# Overview of the Federal Coal Program

Management of the federal coal program has large implications for taxpayers, the coal sector, and the U.S. energy landscape. The predominant leasing process currently used by the Bureau of Land Management (BLM), the agency within the Department of the Interior (DOI) that manages the federal coal leasing program, does not obtain fair market value for taxpayers.

## Background

In 2017, 326 million tons of coal were produced on federal lands, representing 42 percent of all U.S. coal production. This coal was produced from 298 leases, just under half of which are located in the Powder River Basin in Montana and Wyoming. These mines, and all coal production on federal lands, are managed by the BLM. Longstanding concerns about the ability of the federal coal program to attain fair market value for taxpayers prompted the BLM to initiate a comprehensive review of the program in 2016. The review process was halted in 2017 and concerns persist about the return generated for taxpayers from all aspects of the program, from leasing practices before coal mines break ground to the reclamation of the sites when mining ends.

## The Leasing Process

Under the Federal Coal Leasing Amendments Act of 1976, as amended, DOI is required to hold competitive leases for tracts of federal lands classified for coal leasing. Despite this, DOI has been able to circumvent the competitive leasing mandate by introducing a Lease By Application (LBA) system. The LBA process begins with private companies submitting an application to the BLM indicating interest in a specific coal tract. The BLM then reviews the application to determine whether the tract or tracts in question adhere to its land use plans for the area and if the tracts are suitable for development.

If these criteria are met, the BLM prepares an Environmental Assessment (EA) or Environmental Impact Statement (EIS) for coal development on the federal lands in question and collects public comment. Once the EA or EIS process is concluded, the BLM publishes a notice in the federal register of its plan to conduct a lease sale for the tract. Before the sale, the BLM calculates an estimate of the fair market value of the lease, and the coal it contains. Private companies then submit sealed bids to the BLM for the lease. In many cases, there is only a single bidder – the company that nominated the parcel.

## Fair Market Value Calculation

In the absence of a competitive system, accurate determinations of coal values are critical to the revenues realized by the government. The BLM's estimate of "value" or "fair market value" (FMV) serves as the basis for evaluating lease sale bids. If a sealed bid submitted by a company is less that the BLM's FMV estimate, then the bid will be rejected, and vice-versa. Thus, it is essential for the BLM to set a minimum acceptable bid price that reflects fair market value in order for taxpayers to get a fair return from coal leasing. The data and methodology the BLM uses to make FMV estimates are not publicly

available and company bids are sealed, creating an opaque process that can lead to less revenue for federal taxpayers.

**Coal Valuation**

The amount of revenue generated for taxpayers from the federal coal system depends not only on the estimated value of coal when federal land is being leased, but also on the actual value of coal when it's extracted and sold. The latter matters because the DOI, through the Office of Natural Resources Revenue (ONRR), collects a set percentage of the sales value of federal coal, known as a royalty (see Royalty Rates section below). ONRR can be sure it's collecting a portion of the *market* value of federal coal when it's sold from the mine operator to an unaffiliated buyer, known as an "arm's-length transaction." It's much harder to determine the market value of coal when it's sold between affiliated companies – a "non-arm's-length transaction," or "captive sale."

In recent years, concerns have been raised that coal companies are manipulating the value of federal coal through captive sales to reduce the amount of royalties they pay to ONRR. Those concerns are fueled in part by the large amount of captive sales. In 2017, 88 percent of federal coal was produced in Wyoming and Montana, home to the Powder River Basin. The Energy Information Association (EIA) reported that 135 million tons, or 38 percent of all coal produced from those states in 2017, was sold in captive sales.

In 2016, ONRR introduced a rule that changed how coal sold in non-arm's-length transactions would be valued for royalty purposes. The rule was subsequently repealed in 2017, however, leaving the issue of federal coal valuation unaddressed.

**Royalty Rates**

For more than 30 years, royalty rates on federal coal have remained unchanged, but companies frequently pay less than the established rates. In 1979, the BLM set the royalty rate at the minimum 12.5 percent for surface mining and established a minimum 8 percent royalty for underground mining. However, the BLM has broad discretion to reduce these royalty rates and has frequently exercised its authority to do so in recent decades. In between 1992 and 2013, the BLM approved 30 separate royalty rate reductions. These royalty rate reductions have decreased total royalty payments by $294 million according to a study by Headwaters Economics.

**Reclamation Bonding**

In order to receive a permit to begin mining operations, coal companies must explain how they plan to clean up federal land once they finish mining it. They also need to prove they will be able to pay for site cleanup ("reclamation") by providing some type of financial assurance, or "bond." In recent years, a string of coal company bankruptcies revealed weaknesses in the federal government's requirements for these reclamation bonds. In particular, the bankruptcies proved that allowing companies to use the strength of their finances to guarantee cleanup costs, known as "self-bonding," does not adequately protect taxpayers from reclamation liabilities. The relevant federal agency has not yet issued new rules to obviate the problems posed by self-bonding.

**Conclusion**

Systemic issues with coal leasing, valuation, royalty collection, and reclamation bonding have prevented the federal coal program from capturing a fair return for federal coal resources for decades. Each of these issues must be addressed in order to ensure taxpayers are receiving their due from the federal coal program. As the owners of these valuable natural resources, taxpayers should be receiving a fair return.

For more information see www.taxpayer.net/coal