CBM operators should be obligated to drill wells to prevent the drainage and venting of CBM and that condemning coal companies should not be obligated to pay for the value of CBM lost from surrounding areas. This position is totally unrealistic. APD permits to drill for CBM have been severely limited and delayed by the regulatory authorities under NEPA and by the coal companies, which often control the surface and refuse to grant access for oil and gas drilling. Even if such wells could be timely drilled, it would not be physically possible to arrest and capture all of the CBM flowing to the exposed face of a coal highwall and being vented into the atmosphere. Moreover, oil and gas lessees cannot be expected to invest in wells that will almost immediately be lost to coal mining.

HR 4297 repeatedly addresses and refers to the conflict between the "production" of oil and gas and the "development" of coal. The bill also provides that oil and gas operators are only compensated for lost "production." This language, drafted by coal interests, suggests that CBM operators may have no rights, including rights to receive compensation, with respect to CBM resources that are in the ground, but which have not yet been drilled and produced. Even if HR 4297 is not construed in this manner, CBM lessees will bear an intolerable burden to establish the quantity and value of CBM lost from lands that have not yet been drilled. This is particularly unfair in view of the fact that CBM operators have often been materially delayed or precluded from drilling by regulatory authorities and/or by coal companies that control the surface of the lands at issue. The ownership of CBM and CBM leases constitute private property subject to the full protections of the United States Constitution, regardless of whether or not yet drilled and producing. HR 4297 needs to provide appropriate mechanisms to test and value the CBM resource in undrilled areas in order to insure that full and fair compensation is paid for the lost resource.

In addition to considerations of equity and fairness, the United States Constitution requires payment of just compensation for private property taken through condemnation. As currently drafted, HR 4297 would be subject to formidable constitutional challenge because it fails to compensate senior oil and gas lessees for a substantial portion of the CBM that would be lost as a result of surface coal mining.

G. HR 4297 Totally Disregards Seniority.

HR 4297 totally disregards the seniority of the condemning and condemned parties. Junior coal lessees, as well as junior oil and gas lessees, took their interests with full knowledge of the existence of a prior lease and of the need to avoid interference. Under HR 4297, not only will junior lessees be allowed to condemn senior lessees, but senior lessees may be required to condemn and pay for junior leases. This would be a totally inappropriate and unjustified windfall for the junior lessees and would impose an additional and unnecessary expense upon the United States, which funds the payment of condemnation awards through deductions from Federal royalties.

H. HR 4297 Requires a Misleading and Irrelevant Analysis in Order to Determine Whether

Condemnation is in the Public Interest.

In order to determine whether condemnation of the CBM estate is in the public interest, HR 4297 requires a misleading and irrelevant comparison between the royalty revenue stream that would result from the production of coal and the royalty revenue stream that would result from the production of CBM. This comparison, which clearly favors the coal industry, improperly assumes that only one of the two resources can be produced. It is true that surface coal mining results in the venting and waste of the CBM resource. But the CBM and coal resources can both be fully recovered (and royalties can be fully paid on both resources) if the CBM is produced first. The production of CBM in no way harms the coal or prevents or limits its future recovery. In fact, CBM operations actually facilitate the subsequent production of coal by dewatering the deposit and capturing and removing methane gases. Accordingly, the public interest determination should properly be made by comparing (i) the value of coal and CBM that could be recovered if CBM operations were declared dominant and allowed to proceed without restriction or delay, with (ii) the value of all coal and CBM that could be recovered if coal mining were declared dominant and allowed to proceed without restriction or delay.

Moreover, because Federal royalties are not paid on the production of private oil and gas, it is inappropriate to determine comparative value by comparing Federal royalties on Federal coal with Federal royalties paid on private oil and gas.

I. HR 4297 Is Convoluted, Difficult to Understand and Embodies Certain Other Procedural and Constitutional Shortcomings.

In order to protect their interests, and receive compensation for lost CBM, oil and gas lessees are required by HR 4297 to initiate actions no later than 210 days prior to commencement of operations under a coal mining plan. This places an intolerable burden upon the oil and gas lessees to know of the existence and timing of every mining plan, particularly because HR 4297 states that a mining plan need not be submitted for approval in order to trigger applicable time limits.

HR 4297 contains numerous provisions and procedures that violate due process, including limitations on rights of appeal, the use of experts paid by interested parties both to establish the condemnation award and to testify in court, and the right of coal operators to commence mining operations prior to the conclusion of proceedings and the payment of a condemnation award.

In addition to containing constitutionally questionable provisions, including the delegation of condemnation rights to private parties, HR 4297 contains complex and unclear terms, tests and standards. This would likely result in significant litigation which, in turn, will delay the resolution of conflicts between resource users in the PRB.

IV. CONCLUSIONS

HR 4297 unnecessarily involves the Federal government, Federal legislation and Federal subsidies in what is essentially a private and local dispute that can readily and equitably be resolved through private agreement. The bill encourages the condemnation, venting and waste of CBM into our atmosphere at taxpayer expense, rather than promoting the cooperative production and recovery of all valuable energy resources. In establishing condemnation as a means to resolve conflicts between resource users, HR 4297 erodes the sanctity of private property rights and sets a dangerous precedent for the management of our public lands. HR 4297 is a bad bill for the environment and for the prudent stewardship of our non-

renewable natural resources. It is also a bad bill for the Federal budget. HR 4297 must be taken off the "fast track" and certain facets and implications of the bill must be considered more carefully. By accomplishing the Joint Development Agreement with Arch and the Joint Development Agreement with Kennecott we have now resolved, in a positive manner, all of the significant and immediate conflicts between coal and CBM under existing leases. Future conflicts could emerge only under new leases that have not yet been issued. If and when such future conflicts develop, we are confident that they can be resolved by agreement in the same way that the existing conflicts have all been resolved. In fact, RIM has contractually committed in its Joint Development Agreement with Kennecott to negotiate in good faith over lands proposed for future coal leasing. Joint development agreements have successfully resolved and will continue to successfully and appropriately resolve all conflicts. **Condemnation legislation, Federal intervention and taxpayer subsidies are simply not appropriate and not needed.**

Thank you for the opportunity to appear before the Committee and to provide this testimony.

FOOTNOTES

1. The Hilight Field is comprised of four oil and gas units: the Grady Unit, the Jayson Unit, the Central Hilight Unit and the South Hilight Unit.

2. The portion of the Thundercloud Coal Lease assigned to Kennecott was given a new serial number (WYW 148123). Pursuant to applicable Federal regulations, at 43 CFR § 3453.2-5, the Assigned Thundercloud Lease constitutes a separate and distinct Federal coal lease on the same terms and conditions as the original Thundercloud Lease.

3. J. Craig Creel, "Drainage of Coalbed Methane Resources, South Hilight Unit-Hilight Field, Campbell County, Wyoming" (March 18, 1999). This study also concludes that the Jacobs Ranch and Black Thunder Mines are venting in excess of 2.3 million cubic feet of CBM per day.

4. Letter from Asghar Shariff, Chief of Wyoming Reservoir Management Group, BLM, to Mr. Stephen Rector of RIM, received May 4, 1999.

5. EIS at Appendix D.

6. ROD at page 13 and in attached draft stipulations.

7. The ROD recognized the potential for conflicts between coal and oil and gas lessees and, at page 13, stated as follows:

The BLM realizes that some conflicts between Federal lessees or their operators are inevitable when multiple mineral leases are issued for the same lands. Our current guidance for dealing with these conflicts is an August 3, 1992 opinion by the Rocky Mountain Regional Office of the Solicitor related to oil and gas and trona development conflicts in the Green River Basin. In that opinion, the Solicitor states: AIn the absence of lease stipulations to the contrary, a development conflict between a gas lessee and a trona lessee must generally be resolved on the basis of the first in time, first in right principle.@

The opinion of the Regional Solicitor referenced in the ROD (the ARegional Solicitor=s Opinion@) deals with this issue in considerably greater detail. The Regional Solicitor=s Opinion explains that:

First in time, first in right simply means that if two separate mineral deposits in the same lands have been issued to two different individuals, the person who first obtained a lease has operating rights superior to those of the owner of the subsequently issued lease.

Regional Solicitor's Opinion, page 1. The Regional Solicitor's Opinion outlines the regulations and case law which form the basis for the BLM's policy of first in time, first in right. The Regional Solicitor's Opinion notes that the reason that there are not more judicial or administrative precedents is because "there has been no serious challenge to the application of the first in time, first in right principle where there is a conflict between existing mineral leases." Regional Solicitor's Opinion, page 3.

The Regional Solicitor's Opinion discusses several regulations of the BLM which provide that, where a pre-existing lease exists for

one mineral, a subsequent lease for another mineral may only be issued "with suitable stipulations for simultaneous operations." Regional Solicitor=s Opinion, pages 1 and 2. For example, 43 CFR § 3400.1(b) provides that a coal lease may not be issued for lands on which there is a pre-existing lease for another mineral resource, unless the coal lease includes "suitable stipulations for simultaneous operations." In considering the import of these regulations, the Regional Solicitor's Opinion concludes as follows:

The clear implication of these regulations, which provide for the issuance of a second lease only if it includes Asuitable stipulations for simultaneous operation,@ is that **the operating rights of a subsequent mineral lessee are subordinate to those of a prior lessee. . . . [A]n oil and gas lease could be issued for the lands embraced by [a prior] trona lease only if Asuitable stipulations@ i.e., stipulations which would allow the oil and gas development without interfering with the trona lessee's prior existing right to fully exploit the resource he had leased, are included in the oil and gas lease.** See 2 Am. L. of Mining ' 200.04[2][d][i]. As written, the regulations do not require a first lessee to subordinate his or her right to fully develop the mineral deposits included in the first lease to the development rights of the subsequent lessee of another mineral. It is the subsequent lease that must be issued with Asuitable stipulations for simultaneous operation." [*Emphasis added*.] Regional Solicitor's Opinion, pages 2-3.

The Regional Solicitor=s Opinion also discusses certain BLM regulations, such as 43 CFR § 3500.6, which provides that:

Each permit or lease shall reserve the right to allow any other uses, or to allow disposal, of the leased lands that will not unreasonably interfere with the exploration and mining operations of the permittee or lessee . . . . [*Emphasis added*.]

The clear implication of such regulations is that subsequent mineral leases may not be issued that allow operations which "unreasonably interfere with the exploration and mining operations of the" senior lessee. Such regulations and authorities necessitated the inclusion of the Senior Rights Stipulation in the Thundercloud Coal Lease.

The "first in time, first in right" policy is predicated upon and required by fundamental tenets of property law. An oil and gas lease issued by the United States constitutes private property subject to the full protections of the United States constitution. The essential rights of a senior oil and gas lessee to fully develop and produce its resource cannot be prejudiced or diminished by the subsequent issuance of rights in the same lands to a third party. Such fundamental principles have been clearly established by a number of cases.

Several decisions of the Interior Board of Land Appeals ("IBLA") confirm that the rights of a senior Federal mineral lessee are superior to and may not be limited, prejudiced or harmed by the issuance or grant of other rights in the same lands to a third party. In Gulf Oil Corp., 73 IBLA 328 (1983), a coal mining company appealed a decision by the BLM to adjust its coal leases so as to allow certain other uses of the lands covered by the leases. The appellant argued, among other things, that the government could not authorize other uses of the land because those uses might interfere with operations under its senior coal leases. The IBLA rejected this argument and held that such provisions were valid "because uses authorized by the provision would still be subject to the lessee's rights." Id. at 334. In other words, no rights subsequently granted to third parties may be exercised in a manner that interferes with the rights of a senior lessee. See also Kaiser Steel Corp., 87 IBLA 228, 233 (1985); Midcontinent Coal Co., 76 IBLA 312, 313 (1983); and Black Hawk Coal Co., 68 IBLA 96, 98 (1982). In each of these cases, the BLM recognized the superior rights of the prior coal lessee over any subsequent lessee or surface owner use.

A corollary of the "first in time, first in right" policy is the generally accepted rule and practice that subsequent leases may not be issued that might interfere unreasonably with operations under a pre-existing senior lease for the same lands. Several regulations and cases follow and support this rule. See, e.g., 43 CFR § 3500.6; Gulf Oil Corp., 73 IBLA 328, 334 (1983); Kaiser Steel Corp., 87 IBLA 228, 233 (1985); Midcontinent Coal Co., 76 IBLA 312, 313 (1983); Black Hawk Coal Co., 68 IBLA 96, 98 (1982).

The Tenth Circuit has also relied on the principle of "first in time, first in right" to address the rights of competing owners of interests in Federal resources. In Transwestern Pipeline Co. v. Kerr McGee Corp., 492 F.2d 878 (10th Cir. 1974), cert. denied, 419 U.S. 1097 (1975), Transwestern Pipeline Company obtained a right-of-way over lands covered by a potash lease previously issued to Kerr McGee. Transwestern developed its right-of-way by constructing a gas pipeline and compressor station. Transwestern subsequently obtained title from the United States to the land upon which it constructed the compressor station and pipeline, subject to a reservation to the United States of "all minerals in the land so granted, together with the right to prospect for, mine, and remove the same as authorized." Several years later, Kerr McGee advised Transwestern that it intended to mine the potash deposits underlying the compressor station and pipeline. Negotiations between the parties failed and Transwestern initiated litigation in an attempt to prevent the mining of the potash. Applying the "first in time, first in right" principle, the 10th Circuit Court of Appeals held as follows:

Since Transwestern opted to build a compressor station on a pipeline system through Section 31, notwithstanding its knowledge of Kerr McGee's lease, its knowledge that subsidence of the land could damage or destroy its station, and its knowledge of the restrictions within its own right-of-way and patent, Transwestern cannot now prevail in its bid for surface support.

492 F.2d at 882. Transwestern clearly establishes that the rights of a senior mineral lessee to fully develop and produce its resource cannot be prejudiced or diminished by the subsequent issuance of rights in the same lands to a third party nor by actions by such third party in furtherance of its rights.

8. December 29, 1998 letter from Robert A. Bennett, Deputy State Director, Minerals and Land, Wyoming State Office of the Bureau of Land Management, to James Aronstein, attorney representing RIM.

9. Letters dated May 21, 1999 from Alan R. Pierson, Wyoming State Director, BLM, to James Aronstein (representing RIM), Morris W. Kegley and Jacobs Ranch Mining Company (all representing Kennecott), Blair M. Gardner and Thunder Basin Coal Company (representing Arch) and Peter A. Bjork and M&K Oil Co., Inc. (representing M&K).

10. Letter dated September 28, 1999 from Alan R. Pierson, Wyoming State Director, BLM, to representatives of Arch, RIM and the State of Wyoming.

11. Letter dated September 27, 1999 from Stephen A. Reynolds, Director of Office of State Lands and Investments, State of Wyoming, to representatives of Arch, RIM and the BLM.

12. We understand that the BLM has been working on refinements to its policies.

13. M. Q. Wang, "GREET (Greenhouse Gases, Regulated Emissions and Energy Use in Transportation) 1.5 - Transportation Fuel Cycle Model" Volume 1, Center for Transportation Research, Energy Systems Division, Argon National Laboratory (August 1999) - work sponsored by the United States Department of Energy, Assistant Secretary for Energy Efficiency and Renewable Energy, Office of Transportation Technologies.

14. See footnotes 3 and 4, supra.

15. See footnote 3, supra.

16. See footnote 4, supra.

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