"Opportunities and Challenges of Developing the Mancos Shale Resource"

Testimony to the
Subcommittee on Energy and Natural Resources
Committee on Natural Resources
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Chairman Lamborn, Ranking Member Lowenthal, and Members of the Committee, thank you for the opportunity to provide comments today. On behalf of Gordy Oil Company, we share the Committee's interest in the development of the Mancos Shale. It is an exciting opportunity to explore for and develop this tremendous domestic oil and gas resource. Unfortunately, as I will share today, to do so on federal lands can be exceedingly difficult when land management decisions abruptly change—without any apparent legal, policy or common sense explanation. Our experience in purchasing and trying to develop eighteen federal leases in western Colorado is sobering.

The Bureau of Land Management (BLM) is preparing to cancel our federal leases before the end of the year for a mistake BLM made in 2003. The BLM and the U.S. Forest Service, rather than facilitating the development of the Mancos Shale, are making long-lasting land use planning decisions to prevent development of a significant portion of the Mancos Shale resource in the White River National Forest (WRNF) in Colorado.

We believe these agency actions ignore specific congressional direction to the BLM and Forest Service in the Mining and Minerals Policy Act of 1970, 30 U.S.C. § 21(a) to "foster and encourage private enterprise in . . . the development of domestic mineral resources to help assure satisfaction of industrial, security, and environmental needs." That directive is underscored in BLM's organic act, the Federal Land Policy Management Act, 43 U.S.C. § 1701(a)(12) (FLPMA), which requires "the public lands be managed in a manner which recognizes the Nation's needs for domestic sources of minerals. . .from the public lands including implementation of the Mining and Minerals Policy Act of 1970."

Moreover, BLM's lease cancellation decision under these circumstances calls into question the very foundation for the development of federal oil and gas – the sanctity of a federal contract. As Congress well knows, federal oil and gas can't be developed without private enterprise, knowledge and investment. Those private sector investments won't be made if there is no longer confidence in a government lease contract.

We appreciate the opportunity to share this experience with the Committee. We only request that the BLM press the pause button on its National Environmental Policy Act ("NEPA") process of lease cancellation. To do so is right for a number of reasons, but we highlight these two. First, BLM should take into account the U.S. Geological Survey (USGS) Mancos Shale assessment and provide another opportunity for public comment. This report provides significant new information on the outstanding potential for oil and gas development in the region (now subject to BLM's NEPA process) and warrants BLM's review in that process and thorough public scrutiny. On June 6, 2016, SG filed an addendum to its comments on the BLM's *White River National Forest Draft Environmental Impact Statemen*t (WRNF DEIS) providing a copy of the Mancos Shale assessment (June, 2016) with a request that BLM first analyze the USGS report, revise the alternatives and geological and socio-economic analyses and publish a revised DEIS for public comment.

Second, SG is working with a number of stakeholders in Colorado, including the State's congressional delegation, local government officials and conservation groups to pursue a legislative exchange of these contested federal leases for other federal leases in an area open to oil and gas development with similar geological potential. However, pursuing a legislative exchange involves time-consuming and careful collaboration with these stakeholders. Those discussions need time. The House Appropriations Committee's report accompanying the FY2017 legislation to fund the Department of the Interior (including BLM) contains language directing BLM to allow time for this effort to bear fruit. We respectfully ask the BLM to honor the directive of Congress and allow the multi-stakeholder process for a legislative exchange to continue to work towards a reasonable resolution.

The Challenges of Federal Lease Development: SG's Attempt to Develop in 2003-2014

Why is the experience of a relatively small oil and gas operator worth sharing with Congress? In this era of calls to "Keep it in the Ground" — where some call for no new leasing and even no development of existing leases of fossil fuels on federal land—we are concerned that our experience with federal oil and gas leases will not be unique, but could become the "new normal" with detrimental impacts on the development of federal oil and gas. If so, this country would be turning its back on its growing domestic energy independence only to return to an over-reliance on foreign sources of energy that threaten our economy, well-being and national security. This is bad public policy that Congress must avoid.

In 2003, SG Interests VII, Ltd. (SG)[1] purchased eighteen[2] federal oil and gas leases with ten-year terms in the White River National Forest (WRNF) in Colorado. The Forest Service had identified this area in the 1993 WRNF Record of Decision (ROD) as open to oil and gas leasing,

[1] SG Interests VII, Ltd. is the lessee and SG Interests I, Ltd. is the operator of the leases (SG).
[2] Two of the eighteen leases were acquired from another oil and gas company in 2013.

a decision the Forest Service confirmed in the 2002 WRNF Revised ROD. In 2003, the Forest Service gave BLM the required "surface management agency" consent to sell these federal oil and gas leases and BLM sold the leases to SG without objection from the public.

In 2007, SG began the process to develop these leases within the ten-year lease term by conducting a detailed internal geological analysis. In 2009, based on that analysis, SG proposed and BLM agreed that a federal unit to develop these leases made the most sense — since a unit would reduce impacts to all resources, including surface resources, and would allow for the most efficient development of the federal resource. The Lake Ridge Unit application was submitted to BLM in May, 2011 and after BLM requested a slight physical modification of the Unit, the BLM deemed the Lake Ridge Unit application "complete" in March 2012. This is when things start to change.

A campaign led by Pitkin County, home county to Aspen, and several environmental groups, to prevent BLM's approval of the Lake Ridge Unit began when SG submitted our application in May, 2011. A unit approval is a routine administrative, technical, geological decision that is categorically excluded from NEPA analysis. But for the first time in its history BLM allowed public comment on a unit application. Six months went by without BLM acting on this "complete" application. Every time SG contacted BLM, we were told a decision would come "soon." It was not until October 6, 2012, that SG was informed by the Colorado BLM State Director that no unit decision would be issued because BLM had made a paperwork "mistake" in 2003. As a consequence, BLM had to conduct a NEPA analysis on its 2003 lease issuance decision. SG was then directed to address any questions to the BLM Director.

On December 6, 2012, SG met with the Acting BLM Director Mike Pool, then Principal Deputy Director and now Director, Neil Kornze, and the Principal Deputy Solicitor, Jack Haugrud, who confirmed that BLM would not act on the SG unit application and would prohibit all lease development until remedial NEPA was complete. As the reason for this decision, they pointed to a 2007 Interior Board of Land Appeals (IBLA or Board) decision, *Board of Commissioners of Pitkin County,* 173 IBLA 173 (2007) (*Pitkin County).* There the Board found that BLM, despite being an active participant in the Forest Service WRNF NEPA process as a cooperating agency, had failed to formally adopt the Forest Service NEPA and therefor was deemed not to have complied with BLM's separate obligation to conduct NEPA analysis prior to lease issuance. The Board held that BLM could either formally adopt the Forest Service NEPA analysis or conduct its own NEPA.

It is worth underscoring that BLM's new policy arrived more than *five years after* the IBLA issued its finding in *Pitkin County*. During that time, BLM never started a new NEPA analysis on its lease decision. Indeed, BLM did nothing, other than withdrawing the two leases at issue before the IBLA. To the contrary, BLM continued to rely on the Forest Service WRNF NEPA

for oil and gas leasing and development. BLM issued leases, designated federal units and communitization areas and approved drilling permits and master plans of development with site-specific NEPA that tiered to the Forest Service NEPA analysis. BLM and the Forest Service even successfully defended the validity of the subject leases and their respective NEPA compliance in federal court and, of course, collected rents and royalties—all from leases that BLM now claims are subject to a lease issuance infirmity.[3]

Based on government documents obtained from numerous FOIA requests, SG learned that BLM's December 2012 explanation for its abrupt change was a pretext. The real reason, as documented in Exhibit A (a chronology of FOIA documents), was to provide a legal gloss to a predetermined political decision to prevent any development of federal oil and gas in the so-called "Thompson Divide." The Thompson Divide is the name given to a 220,000 acre area on the eastern side of the Piceance Basin, much of it located in the WRNF, by proponents of a wilderness designation for these lands. This wilderness campaign has a long history, earlier as the Hidden Gems Wilderness and now the Thompson Divide.

By 2011-12, a routine BLM unit approval had the attention of two Cabinet Secretaries, two U.S. Senators and political appointees in two Departments. The result, as BLM admitted in their decision to grant a suspension of the SG lease term, was their "unusual delay" in consideration of the Lake Ridge Unit. BLM did not fault SG's development diligence, concluding "the full record shows that SG made adequate efforts at development…Nevertheless a decision on the unit application was delayed pending consideration and internal deliberation of the issues raised in comment from interest[ed *sic*] parties on that request." *See* BLM, SG Suspension Decision (April 9, 2013) at 4-5.

In early 2013, SG sought and received a suspension of the lease term to allow BLM time to conduct the remedial lease NEPA and then act on the Lake Ridge Unit application and six SG "Applications for Permits to Drill (APDs). In June 2012, in the face of BLM's continued delay to process the Lake Ridge Unit application and the looming May 2013 lease termination, SG began the work to submit APDs (including the unit obligation well) on six of its leases. The APDs were submitted to BLM and the Forest Service in October 2012–January 2013.

[3] *See, e.g.,* BLM Notice of Proposed Action to Antero (April 18, 2011) ("Antero holds Federal oil and gas leases within the [Lava Boulder Creek] project area. The leases have created *contractual rights and obligations between Antero and the United States*."); Cache Creek Master Development Plan EA, DOI-BLM-CO-N040-2009-0088-EA (2009) ("This decision will provide for the orderly, economical and environmentally sound exploration and development of oil and gas resources on *valid Federal oil and gas leases*;" and *Natural Resources Defense Council v. Forest Service, BLM, et al.,* 2011 WL 3471011 (D. Colo. August 5, 2011) (a successful federal defense of the Hells Gulch North , Phase 2 EA "[the] project underwent a *robust environmental review*" and "the Federal Defendants approval of [the project] was *consistent with the organic statutes governing the Forest Service and the Bureau of Land Management."* The Colorado Federal District Court determined, "OXY USA holds an oil and gas *lease entitling it to drill* for natural gas on the land at issue."). Emphasis added.

The 2013 SG lease suspensions were extended twice by BLM, upon SG's request, in 2014 and 2016. With each request, SG faced another "first of its kind" public comment process on its suspension request, a request for State Director Review of the suspension decision followed by an appeal to the IBLA of the suspension decision. In *Bd. of Cty. Comm'rs of Pitkin Cty., Colo*., 186 IBLA 288 (2015) the Board dismissed the appeals of BLM's decision affirming the 2013 and 2014 SG lease suspensions. This decision was reaffirmed by the Board upon a request for reconsideration. *See Bd. of Cty. Comm'rs of Pitkin Cty., Colo.,* 187 IBLA 328 (May 5, 2016). On May 27, 2016, an appeal was filed of the April 29, 2016 BLM decision denying a request for review of the 2016 lease suspension. Motions to dismiss this 2016 appeal are pending before the IBLA.

The suspension also allowed SG time to explore negotiations with interested parties in a good faith attempt to address their concerns. In 2012-2013, SG negotiated with a number of interested parties including BLM, Pitkin County, environmental interest groups and elected officials. SG proposed environmental mitigation measures for its development which were not acceptable to the County and environmental groups that wanted no development. SG negotiated with several groups and entities for a "buyout" of the SG leases, but received an offer with several unacceptable contingencies: i) SG's support for and/or the passage of federal legislation permanently withdrawing the area from oil and gas leasing; ii) SG's relinquishment of its valid leases; and iii) payment of the price negotiated for the leases at some point in the future after the funds were raised.

SG also approached BLM with the concept of an exchange of the SG leases for federal oil and gas leases in another location, but was told that a BLM regulation prohibited BLM from making such an exchange of oil and gas leases. SG worked with the State of Colorado on an exchange of SG's federal leases for state-owned leases, but was unable to conclude a deal with all interested parties before the identified state leases were sold.

At this point, BLM determined there was an impasse in the negotiations and elected to begin the remedial NEPA process. On April 2, 2014, BLM published the NEPA scoping notice which stated BLM would "address[ ] previous decisions to issue 65 leases underlying the White River National Forest . . ." and "determine whether these 65 leases should be voided, reaffirmed, [or] modified . . . ." BLM, "Notice of Intent to Prepare an Environmental Impact Statement for the Previously Issued Oil and Gas Leases in the White River National Forest," 79 *Fed. Reg.* 18576 (April 2, 2014). But rather than analyzing its decisions to lease with the facts in existence at the time of lease issuance, as BLM had done in similar instances,[4] BLM in this case chose to rely on

[4] *See, e.g., Pennaco Energy v. Department of the Interior,* 377 F.34d 1147 (10th Cir. 2004) (directing remedial NEPA on coalbed methane leases); *Environmental Assessment, Oil and Gas Leasing, Buffalo Field Office 070-05-064* (August 2005) ("to reconsider all relevant factors and issues that were known during the time period of issuance . . . ;" certain "issues were not considered in detail because they were not known during the time of issuance of the 285 leases.").

facts only known in 2014. BLM justified its choice by alleging, "BLM has identified new information that has become available since the 1993 WRNF Oil and Gas Leasing Final EIS decision that will need to be addressed in the BLM EIS . . ." *Id.* at 18577. SG filed scoping comments on May 16, 2014 and protested the remedial NEPA process as a violation of its lease rights.

BLM Begins a March to Lease Cancellation

On November 20, 2015, BLM issued the Draft EIS for the 65 leases under consideration. *Notice of Availability of the Draft Environmental Impact Statement for Previously Issued Oil and Gas Leases in the White River National Forest, Colorado*, 80 *Fed. Reg.* 72733 (November 20, 2015) (DEIS). BLM explained in its cover letter to the DEIS why it failed to adopt the simple and straight-forward option provided by the IBLA in *Pitkin County* – adoption of the existing Forest Service NEPA – by concluding: "the BLM determined that the U.S. Forest Service NEPA analysis conducted for the 65 previously issued leases is no longer adequate due to changes in laws, regulations, policies and conditions since the earlier EIS was finalized in 1993." Of course, this statement is undercut by BLM's several official decisions which continued to rely on this "no longer adequate" NEPA at least through 2011. *See supra* note 3. In the DEIS, BLM chose to rely on a U.S. Forest Service 2014/2015 WRNF Final EIS and Record of Decision—BLM "incorporated as much of the Forest Service's new NEPA analysis of future oil and gas leasing on the WRNF as possible into this analysis." *See* DEIS at 1-1.

Yet in the WRNF FEIS/ROD, the Forest Service took the position that the SG leases are "valid existing oil and gas lease rights that allow development to continue…through the term of the lease" and that the area of SG's leasehold has a "high potential" for oil and gas development. *See* WRNF FEIS at 608. Nonetheless, because "up to this point no producing wells have been developed on these lands" and "they are on the edge of the Piceance formation," the Forest Service made the decision to put the entire Thompson Divide area in the WRNF, some 61,000 acres, off-limits for future leasing. WRNF ROD at 6.

SG participated in the comment period on the WRNF FEIS/ROD and filed a formal objection (administrative appeal) to this decision. SG argued, among other things, that the Forest Service's 2010 *Reasonably Foreseeable Development Scenario for Oil and Gas Activities*, that formed the foundation for the 2014 FEIS analysis, was out of date and inappropriately based on historical oil and gas development. In particular, SG and several industry groups submitted comments that pointed out the substantial potential of the Mancos Shale Formation in the WRNF based on government analyses and the many exploratory wells that confirmed this potential.

For example, SG in January, 2016 announced the results of a well that it had drilled into the Mancos Shale about seven miles south of the SG leases in the Thompson Divide area. This well

had an average production for the first 21 days of 6,451 MCFD with 3,382 psi of casing pressure and to date has produced 1 BCF of gas. *See also* Dennis Webb, "Industry: Thompson area well is a gusher," *Grand Junction Sentinel* (January 5, 2016). Despite their knowledge of the "high oil and gas potential" of the area, in the 2015 ROD the Forest Service closed this area to future oil and gas leasing "in order to maintain the natural character of the landscape and continue to protect the outstanding wildlife and recreation values of these lands."

Unfortunately, BLM's adoption in the WRNF DEIS of the Forest Service's flawed NEPA analysis means the out-of-date data, the reliance on past development and technologies and the flawed decision-making to prevent development in high potential areas will be perpetuated. BLM has decided that its *past* leasing decision should conform to the Forest Service's decision for *future* leasing. On February 9, 2016, the BLM announced that the WRNF FEIS "preliminary preferred alternative" would be to cancel the twenty-five "Thompson Divide" leases including all eighteen SG leases. *See* Dennis Webb, "BLM planning to cancel Thompson Divide leases," *Grand Junction Sentinel* (February 11, 2016). Tellingly, the BLM's preferred alternative, unlike those in the DEIS, requires no significant changes to the producing leases—those leases will continue to operate under the "no longer adequate" Forest Service NEPA in existence at the time of lease issuance. The BLM plans to publish the FEIS this month and finalize the ROD this fall.

Policy Impacts of the Federal Government's Decisions

These decisions by the BLM and the Forest Service carry far-reaching consequences that set a terrible precedent for oil and gas development on federal lands. These decisions not only reduce the likelihood of development of Mancos Shale on federal lands, but are unsupported by law and undercut the sanctity of contract between the federal government and the private sector. The contract between the federal government and "private enterprise," as Congress recognized in the Mining and Mineral Policy Act, is fundamental to a viable domestic mineral resource development program that helps to "assure satisfaction of industrial, security, and environmental needs."

First and foremost, these actions by the Forest Service and BLM to knowingly prevent development of "high potential" oil and gas resources do not comply with the directive in the Mining and Minerals Policy Act to "foster and encourage private enterprise" or the agencies' organic statutes that emphasize multiple use. *See e.g.* FLPMA 43 U.S.C. § 1701(a)(12).

Second, these actions set a bad precedent for the management of federal oil and gas in the Mancos Shale Formation and beyond. What can be lost as a result of this precedent is underscored by the USGS in its revised assessment of the Mancos Shale development potential. The report highlights the significance of the natural gas resource that underlies the Piceance

Basin as the second-largest potential continuous gas resource in the nation.[5] But can this resource be developed? As one experienced Piceance Basin geological consultant put it, getting access to federal land is the "big question mark" for the Mancos Shale. *See* Dennis Webb, "An even bigger beast?" *Grand Junction Sentinel* (June 25, 2016).

We are concerned that BLM's proposed action to cancel a long-issued federal lease will create a precedent that will have a chilling effect on the private sector's interest in developing federal minerals. The rule of law and the sanctity of contract are fundamental to this country's economic success and it is important that the government abide by the contracts it enters into. If the private sector can't rely on a federal lease contract it will look elsewhere to deploy its investment capital. BLM set a number of unusual precedents in its handling of this matter – allowing public comment on BLM technical unit decisions and lease suspensions and deciding that disparate treatment of leases with the same lease issuance flaw was appropriate. But the most troubling precedent is BLM's argument that it can wait 10 years or more to cancel a lease it has previously recognized as valid for a BLM "mistake" made at lease issuance. Of course, here, this "mistake" merely provided a rationale for the agency's political decision to change its mind *after* it had entered into a lease contract. If this post hoc decision making becomes the "new normal" how can leaseholders trust that the federal government will hold up its end of the bargain in future lease contracts?

As SG has told BLM repeatedly, lease cancellation under these factual circumstances is unlawful and is a breach of the lease contract that SG executed with the BLM. The BLM's preferred alternative of lease cancellation is therefore subject to challenge under the Administrative Procedure Act as "arbitrary and capricious" and SG is entitled to monetary damages for BLM's breach of the lease contract.[6]

SG is not in business to litigate or to seek monetary damages. We want to produce oil and gas. That is why SG continues to seek a congressionally legislated lease exchange that would allow us to do what we do best with other federal leases. This concept of a legislative exchange, which would call for Congress to direct the exchange of the leases held by SG in the contested area of the Thompson Divide for federal leases of equivalent value in a nearby, geologically similar area, is bipartisan in nature and has gained stakeholder support in Colorado. SG has devoted substantial time, funds and energy in pursuit of this exchange. We believe that if accomplished this exchange would result in a broad range of public policy objectives—economic development in struggling communities; development of a significant tax base to fund local social objectives;

[5] Hawkins, S.J., Charpentier, R.R., Schenk, C.J., Leathers-Miller, H.M., Klett, T.R., Brownfield, M.E., Finn, T.M., Gaswirth, S.B., Marra, K.R., Le, P.A., Mercier, T.J., Pitman, J.K., and Tennyson, M.E., "Assessment of Continuous (Unconventional) Oil and Gas Resources in the Late Cretaceous Mancos Shale of the Piceance Basin, Uinta-Piceance Province, Colorado and Utah, 2016: U.S. Geological Survey Fact Sheet 2016-3030" (May 2016), 4 p., http://dx.doi.org/10.3133/fs20163030 (USGS Mancos Shale Report).

[6] *See e.g. Griffen Exploration, LLC v. United States*, 116 Fed. Cl. 163, 173 (Fed. Cl. 2014).

environmental protection in the Thompson Divide area; and, of course, for SG a just result for a private sector entity that has invested significant resources in the development of the eighteen leases subject to BLM's proposed cancellation decision.

But securing bipartisan, multi-sector stakeholder support for a legislative exchange takes time. If BLM cancels our leases before the legislation has been enacted the situation will be made more difficult. We've already experienced a chilling effect on progress for these efforts as a direct result of the BLM's announcement in February of its preferred alternative of lease cancellation. Nonetheless, progress is still ongoing, and parties continue to talk.

We merely ask that the BLM slow down, take the time to review the USGS Mancos Shale assessment in a revised WRNF DEIS, and allow us the time to work on a legislated exchange that provides benefits to all stakeholders.

Respectfully submitted,

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