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LAW OFFICES OF

FLECK, MATHER & STRUTZ, LTD.

400 East Broadway, Suite 600, Wells Fargo Bank Building

P. O. Box 2798, Bismarck, North Dakota 58502

Telephone: 701-223-6585 Facsimile: 701-222-4853 E-Mail: fms@flecklaw.com Website: www.flecklaw.com

GARY R. WOLBERG+
PAUL W. SUMMERS
BRIAN R. BJELLA**
JOHN W. MORRISON
CURTIS L. WIKE**
CRAIG C. SMITH**

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SHANE A. HANSON*
MICHAEL C. WALLER^c
PETRA H. MANDIGO^o
CHRISTOPHER D. FRIEZ
CRAIG B. BURNS^v
WADE C. MANN*

ALSO LICENSED IN:

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- ^o Montana
- ^o Nebraska
- South Dakota
- ^v Texas
- [^] Wyoming

ERNEST R. FLECK
(1921-1995)
RUSSELL R. MATHER
(RETIRED)
WILLIAM A. STRUTZ
(RETIRED)

July 28, 2008

FROM DIRECTOR - RECLAMATION DIV.

Date: 7-29-08

Action: _____

Info. Only: _____

Info & File: _____

Ms. Ilona A. Jeffcoat-Sacco
Executive Director
NORTH DAKOTA PUBLIC
SERVICE COMMISSION
600 E. Boulevard Avenue, Dept. 408
Bismarck, ND 58505-0480

Dear Ms. Jeffcoat-Sacco:

In re: Coal Beneficiation Facility
Our File No. -28878

We are writing on behalf of GTL Energy (USA) Limited (GTL USA), requesting a jurisdictional determination pursuant to North Dakota Century Code Chapter 38-14.1 regarding a proposed coal beneficiation facility.

I. Introduction:

GTL USA is a wholly owned subsidiary of an Australian company, GTL Energy Ltd (GTL Energy) which has developed a proprietary process to upgrade low rank coal by removing a significant amount of moisture. GTL Energy has licensed its process to GTL USA. This upgrading process raises the energy content, reduces emissions when combusted, and improves transportation and handling characteristics of the coal; and thereby increases its market value.

GTL USA operates a pilot plant in Colorado to test this proprietary upgrading process. GTL USA has completed its research and development phase, and now desires to construct its first commercial scale plant near South Heart in Stark County, North Dakota.

In order to construct this plant GTL USA intends on establishing a limited liability company known as GTLE Dakota Plant 1 LLC (Dakota 1). A lease has been obtained on a 40 acre site by South Heart Coal LLC (SHC). The lease will be subleased to Dakota 1, on which the plant will be constructed.

Initially, coal will be brought from around the United States and other countries and to the beneficiation plant and processed on tolling bases. After the South Heart Mine has been permitted and is in operation, a majority of the coal will likely be supplied by that mine.

SHC is an entity owned and controlled by associates of Great Northern Power Development LP (GNPD) and Allied Syngas Corporation (Allied). SHC will be seeking a coal mining permit from the North Dakota Public Service Commission for the South Heart Mine. Coal will then be supplied to the plant by SHC. However, this agreement will be nonexclusive, such that the Dakota 1 can process coals from any other source, including other mines in the United States and from around the world. This beneficiation plant will be entirely separate from a gasification plant planned to be constructed later by GNPD and Allied.

The 40 acre site for the beneficiation plant is located outside of the boundary of the proposed South Heart Mine. In addition, there will be no physical connection between the beneficiation plant and either the coal mine or the gasification plant. The beneficiation plant and the gasification plant will be entirely separate operations on different sites.

It is anticipated that the beneficiation plant will be constructed and operational by the second quarter of 2009.

The operations of the beneficiation plant will not be a dependent upon the coal mining requirements of SHC. The plant will provide a commercial scale demonstration of the GTL Energy beneficiation technology. It will utilize approximately 45 tons per hour of raw coal converting it into 30 tons per hour of briquette product. However, the upgraded coal from the beneficiation plant will not be utilized for the gasification plant. If the GTL Energy technology proves successful, then GTL USA would license the technology to the developer of the gasification plant.

The beneficiation plant will process coal from around the United States and the world to facilitate marketing of the GTL Energy technology. It may also be used to process coal from the South Heart Mine for sale to the stoker market, with the objective of displacing Powder River Basin imported coal with North Dakota beneficiated lignite. All products from the plant will be provided to third party end users seeking a higher BTU coal.

II. Mining Law and Regulation:

“Surface Coal Mining Operations” is defined in part to mean “activities affecting the surface of lands “in connection with” a surface coal mine. Such activities include . . . chemical or physical processing, and the cleaning, concentrating or other processing or preparation, and loading of coal at or near the mine site . . .” NDCC § 38-14.1-02(33)(a). “Surface Coal Mining Operations” also means “the areas upon which such activities occur or where such activities disturb the natural land surface.” Such areas include any adjacent land the use of which is incidental to such activities such as processing areas resulting from or incident to such activities. NDCC § 38-14.1-02(33)(b). The federal Surface Mining Control and Reclamation Act (“SMCRA”) contains virtually identical language is found at 30 USC § 1291(28).

It is unlawful for an operator to engage in surface coal mining operations without first obtaining a permit to do so from the Public Service Commission (“Commission”). NDCC § 38-14.1-10.

A “Coal Preparation Plant” is defined under North Dakota law to mean “a facility where coal is subjected to chemical or physical processing or the cleaning, concentrating or other processing or preparation and includes facilities associated with coal preparation activities, including, but not limited to, the following: loading facilities, storage and stock pile facilities, sheds, shops, and other buildings, water treatment and water storage facilities, settling basins and impoundments, and coal processing and other waste disposal areas.” NDAC § 69-05.2-01-02(11).

A permit to operate a coal preparation plant must be obtained from the Commission. NDAC 69-05.2-09-19(1). Again, federal law with virtually identical language is found at 30 CFR § 701.5 and 30 CFR § 827.11.

III. Issue Presented:

Whether Dakota 1’s coal beneficiation facility constitutes a “surface coal mining operation;” thus necessitating Dakota 1 obtaining a surface coal mining permit from the Public Service Commission (“Commission”).

GTL USA believes that the coal beneficiation facility does not constitute a surface coal mining operation.

IV. Analysis:

A critical determination is what facilities are deemed “in connection with” a surface coal mining operation.

To answer this question; the courts, and state and federal agencies charged with such a determination, refer back to Office of Surface Mining Reclamation and Enforcement (“OSM”) final rules as set forth in the Federal Register at 53 FR 47378 and 53 FR 47384 (November 22, 1988) (“Final Rule”). The purpose for which was to clarify circumstances under which coal preparation plants and support facilities located outside of a permit area of a mine are subject to the permitting requirements of SMCRA.

OSM was concerned that a prior definition of “coal preparation” could be interpreted to regulate certain coal preparation plants which are not actually regulated under SMCRA. “More closely tracking the language of SMCRA in this final rule, OSMRE ensures that coal preparation activities that are carried out ‘in connection with’ a coal mine are appropriately regulated under SMCRA.” Final Rule at 47385.

OSM stated that the purpose of the Final Rule was to clarify that only offsite coal preparation plants that are “in connection with a coal mine” are subject to regulation. *Id.*

Excluded are facilities at the site of ultimate use. *Id.* Due to a change in definition, OSM could no longer treat facilities which handle coal as either “in connection with” a mine or with an end user, as it could when the definition of coal preparation was based on the separation of coal from its impurities. It cited, for example, facilities such as the docks at Baltimore, Maryland, and Long Beach, California, that may occasionally crush or size coal, and may also conduct “coal preparation” under the new definition. OSM clarified that it does not believe that such activities at those facilities are “in connection with a coal mine, or that (SMCRA) was intended to regulate the activities at such facilities.” *Id.*

OSM did note that the term “in connection with” is not defined. It was the desire not to define the phrase such that it would unduly restrict the discretion that regulatory authorities must have in order to make valid decisions about the applicability of SMCRA. *Id.*

Of significance, it was stated that OSM “continues to believe that the ability of mine operators, or coal handlers directly servicing such operators, to have control of processing operations is essential in establishing that a processing plant is being operated in connection with a coal mine.” *Id.* This is a critical and very important statement, which has the effect of exempting the Dakota 1 facility from the definition of a coal preparation plant. South Heart Coal will not have control over the beneficiation facility, and no usable coal product will be returned to either the mine or the gasification plant. The operations of the Dakota 1 facility are not dependent upon South Heart Coal’s requirements.

OSM went on to state that it is “only requiring regulatory authorities to extend their permit requirements as far into the stream of commerce as those activities over which mine operators and the coal handlers who directly serve them, such as coal processors, have or could have control of operations.” *Id.* South Heart Coal will not have control of the Dakota 1 coal beneficiation facility.

In the Final Rule, OSM went on to state that it “believes that geographic proximity, as well as the functional relationship between the mines and coal preparation plants, are proper factors to be considered by regulatory authorities when identifying off-site preparation plants which are operated in connection with a coal mine and therefore are subject to regulation under SMCRA.” *Id.* at 47386. In this case, the Dakota 1 facility is located outside of the South Heart mine. The mine will exist separate from the Dakota 1 facility, and thus the mine has no functional relationship to the facility.

As stated by OSM, “there is nothing in the Act or its history that implies that SMCRA was meant to apply nation-wide to all industrial facilities that process coal irrespective of whether or not they are operating in connection with a coal mine.” *Id.* For example, OSM stated that Congress did not intend that “shipping areas,” regardless of their association with coal mines can be regulated under SMCRA. *Id.* at 47387.

OSM went on to state that “the purpose of this rule is to recognize that there are processing facilities other than those at the point of use that are not in connection with a coal mine, and to ensure that jurisdiction is extended only to preparation plants operating in connection with a coal mine.” *Id.* Thus, the Final Rule does not mandate that to be exempt the facility must be at the point of ultimate use; other facilities are also exempt. One of the purposes of the Final Rule was that OSM “wishes to appropriately limit and concisely state the jurisdiction provided in (SMCRA) over coal preparation which results from or is incident to an activity ‘in connection with’ a coal mine.” Thus, OSM revised the rules to incorporate the phrase “in connection with,” which is also in SMCRA. *Id.* at 47388.

OSM went on to state that it has not changed its interpretation that operations in connection with an end user are not operations in connection with a coal mine. “Coal preparation facilities which are being operated only in connection with another industrial facility, such as the power plant of concern to this commentator, does not operate in connection with a coal mine and are not subject to the rule.” *Id.* at 47388. The Dakota 1 coal beneficiation facility will operate totally independently of any other industrial facility.

Of considerable significance is that the Dakota 1 facility would initially only utilize lignite from either existing North Dakota mines or coals from around the world. To the extent that the facility will utilize such out of area coal, it clearly would not be “in connection with” the South Heart Mine and thus exempt from the definition of a “surface coal mining operation”.

In the Final Rule, OSM stated “that it is valid to consider whether a facility has a useful life independent of the specific mine or mines which it serves, in determining if the facility is operating in connection with a coal mine...” The Dakota 1 facility will have a useful life independent of coal from the South Heart Mine, as its purpose is to prove the beneficiation technology on a commercial scale. *Id.* at 47389.

In addition, in the Final Rule OSM discussed what it called “retail sales dealers,” which have their own coal preparation facilities, and where the only contact with a mine is the purchase of run of the mine coal at wholesale prices. While OSM was not willing to state with certainty that all such facilities do not operate in connection with the coal mine; it did indicate that because coal preparation facilities operated by retail sales dealers tend to be closely linked to end users, OSM did not expect that regulatory authorities will likely find that such facilities are operated in connection with a coal mine. *Id.* at 47390.

In many respects, the Dakota 1 facility will operate as a “retail sales dealer” as it has its own coal preparation facility, and its only contact with the South Heart Mine would be to purchase run of the mine coal. As no usable coal product is returned to the mine, the Dakota 1 facility is clearly not operated “in connection with” the mine. The Dakota 1 facility is closely linked to its ultimate end users, being those facilities which desire beneficiated coal to meet environmental requirements or improve plant efficiency.

OSM agreed that as SMCRA’s primary emphasis is on reclamation and post mining land use; it would be inappropriate to extend SMCRA to industrial facilities designed for long-term use and not operated in connection with a coal mine. *Id.* at 47389.

In a recent case, a federal court of appeals acknowledged that the Secretary of Interior’s interpretation of provisions of SMCRA when the statute is silent or ambiguous are given deference if reasonable. The court recognized that SMCRA is a complex and puzzling statute, and in many cases raises a variety of issues as to its correct interpretation. *Citizens Coal Council v. Norton*, 330 F.3d 478, 481 (Cir. D.C. 2003).

OSM’s interpretations set forth in the Final Rule clearly indicate that coal processing facilities for the purpose of the end user are not “in connection with” a surface coal mining operation.

This position was affirmed in the Interior Board of Land Appeals’ decision in *Pacificorp v. Office of Surface Mining Reclamation and Enforcement*, IBLA 95-175, 143 IBLA 237 (1998). In this case, the mine operator also operated a preparation plant through a wholly owned subsidiary. The preparation plant was located on the site of a power plant. The coal processed at the plant was used by the adjacent power plant. The issue was whether the coal preparation plant must be permitted as a surface coal mining operation. The Board noted that under relevant Utah law that a permit is required for all coal preparation plants operating in connection with a coal

mine, leaving unregulated only coal preparation plants operated solely in connection with an end user or operated without connection to a mine or end user. *Id.* at 242. The Board quoted with approval from the Final Rule that “OSM has not changed its interpretation that mining operations in connection with an end user are not operations in connection with a coal mine. Coal preparation facilities which are being operated only in connection with another industrial facility, such as the power plant of concern to this commentator, do not operate in connection with a coal mine and are not subject to the rule.” *Id.* at 246.

The Dakota 1 facility will operate without connection to the South Heart mine and is for the sole purpose of end users.

Of significance is a ruling from a federal court of appeals in one of the many challenges to SMCRA regulations. The issue was the extent of SMCRA’s jurisdiction over processing and support facilities. *National Wildlife Federation v. Hodel*, 839 F2d 694 (Cir.D.C. 1988). While upholding regulations providing jurisdiction over “processing areas” that are not necessarily at but near the mine site; the court also recognized that OSM only purports to regulate facilities which must be “at or near” and are also “in connection with” a surface coal mine as defined in 30 USC § 1291(28)(a).

The court stated that the phrase “resulting from or incident to” language in subsection (b) of the SMCRA definition, “clearly suggests a causal connection, which, while not indicating an element of geographic proximity, certainly does require some sort of limiting principle of proximate causation that is familiar to the courts in tort law. Otherwise, every support facility that could be considered a “but for” result of a surface coal mining operation would be subject to SMCRA regulation.” In addition, the court stated that “resulting from or incident to” with respect to a facility “connotes an element of proximity to that activity.” *Id.* at 745.

These statements by the Federal Court of Appeals that “resulting from or incident to” requires “some type of limiting principle of proximate causation” is very significant in determination of what processing facilities are subject to SMCRA. The most likely “proximate cause” is that the processing facility depends on the mine’s requirements. In this case, operational success of the Dakota 1 facility will not depend upon the mine’s requirements. The sole purpose of the Dakota 1 facility is to serve the end user purchasers of its beneficiated coal.

In the Final Rule discussing support facilities, it was stated that OSM “would expect the economic dependence of a facility on a mine to be a critical element in determining the degree to which the facility results from or is incident to regulated mining activity.” Final Rule at 47381. In this case the Dakota 1 facility is not economically dependent on the mine, but on its end users, who desire the higher value BTU coal.

V. Environmental Considerations:

In some of the court and administrative law decisions, there was concern that if the coal processing plant was not regulated under SMCRA, that it would be left unregulated. However, there should be no such concerns regarding the Dakota 1 facility. The plant will require an air quality permit and a water discharge permit as issued by the North Dakota Department of Health.

A key advantage of the GTL USA beneficiation process is that it produces negligible emissions. All coal handling and processing will be contained inside buildings. Thus, the collection systems (wet scrubber plus bag/house) will be used to contain particulates and re-use nearly all of the dust created in processing the coal. The only plant emissions will be low amounts of particulates from a gas-fired boiler and the collection systems; along with water vapor emitted from a stack and clean condensed water (both of which have very low concentrates of volatile and semi-volatile organic compounds). As noted, all such emissions and discharges will be regulated by the North Dakota Department of Health.

VI. Other Considerations:

Coal produced from mines in North Dakota is subject to the coal severance tax on a tonnage basis. NDCC Chapter 57-61.

However, coal beneficiation plants are taxed in an entirely different manner. "Coal beneficiation" is defined to mean "improving the physical, environmental, or combustion qualities of coal, but does not include crushing or treatment with dust suppressants or freeze-proofing agents." NDCC § 57-60-01(2). A coal beneficiation facility is deemed for purposes of taxation only to be a "coal conversion facility." NDCC § 57-60-01(3). Such facilities are taxed at the rate of 20¢ on each ton of 2000 pounds of coal of beneficiated coal produced for the purpose of sale, or 1¼% of the gross receipts derived from such facility for the preceding month, whichever amount is greater. NDCC § 57-60-02(6).

Thus, under North Dakota law; coal beneficiation facilities are clearly treated not as coal mines but as coal conversion facilities for purposes of taxation.

It is anticipated that the Dakota 1 facility will be subject to regulation by the federal Occupational Safety and Health Administration ("OSHA") with respect to plant health and safety. A determination by the Commission that the coal beneficiation facility constitutes a "surface coal mining operation" could make it also subject to health and safety regulation by the federal Mine Safety and Health Administration ("MSHA"). However, a determination by the Commission that the coal beneficiation facility does not constitute a "surface coal mining operation" would likely mean that the facility will only be regulated by OSHA thus avoiding bifurcated health and safety jurisdiction over the same facility.

VII. Conclusion:

Recently, the Commission was requested to make a similar jurisdictional determination in Case Number PU-07-686. The Commission issued its determination on October 4, 2007 finding that the facility under consideration was not a “surface coal mining operation.” GTL USA submits that the Dakota 1 facility does not present even as close a case. That is, the primary purpose of the Dakota 1 facility is to prove the beneficiation technology on a commercial scale. Initially, the plant will not even utilize coal from the proposed South Heart Mine. All beneficiated coal will be sold to third party end users.

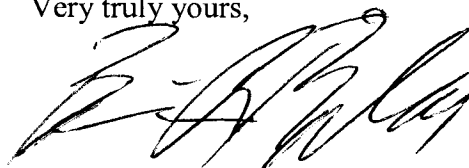
The proposed coal beneficiation facility of Dakota 1 is clearly not a “coal preparation plant” or “support facility” operated “in connection with” or “resulting from or incident to” a surface coal mining operation. It is not owned or operated by SHC, and no usable coal product is returned to the mine. What happens with the coal after beneficiation is solely the determination of Dakota 1.

OSM’s own interpretation of the Final Rule does not merely exempt “coal preparation plants” constructed on the site of the ultimate end user, but clearly indicates that the rule also excludes processing facilities other than those at the point of the ultimate user that are not in connection with the coal mine. In this case, the ultimate user is large industrial facilities located in North Dakota and elsewhere who want to purchase beneficiated lignite to meet environmental requirements.

In many respects, Dakota 1 will operate as a “retail sales dealer” as discussed in the Final Rule. The facility will have a useful life independent of any specific mine, and is not functionally or economically tied to any regulated surface coal mining operation.

The Dakota 1 coal beneficiation facility is not a “surface coal mining operation” under Chapter 38-14.1, NDCC. GTL USA respectfully requests the Commission to concur in this determination.

Very truly yours,

A handwritten signature in black ink, appearing to read 'B. R. Bjella', written in a cursive style.

BRIAN R. BJELLA