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Colorado Supreme Court Rules State Water Officials Must Regulate Coal Bed Methane Operations

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In a decision that will have broad implications for oil and gas producers in the state, the Colorado Supreme Court has ruled that the extraction of tributary ground water produced from coal bed methane ("CBM") wells is a "beneficial use" of water that must be regulated under state water laws. The decision in ***Vance, et al. v. Wolfe***, announced on April 20, 2009, also determined that CBM wells producing tributary ground water are, in effect, water wells that require well permits issued by the Colorado State Engineer, and where applicable, a water court-approved plan to replace out-of-priority depletions to impacted stream systems. While the issues squarely before the Court involved CBM wells, the decision may signal the broader application of Colorado water laws to other oil and gas operations in the state.

Vance involves the appeal of a declaratory judgment issued by the Water Court for Water Division 7, which has jurisdiction over all "water matters" in the San Juan River Basin in southwestern Colorado. The Plaintiffs are ranchers and landowners that own surface water rights in the basin, which they claim could be impacted by water withdrawals related to CBM production. Often, coal seams must be dewatered to release the methane gas, and CBM wells typically produce varying amounts of water as a byproduct of the extractive process. After being brought to the surface, the water is usually disposed of through injection wells, evaporation ponds, or by surface discharge. Historically, the State Engineer has refused to regulate produced water on the grounds that it is a waste product the management and disposal of which is subject to the jurisdiction of the Colorado Oil and Gas Conservation Commission ("COGCC").

The concept of beneficial use of water is expressed in the Colorado Constitution and defined broadly in the 1969 Water Right Determination and Administration Act (the "1969 Act"). The application of a specific quantity of the waters of the state to a beneficial use gives rise to an appropriation of a water right, subject to water court adjudication and administration by the State and Division Engineers. In affirming the Water Court's decision, the Court in *Vance* ruled that the mere extraction of water through CBM wells constitutes beneficial use, and an appropriation, of water; thus, CBM wells that produce tributary water are subject to water

well permitting, water court adjudication, and administration in Colorado's water rights priority system. In so ruling, the Court expressly declined to give deference to the State Engineer's long-standing, contrary interpretations of the 1969 Act.

While the *Vance* decision applies specifically to tributary ground water withdrawn during CBM production, the implications of the decision could be broader. Tributary ground water is water which has a hydrologic connection to surface waters. "Nontributary" water produced during certain extractive processes currently qualifies for a statutory exemption to water well permitting requirements, unless the water will be "beneficially used." Because the Court ruled that mere extraction of the water from CBM wells is itself a beneficial use, the *Vance* decision raises at least some concern as to how the statutory exemption with regard to nontributary water may be interpreted in the future.

In anticipation of *Vance*, the Colorado General Assembly is currently considering legislation, House Bill 09-1303, that would provide an orderly process for bringing CBM wells that produce tributary groundwater into the state's well permitting and water rights administration system. Under the legislation, operators of CBM wells that produce tributary groundwater will be required to obtain well permits and administrative approval of plans to replace depletions caused by well pumping, no later than March 31, 2010, and to file with the Water Court an application for approval of long-term "plans for augmentation" no later than December 31, 2012. The legislation also authorizes the State Engineer to adopt rules to assist with regulation of the production of nontributary groundwater by delineating areas of nontributary groundwater withdrawal.

Finally, while the most immediate impacts of the *Vance* decision are limited to CBM wells, the decision may signal potential regulation of tributary water produced from conventional oil and gas wells. Examining the overlapping statutory schemes of the 1969 Act, the Ground Water Management Act, and the Oil and Gas Conservation Act, the Court stated broadly that the "production of oil and gas" is subject not only to regulation by the COGCC, but is also subject to the state's water laws. All oil and gas producers should closely monitor developments in this rapidly evolving area.

Please contact Chris Thorne (303.295.8488) or Bill Caile (303.295.8403) in Holland & Hart's Denver office with questions regarding the *Vance* decision or related matters.

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