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# The Tragic Story of the Federal Coal Leasing Program

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Mark Squillace

**T**he federal government owns about eighty-eight billion tons of recoverable coal, or about one-third of all U.S. coal reserves, which amounts to nearly 10 percent of the world's known reserves of coal. Because the United States currently consumes about one billion tons of coal each year, federal reserves alone could satisfy current domestic consumption rates for more than eighty years. The federal government, as the owner of vast quantities of coal, powerfully influences the market when it decides whether to sell coal. From the earliest days of federal coal policy to the present, the federal government has exercised its authority in a way that undermines the significant public interests associated with this resource. Ideally, the problems with the federal coal leasing program would have been addressed two decades ago when coal sales were booming. But the issues remain critically important today, as coal companies look overseas to expand the market for the federal coal they are producing. This article explores the source of the problems and offers a road map for reforming the leasing program.

## *The History of Federal Coal Policy*

Throughout much of the nineteenth century, the federal government encouraged western settlement, largely through programs that granted land ownership rights to settlers. Early on, federal land known to contain coal received no special treatment and was available for acquisition by purchase or land grant. In 1864, however, Congress enacted the 1864 Coal Lands Act, which required federal lands known to possess coal to be sold at public auction. Subsequently, Congress passed the Coal Lands Act of 1873, which limited the size of each coal land entry and set minimum per acre sale prices. In 1906, President Theodore Roosevelt responded to the public outcry over speculation of public coal lands and other abuses of the government land policy by withdrawing more than sixty-four million acres of land from coal entry. Roosevelt's action was designed to give the Department of the Interior an opportunity to determine the presence, quality, and quantity of coal on these public lands. But Western settlers, who faced the possible loss of land they were claiming under the Homestead Act, pressured Congress and President Roosevelt to come up with a solution that balanced the settlers' interests with the federal interest in coal lands. One simple corrective was to reopen lands for entry and settlement that were found not to contain coal. Interior Secretary James Garfield suggested a second and

more long-term solution. Why not separate the surface and mineral rights in public land sales? Roosevelt forwarded this idea to the Congress.

In 1909, Congress enacted the Agricultural Coal Lands Act, which allowed settlers who made non-fraudulent agricultural entries on lands later found to contain coal to take legal ownership of the surface, while reserving the coal rights for the federal government. In 1910, Congress reopened all of the coal lands that had been withdrawn by President Roosevelt, but it limited the settlers' rights to the surface estate.

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The Stock-Raising Homestead Act of 1916 (SRHA) expanded the split estate policy by limiting settlers' rights to the land surface for all federal lands available for homesteading. The SRHA required every patent to include "a reservation to the United States of all the coal and other minerals in the lands so entered and patented, together with the right to prospect for, mine and remove the same." 43 U.S.C. § 299(a). The SRHA also increased the size of public land available for a homestead patent to 640 acres. The SRHA allowed a coal company to file "notice" with the Interior Department and surface landowner, which then gave the coal company exclusive exploratory access for minerals over the land from every other person, including the surface landowner. If deposits were discovered, the company would then have the right to mine and remove any coal or other mineral deposits for its own profit. *Id.* at § 299(b)(2)-(3).

In 1920, in response to the nascent conservation movement and to encourage better management of federal mineral resources, Congress enacted the Mineral Leasing Act (MLA). 30 U.S.C. §§ 181 *et seq.* The MLA applies to all deposits of coal, phosphate, sodium, potassium, oil, and gas on federal land. As originally enacted, the MLA created two types of leases for mineral lands. Preference right leasing allowed applicants to file and receive a two-year prospecting permit

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that authorized miners to search for particular types of mineral deposits on areas of public land where no known deposits existed. If minerals were found in commercial quantities, the permit holder was entitled to receive an exclusive lease for the land to mine the mineral. When minerals were known to exist on federal land, the MLA established a system of competitive leasing whereby leases were awarded to the highest qualified bidder.

Among other things, the MLA required lessees to use reasonable diligence to develop and continuously operate their leases for mineral production. This was not a significant issue for coal properties because there was little demand for federal coal and few leases were issued before 1960. The number of federal coal leases increased abruptly in the 1960s, as did the size of the leases. Production, however, remained almost nonexistent on these leases, and the diligent development requirement of the MLA was largely ignored on most coal leases. See ROBERT NELSON, *THE MAKING OF FEDERAL COAL POLICY* at 25 (1983).

By 1970, speculation had become rampant. The government had leased nearly sixteen billion tons of federal coal, yet little federal coal was actually being mined. An internal BLM study conducted in 1970 revealed that less than 10 percent of federal land being leased for coal production was actually producing coal. See U.S. Department of the Interior, Bureau of Land Management, *Holdings and Development of Federal Coal Leases* (1970). As a result, calls for reform became more pronounced. In 1973, Secretary of the Interior Rogers Morton imposed a moratorium on all new coal leasing and the issuance of any new coal prospecting permits “in order to allow the preparation of a program for the more orderly development of coal resources upon the public lands of the United States under the Mineral Leasing Act, with proper regard for the protection of the environment.” Secretarial Order No. 2952, 38 Fed. Reg. 4682 (Feb. 17, 1973).

### **Modern Federal Coal Policy**

Congress responded to the problems with federal coal policy in 1976 with the enactment of the Federal Coal Leasing Amendments Act (FCLAA). Pub. L. No. 94-377 (1976). The House Report identified seven specific problems that FCLAA was designed to address: (1) speculation; (2) concentration of holdings; (3) fair return to the public; (4) environmental protection, planning, and public participation; (5) social and economic impacts of coal mining; (6) the need for information; and (7) maximum economy recovery of the resource. H.R. Rep. No. 94-681 (1975).

After several attempts, new federal regulations under FCLAA were promulgated in 1979, and then amended in 1982. It was not long, however, before problems with the new program emerged. In 1982, the Department of Interior sold two coal leases in the Powder River Basin that were legally suspect and publicly criticized for not receiving fair market value. The ensuing public outcry led Congress to create The Commission on Fair Market Value Policy for Federal Coal Leasing (known as the Linowes Commission), which was tasked with investigating federal coal leasing policies. The Linowes Commission published a report with thirty-six recommended changes designed to promote a more predictable and stable coal leasing program, to encourage more competition between bidders, to assure that the government received

fair market value, and to set standards for lease selection and development.

The basic structure for the federal coal leasing program established under FCLAA was set out in the 1979 and 1982 regulations. The process begins with the establishment of “coal production regions” by BLM. The rules do not define the term “coal production regions,” but the words seem self-explanatory. The meaning of the phrase “coal production region” is critical to the operation of the leasing program because the rules make clear that “[c]oal production regions shall be used for establishing regional leasing levels. . . .” 43 C.F.R. § 3400.5 (2011).

Under these regulations, coal leasing is supposed to be carried out in four phases. First comes land use planning, which is designed to ensure that coal leasing passes through four screening procedures. The first screen requires the agency to determine the development potential for coal in the planning area. This analysis includes estimates of the quality and amount of economically recoverable federal coal reserves. Next, the agency considers whether lands may be unsuitable for mining. Lands deemed unsuitable are dropped from consideration from leasing. Multiple use trade-offs are then assessed to determine whether other important uses may be incompatible with mining. Potential conflicts may lead to removing additional areas from consideration for leasing. Finally, the agency consults with surface owners to obtain the necessary consent for mining as required by the Surface Mining Control and Reclamation Act.

Once planning is completed and a final land use plan (Resource Management Plans on BLM lands and Land and Resource Management Plans on Forest Service lands) is adopted, regional leasing levels are supposed to be set through a rather complex process. This process is guided by the Regional Coal Team (RCT), an advisory committee established under the Federal Advisory Committee Act that includes three federal agency representatives and two representatives from the affected state. The chair of the RCT provides recommendations from the RCT’s members to the appropriate BLM State Director who, among other things, must outline alternative leasing levels. The RCT then considers the BLM State Director’s review and transmits to the Secretary alternative leasing levels and a preferred leasing level. After various consultations, the Secretary then considers a variety of factors before setting the lease level. Among the factors that must be considered are: (1) “the potential economic, social, and environmental effects of coal leasing . . .”; (2) the “expressed industry interest . . . and indications of the demand for coal . . .”; (3) the expected production from existing federal and nonfederal coal holdings; (4) “the level of competition in the region . . .”; (5) U.S. coal production goals, national energy needs, and the demand for federal coal; and (6) public comment. 43 C.F.R. § 3400.2(c). Leasing levels must be established for every coal production region where activity planning is conducted. *Id.* at § 3420.2(e).

Coal lease activity planning is the third step, and it is a critical part of the leasing process. Here, the RCT guides the tract delineation process, including the selection of tracts that will meet the leasing level set by the Secretary. The activity-planning phase includes a review of the land use plan and a long-range market analysis that is supposed to help BLM decide whether to proceed with leasing. If the RCT decides to move forward with leasing, a panel of science advisors and an internal BLM review council are appointed to assist the RCT

in tract delineation, site-specific analysis, and EIS preparation. A call for expressions of interest in leasing is also published in the Federal Register. Responses may be used by the RCT in delineating potential coal lease tracts. The RCT then recommends a regional leasing level to the Secretary and identifies, ranks, analyzes, and selects tracts for study in a regional coal lease sale environmental impact statement (EIS). A regional lease sale decision is then published in the Federal Register.

Finally, the lease sale is scheduled. To achieve the maximum economic recovery of the coal resource, public comment is solicited on fair market value and appropriate mining methods. A regional evaluation team then prepares its own estimate of the value of each lease tract. Following a thirty-day period of public notice, the lease sale is offered by means of sealed bids. This is sometimes called the “bonus bid,” and it is paid up front to the federal government by the high bidder, assuming BLM accepts the high bid as representing fair market value.

The bonus bid is paid on top of a 12.5 percent production royalty for federal surface-mined coal as provided under the FCLAA. 30 U.S.C. § 207; 43 C.F.R. § 3473.3–2(a)(1) (2011). The royalty rate for coal mined by underground methods is set at 8 percent. *Id.* at § 3473.3–2(a)(2). Both the bonus bid and royalty payments are shared equally by the state and federal governments. A post-sale analysis of the bids is then made recommending acceptance of the high bids. Only high bids representing fair market value may be accepted. A successful bidder must also pass an antitrust review by the Department of Justice.

There are no exceptions to the phase one land use planning and phase four lease sale activity requirements. But the rules establish a “lease on application” process (usually described as “lease by application” or LBA) that effectively allows BLM to avoid phases two and three of the leasing process—the stages where the federal government sets the leasing levels and designs tracts for lease sale—in two circumstances. First, LBAs are allowed for emergency leasing within designated federal coal production regions. Such leases are designed for those limited circumstances where federal coal might be bypassed or where a new lease is needed to maintain production levels in the near term. Second, LBAs are allowed for leases issued “outside coal production regions.”

In 1990, the Powder River RCT decided that the Powder River Basin (PRB), which straddles the Wyoming/Montana border and is one of the richest coal production regions in the world, was *not* a coal production region. The RCT made this decision notwithstanding the fact that more than 40 percent of U.S. coal production comes from the PRB and that coal is shipped to more than thirty U.S. states and several foreign countries. The reasons for declaring that the PRB is not a coal production region are somewhat unclear, but in a letter responding to a request from environmental groups to recertify the Powder River Basin as a coal production region, BLM explained that its decision to decertify the area was “based on current and projected market conditions, the potential for emergency leasing, the level of industry interest in Federal coal, public comment, and views expressed by the RCT and the affected state governor . . . . Leasing demand in the decertified [region] was anticipated to be limited to replacement of exhausted reserves, which could be accomplished through maintenance leasing.” Letter from Robert Abbey, Director, BLM, to Jeremy Nichols, Executive Director of WildEarth Guardians (Jan. 28, 2011). BLM’s rules, however, say nothing

about an exception for “maintenance leasing,” and the very notion of such leasing is arguably anticompetitive, especially in an area where more than 40 percent of the nation’s coal supply is produced.

Indeed, since 1991, BLM has leased nearly 7.3 billion tons of federal coal in the Powder River Basin on tracts designed by existing coal operators without the benefit of setting regular leasing levels or engaging in regional sale activity planning. Moreover, all of the historic federal coal production regions in the country have been decertified, thus essentially eliminating the critical second and third steps in the leasing process provided for under the federal rules.

As a practical matter this means that, contrary to the plain language of FCLAA and BLM rules, the coal industry—not the federal government—drives the coal leasing process. Under BLM’s rules, the Department of Interior was supposed to take the lead by first deciding whether there was sufficient demand for new coal leases to warrant setting lease sale levels and, if so, then designing tracts to maximize competition and ultimately the return to the state and federal treasuries. On only one occasion during the modern era of leasing has Interior said no to a proposed LBA sale—and that case involved the refusal of a surface owner to consent as required by law. BLM sometimes has rejected the bid received at a lease sale on the grounds that it was lower than BLM’s determination of fair market value, but the agency has never come close to testing the limits of the market by, for example, setting a minimum bid price that better reflects the national market for coal.

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Under the current system, industry decides whether, where, and how much coal they want to lease, subject to BLM approval and in certain cases adjustment of the boundaries of an LBA tract proposed by industry. Not surprisingly, the industry has demanded far more leasing than some believe the market can rationally bear and has applied for leasing tracts that adjoin existing mines and that are arguably designed by the industry applicant to avoid competition. In the Powder River Basin, for example, BLM has held twenty-seven coal lease sales over the last twenty-one years. Twenty-two of those sales have attracted one bidder and, in every case, the sole bidder was the owner of the adjacent coal mine. The other five have attracted just two bidders and most of the second bidders owned another adjacent mine. Bonus bids for PRB tracts have ranged from 0.111 cents per ton for 166.4 million tons of coal at the Eagle Butte mine in 1995 to \$1.1016 per ton for 130.196 tons of coal at the Caballo West mine in 2011. Most bids were well below one dollar per ton.

This record does not reflect the kind of robust competition that Congress intended when it passed the FCLAA. Five

sales did attract two bidders, including the Caballo West sale in 2011. However, a two-bid sale that is fought over between neighboring coal companies does not constitute a sale that is as competitive as it might otherwise be. One example from 1998 shows how competition increases revenue: The lessee applicant bid \$124 million and the competing (and winning) bidder offered \$158 million, resulting in an additional \$34 million for state and federal treasuries. Likewise, a competing company in the 2011 Caballo West sale noted above beat the applicant's bid by \$15 million.

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If the lease sales were designed by BLM to maximize revenues and BLM had been able to get bids at a substantially higher market value, the government arguably would have realized hundreds of millions of dollars of additional revenues. Indeed, FLCAA's goals of avoiding speculation, assuring a fair return to the public, and minimizing the concentration of holdings have all been undermined by BLM's implementation of FCLAA. Just a handful of companies now account for all of the coal produced in the Powder River Basin of Wyoming, even while PRB coal accounts for more than 45 percent of U.S. coal production. Even without this consolidation in the industry, it would likely be difficult for new players to break into the PRB coal market, given the enormous capital costs associated with such entry. Still, by undervaluing coal, the current federal coal leasing program encourages more coal leasing, production, and consumption as well as the marketing of federal coal outside the United States, where the coal companies can demand prices that are far beyond what they pay for federal coal rights.

The sale price of coal at the mine mouth on federal lands is far less than the price for coal available virtually anywhere else in the world. The latest figures available from the Energy Information Administration (EIA) show that an average 2010 sales price of Wyoming coal, which is primarily federal PRB coal, was \$12.03 per ton on the open market. See *Average Sales Price of Coal by State and Disposition*, DOE/EIA-0584(2010). The highest price for coal in any of the Western states was in Colorado, where the EIA lists the 2010 open market price at \$39.45 per ton. By contrast, the 2010 price of Appalachian coal ran as high as \$96.15 in Virginia, but was mostly in the \$60–70 range. *Id.* All of these prices have declined since 2010 due to the precipitous drop in domestic demand for coal, but the relative values are fundamentally the same.

To be sure, the value of any coal varies depending on Btu

value, sulfur content, and other factors. But even accounting for these differences the price of PRB coal in particular is out of line with the domestic market generally. Indeed, while PRB coal generally has a lower Btu value, it is widely praised for its low sulfur content, which is highly valued by utilities.

The price of coal worldwide is generally higher than in the United States. When the sale price for coal at the mine mouth in the PRB is less than ten dollars per ton, as it is today, the export market begins to look very attractive. But why would the federal government sell its coal so cheaply that it becomes attractive to ship that coal halfway around the world? See EIA, *U.S. Coal Exports and Imports, 2006–2012* (June, 2012) (noting that 107 million tons of coal were exported from the United States in 2007). If the federal government is indeed underpricing its coal, it has cost the state and federal treasuries billions of dollars in lost receipts.

### *Reforming the System*

There seems little doubt that the current system has brought about a significant loss of public revenues. One recent study estimates the loss of public revenue at \$28 billion. Tom Sanzillo, *The Great Giveaway: An Analysis of the United States' Long-term Trend of Selling Federally-owned Coal for Less than Fair Market Value*, Institute for Energy Economics and Financial Analysis (June, 2012). What can be viewed as a substantial subsidy to the coal industry comes at a time when public concerns about the adverse impacts from coal development and use have never been greater. One argument frequently invoked to support current coal leasing protocols policy is that such actions implement the provision of the Energy Policy Act of 2005 that promotes the increased use of coal to meet domestic energy needs. 42 U.S.C. § 13571. But FCLAA demands that the government obtain fair market value for its coal, and nothing in the Energy Policy Act undercuts that legal requirement.

BLM could begin to solve the problem with the current coal leasing program by recertifying the Powder River Basin and all of the other federal coal producing areas of the country as “coal production regions.” In taking such action, BLM could also make clear its commitment to assuming responsibility for setting leasing levels, engaging in regional sale activity planning, and designing lease tracts all with a goal of maximizing competition. Given the vast quantities of coal that have already been leased under the current flawed system, this is only a starting point.

In thinking about reform in 2012, it is hard not to look back at what might have been. Imagine, for example, that the federal government had decided twenty years ago, in response to the Linowes Commission report, to experiment with minimum bid prices to see what the market could tolerate. They might have started the process with a minimum bid price of two, three, or even five dollars per ton. This would have modestly increased the mine mouth price of PRB coal as compared with the prices where most PRB coal is sold, while still keeping PRB coal competitive except in the most remote areas of the country.

Consider, for example, how a minimum bid of three dollars per ton would have impacted revenues for the eleven lease sales that occurred during the decade between 1991 and 2000. These sales encompassed a little more than 2.64 billion tons of coal and the bonus bids ranged from 11.1 cents to 38.5 cents.

(The high bid was for the only sale during this decade that attracted more than one bidder.) Bonus bid revenues for this 2.64 billion tons of coal totaled \$612.91 million. If, however, the government had imposed a minimum bid of three dollars per ton—and accepted that bid in every case as the fair market value and had been able to sell the same amount of coal—revenues would have increased to \$7.92 billion, or nearly thirteen times the revenues that were realized from the actual sales. At five dollars per ton, revenues would have soared to \$13.2 billion. Moreover, because the sale price of the coal would presumably have been higher, the 12.5 percent royalties paid to the state and federal governments would also have risen dramatically. Consider, for example, that a two-dollar increase in the price of PRB coal translates into \$100 million in additional revenues for the approximately 400 million tons of federal PRB coal sold each year.

It is possible that the sale of PRB would have declined at these prices, but PRB coal would still have been more than competitive with most other coal around the world even if it had cost three, five, or even ten dollars more per ton. If the government had leased just half as much coal but demanded at least three dollars per ton as a bonus bid, the state and federal governments would have realized more than six times the revenues actually realized, or nearly four billion dollars.

We will never know what revenues were lost as a result of the government's mismanagement of the coal leasing program. But what we do know is that BLM has refused to recertify the PRB as a coal production region and begin the process of establishing a truly competitive leasing program. In November 2009, the WildEarth Guardians and other organizations petitioned BLM to recertify the PRB as a coal production region for many of the reasons outlined in this article. It took BLM more than a year to respond. When it finally did, BLM declined the request, claiming that the PRB is most effectively managed as a decertified coal region. A challenge to this decision in federal court was recently dismissed, not on the merits, but on the grounds that the plaintiffs lacked standing. *WildEarth Guardians v. Salazar*, 2012 U.S. Dist. LEXIS 65411.

One of the most tragic aspects of this story is that so many bad decisions were made during a time of robust coal markets, when assertive government planning and leasing policies might have yielded substantial public benefits. The domestic market for coal is now in decline, and one wonders whether

it is too late to fix the problems documented in this article. But one important trend that has yet to play out could benefit from a new commitment to a sound coal leasing policy. Even as domestic coal markets have waned, coal companies have begun looking overseas for new markets. Asia looks especially attractive because of China's seeming insatiable demand for new energy, and its historical willingness to pay more than \$100 per ton for coal. Some federal coal is currently shipped to Asia out of a deepsea terminal in British Columbia, and coal companies are now eyeing locations for other possible ports in the Pacific Northwest. Before any new ports are built, the federal government must reform its coal leasing policy to ensure that what amounts to pricing subsidies to the coal industry comes to an end.

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Oregon Governor John Kitzhaber, among others, has called on the federal government to prepare an environmental impact statement to consider the consequences of increasing exports of domestic coal through new terminals on the West Coast. Such a review might offer a useful vehicle for considering the role that federal coal leasing policy plays in promoting greater exports of domestic coal. This would also allow a public review of the prospect of making the PRB a major player in promoting further carbon emissions around the world.

At a bare minimum, the federal government has a legal obligation to ensure that it is not giving away federal coal—our coal—at fire sale prices. We cannot go back and redo the last thirty years of the federal coal leasing program, but neither should we accept the current broken system. We can do better. 🌳