

Vance v. Wolfe Adds Water Considerations for Colorado Oil and Gas Producers

DAPL Newsletter, October 2009

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Oil and gas producers in Colorado should be aware of the implications of H.B. 1303, enacted this year by the General Assembly on the heels of the Colorado Supreme Court's April 20, 2009 decision in *Vance v. Wolfe*, 205 P.3d 1165 (Colo. 2009). The Court affirmed the ruling of the District Court, Water Division 7 that water produced from CBM wells is subject to the requirements for permitting, adjudication and administration under the Water Right Determination and Administration Act of 1969 (the "1969 Act") and the Colorado Ground Water Management Act (the "Ground Water Act") (together, the "Acts").<sup>1</sup> In light of this ruling, the Colorado Oil and Gas Conservation Commission (COGCC) can no longer be presumed to have exclusive regulatory authority over water produced from oil and gas wells in Colorado.

The Court in *Vance* approached what it called "the primary question" of the case – "whether CBM production obtains water for a 'beneficial use,' such that it requires a well permit under the Ground Water Act in connection with an 'appropriation' under the 1969 Act" – from the established presumption that all ground water, including water pumped in CBM production, is "tributary" until proven otherwise. *Vance*, 205 P.3d at 1169, 1168 (citing *Safranek v. Limon*, 228 P.2d 975, 977 (Colo.1951)). "In Colorado, ground water that is hydrologically connected to a surface stream is generally considered "tributary"<sup>2</sup> and is subject to the constitutional doctrine of prior appropriation." *In re the Application for Water Rights of Park County Sportsmen's Ranch LLP*, 986 P.2d 262, 265 (Colo.1999). One crucial tenet of the prior appropriation doctrine is the application of any appropriated water to a "beneficial use," defined in the 1969 Act as "the

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<sup>1</sup> C.R.S. §§ 37-92-101 through -602, (2008), and C.R.S. §§ 37-90-101 through -143, C.R.S. (2008), respectively.

<sup>2</sup> As opposed to "nontributary," defined in C.R.S. § 37-90-103(10.5) (2008) as "ground water, located outside the boundaries of any designated ground water basins in existence on January 1, 1985, the withdrawal of which will not, within one hundred years, deplete the flow of a natural stream ... at an annual rate greater than one-tenth of one percent of the annual rate of withdrawal."

use of that amount of water that is reasonable and appropriate under reasonably efficient practices to accomplish without waste the purpose for which the appropriation is lawfully made.”<sup>3</sup> In the Court’s interpretation, “the CBM process ‘uses’ water by extracting it from the ground to ‘accomplish’ a particular ‘purpose’--the release of methane gas. The extraction of water to facilitate CBM production is therefore a ‘beneficial use’ as defined in the 1969 Act.” *Vance*, 205 P.3d at 1167.

Colorado’s Constitution establishes public ownership of the waters within the state, “subject to appropriation,”<sup>4</sup> while prior appropriations principles in Colorado have their origin in territorial laws, predating the constitution.<sup>5</sup> Article XVI, Section 6 of Colorado’s Constitution provides that “the right to divert the unappropriated waters of any natural stream to *beneficial use* shall never be denied,” subject to priority of appropriation. Thus, waters applied to a beneficial use may be appropriated, but only subject to a senior appropriator’s prior rights in the same source. *See Empire Lodge Homeowners' Ass'n v. Moyer*, 39 P.3d 1139 (Colo.2001). When water is extracted in CBM production, such extraction, in and of itself, is a beneficial use requiring the “comprehensive process [of permitting] that provides notice to potentially injured parties and involves the determination [by a court] of whether there is unappropriated water available for appropriation and whether an appropriation can be made without injury.” *Vance*, 205 P.3d at 1172 (citations omitted). No such appropriation can be made without regard for the constitutional and statutory protections for vested rights, at risk of infringement where unpermitted CBM dewatering occurs.

In the Court’s ruling, regardless of whether the water extracted in CBM well dewatering

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<sup>3</sup> C.R.S. § 37-92-103(4) (2008).

<sup>4</sup> Article XVI, Section 5.

<sup>5</sup> *See Farmers' High Line Canal & Reservoir Co. v. Southworth*, 21 P. 1028 (1889); *People ex rel. Park Reservoir Co. v. Hinderlider*, 57 P.2d 894 (1936).

stems from tributary or nontributary sources, the outcome is the same: all water produced from CBM wells is “beneficially used” and thus subject to the permitting process. In contrast, the distinction between “tributary” and “nontributary” offers a critical point of departure for the treatment of oil and non-CBM gas wells in Colorado. It is important to note that the *Vance* ruling does not alter the accepted interpretation of C.R.S. § 37-90-137(7), which requires no permit for nontributary ground water removal in minerals extraction “unless the *nontributary* ground water being removed will be beneficially used.” *Vance*, 205 P.3d at 1171. Since nontributary groundwater falls outside the strictures of prior appropriation, such water can be exempted entirely from regulation by Colorado Statute. *See Park County Sportsmen's Ranch LLP*, 986 P.2d at 269. Thus, where no beneficial use is involved, permitting for any produced water from an oil and gas well in Colorado will turn on the determination of the water as tributary or nontributary.

The Colorado General Assembly introduced H.B. 1303 in March 2009 in anticipation of the Supreme Court’s ruling in *Vance*, that produced water from CBM wells constitutes appropriation of the water for a “beneficial use.” Prior to the ruling, State and Water Court Division Engineers generally did not issue water permits for CBM wells, thought to be under the exclusive purview of the COGCC. In light of the regulatory changes wrought by *Vance*, H.B. 1303 brings three major points of revision to the Acts, beginning with the SEO’s authorization, under the added subsection (c) of the revised § 37-90-137(7), to conduct a rulemaking for establishing criteria for determining the tributary or nontributary status of water produced from oil and gas wells. The State Engineer is also tasked with discovering any deficiencies in the permit status of any current wells, to be corrected by the users thereof within 60 days’ notice. Under revised C.R.S. § 37-90-138(2), this correction requirement will not apply to oil and gas

wells until March 31, 2010.

A second major point of revision is a “time out” period for application of the new statutes to any CBM well, defined under revised C.R.S. § 37-92-103(5.5) as a well permitted under applicable authority “for the primary purpose of producing methane gas from a coal bed.” Substitute water supply plans for CBM wells, under Revised C.R.S. § 37-92-308(11)(a)(I), may be approved by the state engineer during 2010, 2011 and 2012 as set forth in the section in order “[t]o provide sufficient time to integrate coal bed methane wells into the water court adjudication process for augmentation plans. . . .” Under the revised scheme, between March 31, 2010 and December 31, 2012, CBM wells withdrawing tributary ground water and impacting an “over-appropriated” stream will be allowed to operate only under any necessary substitute water supply or “augmentation” plan approved as specified, or where no such plan is necessary. This “time-out” period is a third major point of the changes, after which, beginning in January 1, 2013, any necessary augmentation plan will need to have been approved by the water court, under penalty of curtailment of the well in question. Temporary plans are provided for under subsection (b), with limited provisions under subsection (c) for renewal after December 31, 2012. It is important to note that any permit approval or denial by the State Engineer is subject to challenge and final adjudication by the appropriate water court division.

Prospective options for proving the nontributary status of produced water from oil and gas wells may include hydrologic modeling, or such alternative methodologies as geologic and geophysical mapping, cross sections and other combinations of data, petrophysics and reservoir data, water chemistry, or some combination thereof. The SEO’s initial position is that every oil and gas well in Colorado must either obtain a nontributary (NT) determination or submit a substitute water supply/augmentation plan no later than April 1, 2010. Pursuant to a HB 1303

rulemaking commencing on December 2, 2009, the SEO will hear and decide on “alternative” rules that exempt geographic areas/basins and formations. 2 CCR 402-17. This rulemaking opportunity to obtain NT determinations does not expire, and will be available to operators in basins/formations not reviewed in this initial round of rulemaking.

It will be crucial in the months ahead for oil and gas producers to keep abreast of the developments in the SEO’s rulemaking process for NT determinations. Operators should keep in mind that, while an NT determination for produced water obviates the requirement for a substitute water supply/augmentation plan, application of NT produced water to a “beneficial use” -- such as discharge to a stock watering pond, dust control, or recycling/reuse – will require obtaining a water well permit.