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Taxpayers for Common Sense Comments to Bureau of Land Management on the Federal Coal Leasing Program Review

Mr. Huebner and Members of the Bureau of Land Management Coal Review Team:

Taxpayers for Common Sense (TCS) is a national non-partisan budget watchdog that has been working on behalf of the nation's taxpayers since 1995. Part of our mission is ensuring taxpayers are fairly compensated for the natural resources we collectively own. The revenues received from royalties and fees collected from natural resource extraction on public lands and waters represent an important source of non-tax income for the federal government. Fair assessment and accurate collection is vitally important to ensure taxpayers are receiving the fair return we are due as the resource owners.

For decades the federal coal program has been riddled with problems that have led to taxpayers losing valuable revenue year after year. TCS has tracked, monitored, and scrutinized actions of the federal coal program, sounding the alarm in testimony, reports, policy briefs, and in other communications with the Department of the Interior, Congress, and the public. The bottom line is that in the existing system, our nation's coal has been substantially undervalued and substantial liabilities have been passed on to taxpayers.

For this reason, TCS strongly supports the Department of the Interior and its subagency the Bureau of Land Management undertaking a robust review of the federal coal program.

Under the current system, the coal industry has effective control over much of the federal leasing process, leading to a largely opaque process that does not obtain fair market value. The federal coal program's lack of transparency has led to decades of revenue losses from the sale of federal coal.

The Bureau of Land Management (BLM) has the fiduciary responsibility to manage all natural assets, including federal coal, on behalf of nation's taxpayers. We urge you to review the program with special attention to Fair Market Value calculations, Royalty Rates, Royalty Valuation, Royalty Rate Reductions, and Reclamation and Bonding Requirements as these are all areas where taxpayers lose.

Background

The leasing process generally used by the BLM does not obtain fair market value for taxpayers. Competitive bids are seldom generated, and studies indicate that the resulting losses for taxpayers are substantial. Congress enacted the Federal Coal Leasing Amendments Act of 1976 (FCLAA)[1] to require competitive bids and to specify that no bid may be accepted that does not represent fair market value. The act also established diligent development requirements to reduce speculation and to institute minimum royalty rates. BLM's FCLAA implementing regulations[2] require the Secretary to delineate tracts for leasing from among those lands classified for coal leasing. Tracts are to be of a size the Secretary *"finds appropriate and in the public interest* and which will permit the mining of all coal which can be economically extracted…"[3] Tracts are then offered for lease at sales held either on the motion of the Secretary or upon the request of any qualified applicant. The Secretary must award leases by competitive bidding, except for certain sales expressly authorized to be negotiated sales.

Coal Production Regions. Federal coal lease sales have little resemblance to the process described in the BLM's own regulations. A principal reason current practices fail to follow the rules is the BLM's decertification of coal producing regions that form the cornerstone of the regulatory structure.[4] Since the BLM concluded that there were no coal production regions in America, it has lost control of the coal leasing process. Decertification of coal producing regions short-circuited the full competitive system envisioned by Congress, eliminating the first step on which many other regulations depend.

Lease-by-Application ("LBA"). The LBA system eliminates the formal process by which the regulations anticipate BLM would set leasing levels — a process that involved extensive public participation and directed the consideration of many facets of the coal resource, uses of the public lands, and current and future market factors. Under the LBA system, the BLM allows coal companies to play a large role in delineating tracts for leasing — a process that typically results in tracts that do not generate competitive bids. The reason: The location and configuration of a given tract limit its appeal only to the one company that applied for the tract to be sold.

Lease Modifications. The Mineral Leasing Act (MLA) allows the Secretary to modify an existing lease to avoid "bypass" coal – stranded coal formations that don't offer sufficient quantity to be sold competitively on their own. The Energy Policy Act of 2005 expanded the amount of acreage that can be added to an existing lease by a lease modification from 160 acres to 960 acres – a size that might represent significant value to a company with equipment already in the area.

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[1] P.L. 94-377 – August 4, 1976

[2] Bureau of Land Management, U.S. Department of the Interior, Final Rulemaking: "Coal Management; Federally Owned Coal," 42 FR 42584 – July 19, 1979; and Bureau of Land Management, U.S. Department of the Interior, Final Rulemaking: "Coal Management; Federally Owned Coal; Amendments to Coal Management Program Regulations," 47 FR 33114 – July 30, 1982

[3] 30 U.S.C. §201(a)(1)

[4] 43 CFR 3400.5

The DOI Inspector General (IG) examined 45 lease sale modifications since 2000 and concluded that $60 million had been lost by those adjustments.[5] The BLM faulted that conclusion because the IG had valued the coal in the additional lease areas at the same rate as the main leases to which additional deposits were added. This conflict highlights the need for further review and guidance on valuing coal deposits, both for lease modifications and for maintenance tracts. The BLM argued that the coal should be valued at a lower rate because there was no competitive interest – one choice for valuation. If coal is being added to an existing lease because it is by definition coal for which there is no competitive interest, determining its value to the company requesting it might be appropriate – a second valuation alternative. The IG proposed yet a third alternative– valuing the coal at the same rate as the lease being modified.

Fair Market Value. Because lease modifications and most LBA lease sales are not competitive, it is imperative that the BLM establish the correct Fair Market Value ("FMV") for federal coal. The process of determining the FMV for a lease tract is shrouded in secrecy. The data and methodology the BLM uses to determine FMV are not publicly available. Bids are sealed. The public has no idea what the coal is worth or how it was valued.

Royalty Rates. The BLM should consider increasing the royalty rate to 18.75 percent for federal coal production, as this royalty rate would ensure that the taxpayers are recovering a fair share of the market value of the resource and not favor one energy source over another. The federal government currently charges a royalty rate of 18.75 percent for offshore oil and gas production, and many states charge similar or higher rates for state-owned oil and gas.

The industry has argued at times that the taxes that coal companies pay to local, state, and federal governments should offset the royalties they pay for the right to mine and sell federal coal. Just because the coal industry pays taxes, like every other industry, does not mean it should not pay fair market value for federal coal. Private landowners charge royalties on the market value of private coal, in addition to whatever taxes the companies might pay. Taxpayers, the owners of federal resources, should also charge market-based royalties.

Royalty Valuation

The process used to determine the value of federal coal for calculating a royalty is also done in secret and is largely controlled by industry. The Office of Natural Resource Revenue (ONRR) released its final rule governing the valuation of federal coal in June 2016.[6] The updated rule was certainly an improvement, but TCS was disappointed that well-documented problems with coal valuation were not eliminated. Numerous studies, including a recent report by the Council of Economic Advisers (CEA),[7] have demonstrated how coal companies manipulate the current valuation system to reduce royalty payments.

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[5] Office of Inspector General, U.S. Department of the Interior, Report No. CR-EV-BLM-0001-2012,"Coal Management Program," June 2013

[6] Office of Natural Resource Revenue, Final Rulemaking: "Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform," 81 FR 43338 – July 1, 2016

[7] White House Council of Economic Advisers (CEA), "The Economics of Coal Leasing on Federal Lands: Ensuring a Fair Return to Taxpayers," June 2016

The Trump Administration tried and failed to repeal the 2016 rule before publishing a rule in its final week that largely reverted the non-arm's-length valuation system to its pre-2016 form. After the change in administration, ONRR delayed the effective date of that January 2021 rule and requested public comments. TCS submitted comments urging ONRR to rescind the Trump Administration's rule and strengthen protections for taxpayers. In June 2021, ONRR formally proposed to withdraw the 2021 valuation rule. On September 30, 2021, ONRR withdrew the rule.[8]

If the 2016 rule remained in effect, ONRR would be using the gross proceeds from the first independent, or "arm's-length," sale of the coal to calculate royalties owed to the federal government. The change would have improved the system by ensuring that the royalty value of coal in a non-arm's-length transaction is rooted in prices set between unrelated parties – the economic gold standard for establishing value in the market. ONRR must try again to revise valuation method for non-arm's-length coal sales to better capture its value for royalty purposes.

Reclamation and Bonding Requirements

The BLM must review its bonding regulations and practices to determine whether current arrangements will adequately cover reclamation costs in the event of default. Reclamation costs must be reviewed to keep pace with current development costs. And BLM must change self-bonding practices to ensure that companies have assets adequate to cover all unreclaimed leases.

The Surface Mining Control and Reclamation Act of 1977 (SMCRA) requires coal mining operators to restore all land affected by their operations and to post a bond to cover reclamation costs if they fail to restore the land.[9] With many coal companies financially stressed, the ability of BLM to implement the law's bonding requirements, particularly in allowing "self-bonding,'' is questionable.

In recent years, coal companies have qualified for self-bonding in ways that were not anticipated by the original self-bonding rules promulgated in 1983[10] by the Office of Surface Mining Reclamation and Enforcement (OSMRE), the regulatory authority created by SMCRA. Specifically, large coal companies have used the financial statements of subsidiaries to prove they have the assets available to cover reclamation costs.[11] Frequently, the same assets used to signify the health of a subsidiary for self-bonding purposes are also posted as collateral to cover debt carried by its parent company. They are, in a sense, "double-pledged." In the event of a bankruptcy, there is no requirement that a company's promise to pay for reclamation costs

[8] Office of Natural Resource Revenue, ONRR 2020 Valuation Reform and Civil Penalty Rule: Final Withdrawal Rule. https://www.federalregister.gov/documents/2021/09/30/2021-20979/onrr-2020-valuation-reform-and-civil-penalty-rule-final-withdrawal-rule
[9] P.L. 95-87 – August 3, 1977, Section 509(c)
[10] 30 C.F.R 700-999
[11] Benjamin Storrow, Casper Star Tribune, "Feds Say Peabody Energy may be violating mining law," February 17, 2016. Available at: http://trib.com/business/energy/feds-say-peabody-energy-may-be-violating-mining-law/article_9f9ff61c-a338-5433-b77a-36ccab78b628.html

through a self-bond will get any higher priority than other creditor claims. Therefore, SMCRA's self-bonding option has proven inadequate to protect taxpayers.

Royalty Rate Reductions

BLM should review its guidance and application of standards for the approval of royalty rate reductions. Reductions in royalty rates should be the exception, not the rule. According to ONRR data, almost half of the federal coal lease sales in the last 25 years received a royalty rate reduction. Between 1990 and 2010, roughly 200 requests for royalty relief were filed by federal coal lessees, about nine each year. In 2014, the Bureau issued an Instruction Memorandum specifying how relief requests should be evaluated. From 2015 to 2019, coal companies submitted eight requests per year, on average. In 2020, BLM received 58 requests for royalty relief. The surge is at least partly due to the BLM's invitation to submit requests under the guise of COVID-19 related economic relief. Some of the requests approved at the 11th hour of Trump Administration were highly questionable.[12]

The major amendments to coal leasing enacted in 1976 authorized the Secretary to, "waive, suspend, or reduce a rental, or minimum royalty, or reduce the royalty on an entire leasehold or on any tract or portion thereof … whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provide therein…"[13] Two essential MLA elements must both be met to qualify for a rate reduction: 1) the royalty rate reduction must encourage the greatest ultimate recovery of coal; and 2) the royalty rate reduction must be in the interest of conservation of natural resources. Even if these elements are demonstrated, a rate reduction may be granted only when it is necessary to promote development or if the lease cannot be successfully operated under the lease terms. Royalty rates may be reduced to as low as two percent.

Conclusion

From the designation of lease tracts to the reclamation of abandoned mines, the federal coal program creates controversy by failing to ensure a fair return to taxpayers. Given that backdrop, it is appropriate for the Interior Department to reevaluate the process and to update policies that have not kept pace with today's energy markets. The goal of this review should be to create a program that strives for transparency and fulfills the department's fiduciary responsibility to wisely manage public resources on behalf of taxpayers.

[12] Taxpayers for Common Sense, New Royalty Relief for Coal Spells Headache for Taxpayers, Aug 2021.
[13] 43 C.F.R. 3103.4-1