



The State of Utah
 Department of
 Natural Resources
 Division of
 Oil, Gas & Mining

ROBERT L. MORGAN
 Executive Director

LOWELL P. BRAXTON
 Division Director

OLENE S. WALKER
 Governor

GAYLE F. McKEACHNIE
 Lieutenant Governor

| Representatives Present During the Inspection: | |
|--|--|
| Company | Vicky S. Miller Environmental Specialist |
| OSM | Henry Austin |
| OGM | Pete Hess Environmental Scientist III |

Inspection Report

| | |
|------------------|-------------------------------|
| Permit Number: | C0070039 |
| Inspection Type: | COMPLETE OVERSITE |
| Inspection Date: | Wednesday, October 20, 2004 |
| Start Date/Time: | 10/20/2004 9:25:00 AM |
| End Date/Time: | 10/20/2004 1:25:00 PM |
| Last Inspection: | Wednesday, September 22, 2004 |

Inspector: Pete Hess, Environmental Scientist III

Weather: Cold, 40's F. Raining; 30-40 MPH winds.

InspectionID Report Number: 437

Accepted by: whedberg

11/2/2004

Permittee: **CANYON FUEL COMPANY LLC**
 Operator: **CANYON FUEL COMPANY LLC**
 Site: **DUGOUT CANYON MINE**
 Address: **PO BOX 1029, WELLINGTON UT 84542**
 County: **CARBON**
 Permit Type: **PERMANENT COAL PROGRAM**
 Permit Status: **ACTIVE**

Current Acreages

| | |
|----------|------------------------|
| 7,083.71 | Total Permitted |
| 51.11 | Total Disturbed |
| | Phase I |
| | Phase II |
| | Phase III |

Mineral Ownership

- Federal
 State
 County
 Fee
 Other

Types of Operations

- Underground
 Surface
 Loadout
 Processing
 Reprocessing

Report summary and status for pending enforcement actions, permit conditions, Division Orders, and amendments:

The only "Special Permit Condition" currently pending for the Dugout Canyon permit area is the requirement to submit quarterly water monitoring data to the Division EDI in an electronic form. The Division notified the permittee on October 1, 2004 that all required surface and ground water monitoring information had been successfully uploaded to the Division web site, meeting the "Special Permit Condition" requirement.

Mr. Henry Austin, OSMRE/WRCC, accompanied the DOGM representative during today's inspection as part of that agency's oversight duties.

There are no compliance actions pending within the Dugout Canyon Mine permit area. No compliance actions were issued during today's inspection.

Inspector's Signature

Pete Hess, Environmental Scientist III

Inspector ID Number: 46

Date Wednesday, October 20, 2004

Note: This inspection report does not constitute an affidavit of compliance with the regulatory program of the Division of Oil, Gas and Mining.

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REVIEW OF PERMIT, PERFORMANCE STANDARDS PERMIT CONDITION REQUIREMENTS

1. Substantiate the elements on this inspection by checking the appropriate performance standard.
 - a. For COMPLETE inspections provide narrative justification for any elements not fully inspected unless element is not appropriate to the site, in which case check Not Applicable.
 - b. For PARTIAL inspections check only the elements evaluated.
2. Document any noncompliance situation by reference the NOV issued at the appropriate performance standard listed below.
3. Reference any narratives written in conjunction with this inspection at the appropriate performance standard listed below.
4. Provide a brief status report for all pending enforcement actions, permit conditions, Divison Orders, and amendments.

| | Evaluated | Not Applicable | Comment | Enforcement |
|--|-------------------------------------|-------------------------------------|-------------------------------------|--------------------------|
| 1. Permits, Change, Transfer, Renewal, Sale | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Signs and Markers | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Topsoil | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 4.a Hydrologic Balance: Diversions | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4.b Hydrologic Balance: Sediment Ponds and Impoundments | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 4.c Hydrologic Balance: Other Sediment Control Measures | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 4.d Hydrologic Balance: Water Monitoring | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 4.e Hydrologic Balance: Effluent Limitations | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 5. Explosives | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Disposal of Excess Spoil, Fills, Benches | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. Coal Mine Waste, Refuse Piles, Impoundments | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 8. Noncoal Waste | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 9. Protection of Fish, Wildlife and Related Environmental Issues | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 10. Slides and Other Damage | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 11. Contemporaneous Reclamation | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 12. Backfilling And Grading | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 13. Revegetation | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 14. Subsidence Control | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 15. Cessation of Operations | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 16.a Roads: Construction, Maintenance, Surfacing | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 16.b Roads: Drainage Controls | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 17. Other Transportation Facilities | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 18. Support Facilities, Utility Installations | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 19. AVS Check | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 20. Air Quality Permit | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 21. Bonding and Insurance | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| 22. Other | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

3. Topsoil

The Dugout Mine topsoil storage facility located along the Nine Mile Canyon road was inspected this day. All retention berms were in place and functioning. All topsoil storage signs were in place. There was no visible evidence of erosion on the piles. Roughening of the piles in order to enhance their revegetation was not practiced during their construction.

4.b Hydrologic Balance: Sediment Ponds and Impoundments

The permittee conducted the fourth quarter impoundment inspections for the Mine site and waste rock sediment containments on October 14, 2004. There were no signs of instability or other hazardous conditions reported by the permittee's qualified person, Ms. Miller. The Mine site pond was cleaned during the period of June 30, through July 8. Mr. Dave Spillman, P.E., and Manager of Technical Services for the permittee conducted the 3rd quarter and re-certification inspection of this pond on July 12, 2004 in order to meet the requirements of R645-301-514.312. This report was certified by Mr. Spillman on August 24, 2004, and same will be used as the annual impoundment certification for that pond. A copy of the permittee's inspection and re-certification has been forwarded to the SL Division headquarters.

4.c Hydrologic Balance: Other Sediment Control Measures

Areas of the Mine which utilize other methods of sediment control appeared to be functioning as designed. The methods utilized include silt fences, gravel, berms, and vegetation.

4.d Hydrologic Balance: Water Monitoring

All required second quarter 2004 surface and ground water monitoring information was uploaded to the Division EDI site on or before October 1, 2004, as confirmed via an E-mail from the Division to the permittee on that date. Relative to third quarter information, Ms. Miller has received water analyses from the contracted lab, but as yet, has not initiated loading of that information for the required monitoring points into the Division "pipeline". A review of the second quarter information revealed that UPDES sites 001 and 002 had flows and were sampled in May and June, and 001 was also sampled in July. Points 003 and 004 were reported as having no outfall during the second quarter. Point 002 had no outfall during the month of July, 2004. The discharge monitoring reports for the month of September were reviewed and noted as having been completed and forwarded to the respective government agencies on October 15, 2004.

4.e Hydrologic Balance: Effluent Limitations

The permittee is continuing the process to obtain a site specific UPDES permit which will allow the Mine to continue to discharge water from the old Knight Mine workings to the Dugout Creek channel, yet remain in compliance relative to the approved limits for total iron and total dissolved solids. According to Ms. Miller, it was necessary for the DEQ/DWQ to republish the proposed draft version of the pending UPDES permit. All of the details relative to a salinity mitigation project (the purchase of salt credits) are still being worked through with the DWQ and the Colorado Salinity Forum. The current UPDES permit remains in effect until April 30, 2008. As observed this day, Mine water was being discharged from the 20-inch black pipe to the Dugout channel just north of the coal storage pad. A written notice of a failure to comply with the total dissolved solids effluent parameter was received by the Division on October 4, 2004. The permittee discharged approximately 2.2 tons / day from outfall 001A for the month of September. The allowable limit is one ton / day. This letter meets the written five day reporting requirement for noncompliance mandated by the UPDES permit.

7. Coal Mine Waste, Refuse Piles, Impoundments

The permittee's Manager of Technical Services, Mr. Dave Spillman, P.E., conducted the third quarter of 2004 waste rock pile inspection on September 24. There were no signs of instability or other hazards reported during that inspection. Mr. Spillman certified the inspection report on October 13, 2004. As observed this day, a contractor was making preparation to level and compact coal mine waste material at the site. Soft ground conditions and continuing rain will delay this for several days. There were no signs of instability, spontaneous combustion, or other hazards noted during today's inspection. All drainage ditches appear to be functioning as designed; minor erosion was observed in certain lengths of the ditches reporting to the sediment pond. The surface elevation of the contained water in the pond was well below the elevation of the primary open spillway.

9. Protection of Fish, Wildlife and Related Environmental Issues

In order to initiate drilling of the degasification well G-6 during the migratory period for the Mexican spotted owl, and other wildlife species, it was necessary for the permittee to complete a mitigation project through the Utah Department of Wildlife Resources. This involved constructing 46 nesting boxes and installing them in locations selected by the DWR. The completed project will allow the Dugout Mine to drill degasification wells through 2006. A copy of the letter from the DWR to Ms. Miller of CFC thanking her for the permittee's efforts was provided to the OSM representative.

14. Subsidence Control

The annual surface subsidence field monitoring survey was conducted and completed by Mr. Bruce T. S. Ware, Utah registered land surveyor, on August 27, 2004. The permittee is compiling that information and preparing a drawing / map for submittal with the 2004 annual subsidence report.

18. Support Facilities, Utility Installations

Today's weather made it impossible to inspect the degasification wells which are located in the Pace Canyon area of the Book Cliffs. According to Ms. Miller, the methane pump previously located on well G-2 has been relocated to well G-5. G-6 is also venting combustible gases from the second longwall panel being extracted in the Gilson seam. Hydroseeding which had been scheduled for last week at several of the well sites was not completed due to some landowner concerns. The permittee remains hopeful that the reseeding of those sites can be accomplished prior to the onset of difficult road conditions. Both the primary and secondary substation locations at the Mine site were inspected. Drainage in those areas is functioning as designed. There were no problems noted.

19. AVS Check

ARCH Coal International, the parent company of Canyon Fuel Company, has recently completed the purchase of those interests which had been held by Itochu Coal International. The permittee is aware that the update of ownership and control information is necessary upon the completion of the filling of key corporate positions.

20. Air Quality Permit

The Air Quality Approval Order for the Dugout Canyon operation was issued by the Utah DEQ / DAQ in 2003. The amount of coal production or "throughput" permitted for the Dugout operation is 5 MTPY.

21. Bonding and Insurance

The permittee's current general liability insurance coverage term extends from July 31, 2004 through July 31, 2005. A general aggregate coverage amount of \$500,000 is in place, with \$300,000 worth of coverage provided for each occurrence. Coverage for damages incurred from the use of explosives is included. The Federal Insurance Company is providing all coverage via policy number 3711-00-10. The reclamation agreement for the Dugout Canyon site was last updated on March 18, 2004. The bond amount for reclamation purposes was reduced from \$3,682,000 to \$2,400,000 on April 7, 2004 via DOGM review / approval.