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State of Utah

**Department of
Natural Resources**

MICHAEL R. STYLER
Executive Director

**Division of
Oil, Gas & Mining**

JOHN R. BAZA
Division Director

JON M. HUNTSMAN, JR.
Governor

GARY R. HERBERT
Lieutenant Governor

March 17, 2006

Keith Thompson, Vice President
Covol Engineered Fuels, LC
10653 South River Front Parkway, Suite 300
South Jordan, Utah 84095

Subject: Determination to Permit Under the Surface Mining Control and
Reclamation Act, C/007/0046, Outgoing File

Dear Mr. Thompson:

As we discussed on last December 20, 2005, the Division of Oil, Gas and Mining ("OGM") has made a determination that the Surface Mining Control and Reclamation Act applies to the Wellington Utah Headwaters Energy Services coal processing facility. Enclosed, please find a copy of the OGM Finding that Covol/Headwaters must obtain a permit. I suggest that we meet in the near future to set the timeline for posting a bond and submitting an operation and reclamation plan. Please contact Pamela Grubaugh-Littig at (801) 538-5268 or pamgrubaughlittig@utah.gov.

Pursuant to Utah Code Ann. § 40-10-14 and Utah Administrative Code R645-300-200, an appeal may be made to OGM's Finding. Should you choose to appeal to the Board of Oil, Gas and Mining, please contact Ms. Julie Carter, Secretary to the Board, at juliecarter@utah.gov or at (801) 538-5277 for further instruction on the Board appeal process.

Sincerely,

Mary Ann Wright
Associate Director, Mining

Enclosure: Analysis memo
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TO: File

FROM: Mary Ann Wright, Associate Director, Mining 

RE: Covol Engineered Fuels, LC, Wellington, Utah

INTRODUCTION

Covol Engineered Fuels, L.C. ("Covol") plans to operate a coal processing plant in Carbon County, Utah. Covol will receive coal from coal mines and coal handlers and send the coal through a dry air separation process to separate the coal from its impurities. Covol is currently under contract to process coal from two coal handlers and return the beneficiated coal to the handler. Covol intends to expand its business portfolio to purchase waste pile coal, add a chemical additive to the coal and reap the benefit of a federal tax credit for Synfuel production, and possibly sell NOx emission credits under the Clean Air Act. The Division of Oil, Gas & Mining ("Division") finds, based upon several inspections of the Covol plant and information provided by Covol, that Covol will engage in "coal mining and reclamation operations" and will therefore need to obtain a permit from the Division, in accordance with the Coal Mining and Reclamation Act, Utah Code Ann. § 40-10-1 et seq. ("Act") and the implementing regulations, Utah Administrative Code R645-100 et seq.

FACTS

On July 13, 2004, Covol sent the Division a proposal to install a 500,000 ton-per-year coal cleaning and blending facility in Carbon County, Utah. In its original proposal, Covol stated that it plans to:

utilize patented equipment to beneficiate out-of-specification run-of-mine coal by reducing ash, pyretic sulfur and mercury through a dry air separation process. . . . High ash, high sulfur coal will be delivered to a facility via truck from several sources, including mines, in Carbon and Emery counties. . . .The selected coal to be cleaned will be removed from the appropriate coal storage pile by front end loader and dumped into a receiving hopper. The coal will be conveyed to a vibrating screen and crusher unit. The screened and crushed coal is then conveyed to three (3) air jig cleaning units, according to size. The air jig units are complete with bag houses for particulate collection.

This unit separates the ash and coal using pulsating air. The cleaned coal is then conveyed to a storage silo or several clean coal storage piles. This cleaned coal can be blended to meet specifications for ash, sulfur, mercury content and BTU values. The beneficiated coal is then loaded into trucks via the drive under silo or loading hopper feed by a front-end loader.

Letter from R. Keith Thompson, Vice President, Covol, to Lowell P. Braxton, Director, Division of Oil, Gas & Mining (July 13, 2004). This process will produce a waste pile, which Covol intends to store for future use as "road base or fill" or return it to the mine of origin waste stockpile.

Furthermore, Covol intends to add a chemical additive to the cleaned coal, which it claims reduces NOx emissions. By adding a chemical additive, Covol intends to market the coal as a Synfuel product and take advantage of a federal tax credit for production of Synfuel. Covol also intends to market its NOx credits under the Clean Air Act. As of December 2005, Covol had taken no concrete steps toward realizing these business plans.

Currently Covol is storing 27,080 tons of coal from PacifiCorp's Deer Creek Mine. Covol has contracted with PacifiCorp to process approximately 25,000 tons of raw coal each month for a period of one year. Under this contract, PacifiCorp will retain ownership of the coal and Covol will receive a tolling fee for the processing. PacifiCorp retains the right to terminate the agreement based upon PacifiCorp's sole judgment that the "process is no longer economically viable to PacifiCorp." PacifiCorp has also entered another tolling agreement with Commonwealth Coal Services, Inc. ("Commonwealth") with similar provisions to the PacifiCorp Tolling Agreement.

To date, Covol has only contracted to process coal from PacifiCorp and Commonwealth. While it intends to expand its business portfolio, there is no indication if or when that would happen.

ANALYSIS

Covol will operate a "surface coal mining operation" because it will crush, screen, and separate the coal from its impurities, operate "in connection with" a coal mine, and because it is not located at the site of ultimate use. Therefore, Covol must obtain a permit from the Division. In Utah, it is unlawful to engage in "surface coal mining operations" without a permit from the Division. Utah Code Ann. § 40-10-9(1) (2004 & Supp. 2005). "Surface coal mining operations" means:

- (a) Activities conducted on the surface of lands in connection with a surface coal mine These activities include . . . in situ distillation or retorting, leaching or other chemical or physical processing
- (b) The area upon which the activities occur or where the activities disturb

the natural land surface. These areas shall also include any adjacent land the use of which is incidental to the activities, . . . or other property or materials on the surface from or incident to the activities.

Id. § 40-10-3(20). Based upon this definition, a person engages in “surface coal mining operations” if (A) the activity falls within one of the listed activities, and (B) the facility operates “in connection with a surface coal mine.”

A. Covol’s Activity Will Fall Within the Definition of “Surface Coal Mining Operation” Because it Will Engage in a “Chemical or Physical Processing” of Coal.

“Surface coal mining operations” includes “in situ distillation or retorting, leaching or other chemical or physical processing” of coal. Neither the Act, nor the implementing rules define “chemical or physical processing.” Because the Utah Act closely patterns the federal Surface Mining Control and Reclamation Act (“SMCRA”), 30 U.S.C.A. § 1201 et seq., the Division looks to federal law, regulations, and interpretations to decipher the meaning of “chemical or physical processing.” SMCRA does not provide a definition for “chemical or physical processing.” However, the Office of Surface Mining Reclamation and Enforcement (“OSM”), the federal regulatory agency, has interpreted “chemical or physical processing” to include both those activities which separate coal from its impurities, and those activities “which do not separate coal from its impurities but which otherwise engage in physical or chemical processing (i.e.: crushing, screening, and sizing facilities).” Permanent Regulatory Programs; Definitions; Requirements for Permits for Special Categories of Mining; Coal Preparation Plants: Performance Standards, 52 Fed. Reg. 17,724, 17,725 (May 11, 1987)

Covol will crush, screen, and use a dry air separation process to separate the coal from its impurities. This activity falls within the definition of “chemical or physical processing” of coal, and therefore, Covol must obtain a permit if it also operates “in connection with” a coal mine.

B. Covol Will Operate “In Connection with a Surface Coal Mine.”

Neither the Coal Mining and Reclamation Act nor the Utah Administrative Code defines “in connection with a surface coal mine.” As noted above, the Utah Act closely follows SMCRA, and therefore, the Division looks to the federal law for the meaning of “in connection with” a coal mine. Neither Congress nor the OSM has defined “in connection with” a coal mine. However, the phrase has generated extensive discussion from the mining community because it is unclear from the language whether off-site facilities were categorically excluded from regulation.

To clarify that off-site facilities operating “in connection with” a coal mine are to be regulated, OSM and the Utah Board of Oil, Gas & Mining (“Board”) adopted regulations requiring “any person who operates a coal preparation plant in

connection with a coal mine but outside the permit area for a specific mine” to obtain a permit. 30 C.F.R. § 785.21. See Utah Admin. Code R645-302-260. OSM refused to define “in connection with” because it believed that “[a]ny attempt to further define this phrase in a regulation would unduly restrict the discretion that regulatory authorities must have in order to make valid decisions about the applicability of the performance standards of SMCRA in individual cases.” Permanent Regulatory Program; Coal Preparation Plants Not Located Within the Permit Area of a Mine, 53 Fed. Reg. 47,384, 47,385 (Nov. 22, 1988). Instead, OSM provided a non-exhaustive list of factors that would be appropriate to consider in making a determination of “in connection with” a coal mine. Those factors are:

1. Whether the facility receives a significant portion of its coal from a mine.
2. The economic relationship between the facility and a mine.
3. The functional relationship between the facility and the mine it services. Does the facility have a useful life independent of a mine?
4. Geographic proximity to a mine, although geographic proximity is not a determinative factor.
5. The degree of control a mine has over the processing operations.
6. Any other type of integration that exists between a facility and a mine.

Surface Coal Mining and Reclamation Operations; Permanent Regulatory Program; Support Facilities and Coal Preparation Plants, 48 Fed. Reg. at 20,393; Permanent Regulatory Program; Coal Preparation Plants Not Located Within the Permit Area of a Mine, 53 Fed. Reg. at 47,385-89. Also, a facility will not be considered “in connection with” a coal mine if such facility is located at the “site of ultimate coal use,” unless the facility is also located at the site of the mine. Utah Admin. Code R645-302-260. See also PacifiCorp v. Office of Surface Mining Reclamation and Enforcement, 143 IBLA 237, 252 (1998) (holding coal processing plant located adjacent to power plant and delivering coal to power plant via conveyor belt did not operate “in connection with” coal mine because it was located at site of ultimate coal use and not located at site of mine). While the statute and the regulations refer to “mine” singularly, neither OSM nor the Division interprets the language to limit application to activities in connection with only one mine. Permanent Regulatory Program; Coal Preparation Plants Not Located Within the Permit Area of a Mine, 53 Fed. Reg. at 47,388. Regardless of the number of mines a facility is operating “in connection with,” if the Division finds, based upon the above-listed factors and any other factors it deems pertinent, that a facility is both engaged in the “chemical or physical processing” of coal and operating “in connection with” a coal mine, the Division will require permitting.

Furthermore, even though a facility receives coal from a coal handler instead of directly from a mine does not mean that a facility is not operating "in connection with" a coal mine. A facility cannot exempt itself from regulation by merely purchasing coal through a middleman. Instead, the Division will consider this factor in looking at the facility as a whole in determining whether the facility is operating "in connection with" a coal mine.

Upon reviewing Covol's operations, the Division finds:

1. Covol's plant is located outside the permit area of any specific mine.
2. Covol is not an end user. Covol is currently building a plant that would clean coal and has indicated its intention to create a Synfuel product by applying a chemical additive. Labeling the treated coal as "Synfuel" is only relevant in determining whether Covol will reap the benefits of a federal tax credit and is not relevant to determining whether Covol is an end user. Covol sells coal to power plants. The power plant is the end user.
3. Covol is not located at the site of an end user.
4. Covol intends to buy and sell coal on the open market in the future. Regardless of where Covol sells its coal, it intends to purchase coal from either a coal mine, coal handler, or a waste pile, all of which are regulated by the Division. Covol will be just one step further in the process of marketing coal taken from a coal mine.
5. Covol only has plans to receive coal from either the Deer Creek Mine or the Hidden Splendor Mine, both of which are located in the same valley as Covol.
6. Covol will serve a necessary function of the coal mine operations by processing out-of-specification coal that might otherwise be treated as waste.
7. Currently, Covol is economically dependent upon its contracts with the coal mines. Covol has indicated that it plans to broaden its business plan to include NOx emission credit trading, and Synfuel tax credits. However, selling NOx emission credits and benefiting from a Synfuel tax credit depends upon Covol processing coal purchased from either a coal mine or a waste pile, both of which are regulated by the Division under the Utah Coal Mining and Reclamation Act and SMCRA.
8. Under the PacifiCorp and Commonwealth Tolling Agreements, Covol does not have the authority to sell the processed coal on the open market. Covol is contractually obligated to return the coal to the coal handler.

9. Covol will serve as an intermediary between several coal mines located in Utah and end-users. It currently has plans to purchase all of its coal from coal mines for sale to various power plants.

Based upon the above facts as made known to OGM, the Division finds that Covol will operate "in connection with" a coal mine. While the fact that Covol intends to buy and sell coal on the open market might weigh against permitting, the fact that Covol will also serve as a mere processing plant for several coal mines or handlers weighs in favor of permitting. Even if Covol's business plan were fully developed as it is proposed, the Division would still require permitting because some of its business would be "in connection with" a coal mine. Covol cannot escape regulation by conducting some types of business that would not be regulated where it also conducts business "in connection with" a coal mine. Covol has strategically placed itself close to five coal mines. Covol intends to clean out-of-specification coal for use by an end-user and may create a Synfuel by applying a chemical additive. It is and will continue to be functionally and economically integrated with various Utah coal mines and thus, the Division concludes that Covol will operate "in connection with" a coal mine.

CONCLUSION

Covol will engage in "coal mining and reclamation operations" because (1) by crushing, screening, and running the coal through an air separation device, Covol will be engaging in the "physical processing" of coal; and (2) Covol will operate "in connection with" a coal mine because it is functionally and economically dependent upon coal mines and because it is not located at the "site of ultimate coal use." Therefore, Covol must obtain a permit from the Division.