COLORADO LAW
UNIVERSITY OF COLORADO BOULDER

Mark Squillace
Professor of Law

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Testimony of Professor Mark Squillace, University of Colorado Law School
Before the Subcommittee on Energy and Mineral Resources
of the House Natural Resources Committee
On H.R. 5259, *Certainty for States and Tribes Act*, 114th Cong., 2nd Sess. 2016

The Honorable Doug Lamborn
Chair, Subcommittee on Energy and Mineral Resources
1324 Longworth House Office Building
Washington, D.C. 20515-6201

Dear Chairman Lamborn:

Thank you for the opportunity to appear today to offer my views on H.R. 5259, the *Certainty for States and Tribes Act*. My name is Mark Squillace. I am a professor of law at the University of Colorado Law School. I teach primarily in the field of environmental and natural resources law and have written extensively on these subjects. I have also worked on coal policy issues for most of my professional career. My comments today are my own and do not necessarily reflect the views of the University of Colorado or its employees.

While I understand the concerns that some States have over falling revenues from federal mineral leasing and production I do not believe that H.R. 5259 offers an effective means for addressing that problem. On the contrary, I believe that it would make the federal mineral leasing program more cumbersome and bureaucratic and that it would not have any salutary impact on the transparency of the leasing process or on state and federal revenues from mineral leasing.

While H.R. 5259 addresses federal mineral leasing policy generally, I will focus my remarks on the coal leasing program because that seems to be the primary focus of the bill. To be sure, there are important issues to be addressed with federal oil and gas leasing policy as well, most notably the significant disparity in royalty rates between offshore and onshore oil and gas,[1] but the federal coal leasing program is garnering most of the attention due to the recent leasing moratorium and the decision to prepare a new programmatic environmental impact statement (PEIS) on the federal coal leasing program and that seems to be the impetus for this bill.

Background on the Federal Coal Leasing Program

Some background on the federal coal leasing program will afford context to my comments. In an article published in 2013, I recounted the multiple failures of the federal government to

[1] Royalty rates for federal onshore oil and gas are 12.5%, while royalties for offshore oil and gas production are 18.75%, notwithstanding the fact that per barrel production costs for offshore oil and gas are generally much higher. Several major oil and gas producing states impose much higher royalties on their oil and gas resources. *See generally* Nicole Gentile, *Federal Oil and Gas Royalty and Revenue Reform*, *available at* https://www.americanprogress.org/issues/green/report/2015/06/19/115580/federal-oil-and-gas-royalty-and-revenue-reform/

adopt a successful coal leasing program going back to the time that the Mineral Leasing Act was first enacted in 1920. Mark Squillace, *The Tragic Story of the Federal Coal Leasing Program,* 27 NAT. RES. & ENV. 29 (2013). That article is appended to these comments. For purposes of this hearing I wish to focus my attention on the current program that evolved from the BLM's 1982 regulations. 43 C.F.R. part 3400 (2015).

Federal coal leasing under those rules was supposed to begin with the establishment of "coal production regions" by the BLM. Twelve such regions were initially identified by the BLM in its 1979 federal coal program EIS, although this number was reduced to six such regions in a supplemental EIS published in 1985. As will be shown, the coal production regions concept was critical to the design and operation of the leasing program.

The 1982 rules provide for coal leasing 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. The agency then considers whether lands may be unsuitable for mining. Lands deemed unsuitable are dropped from consideration from leasing. This is followed by an assessment of multiple use trade-offs 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 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 for each coal production region. The RCT includes three federal agency representatives and two representatives from the affected state. One of the RCT's tasks is to transmit to the Secretary alternative leasing levels and a preferred leasing level. After relevant consultations, the Secretary must consider various factors before setting the leasing level, including: (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 levels 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 the 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. The RCT then identifies, ranks, analyzes, and selects tracts for study in a regional coal lease sale environmental impact statement (EIS). An important aspect of this process is to select and design tracts to maximize competition, and thereby the financial return to the state and federal governments.

Finally, the lease sale is scheduled. 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 public notice, the lease sale is offered by means of sealed bids. This "bonus bid" is paid up front to the federal government by the high bidder, if the BLM determines that the high bid represents fair market value. The bonus bid is paid on top of royalty and rental payments for federal surface-mined coal as provided under the Federal Coal Leasing Amendments Act (FCLAA). 30 U.S.C. § 207; 43 C.F.R. § 3473.3–2(a)(1) (2011). The bonus bid, rental fees, and royalty payments are shared equally by the state and federal governments.

The point of this somewhat extended story about the federal coal leasing program is that it has never worked as it was designed. An exception to two key parts of the four phases of coal leasing – setting regional leasing levels and carrying out coal activity planning – is allowed for lease tracts that are located outside of coal production regions. Such leases may be issued on the application of an interested lessee. *Id.* at § 3425.1-5. These leases by application[2] (LBAs) were plainly intended to be exceptional cases because the government estimated in its 1985 supplemental EIS that 92% of federal coal reserves and 97% of 1976 federal coal production occurred in coal production regions. But no one had apparently anticipated that every single one of the coal production regions – including the massive Powder River Basin region – would be "decertified." As a result, all federal coal leases are handled on the application of an interested coal company.

The importance of this shift cannot be overstated. What had been intended as a leasing program that would be managed *proactively* by the federal government for the vast majority of federal coal instead became a *reactive* program, with the federal government and the RCT simply responding to industry applications. The careful scheme of setting regional leasing levels to avoid oversupply problems and of planning lease sales and delineated tracts to maximize competition and minimize adverse environmental impacts was abandoned. It was replaced with a system effectively managed by the coal industry to maximize the acquisition of federal coal at rock-bottom prices and to avoid competition by designing new tracts immediately adjacent to the applicant's existing mine and too small to be attractive to a new entrant into the market. Since these applicants could go back multiple times for additional leases there was no need to risk designing a tract that might attract a third party bidder.

Industry applicants have been remarkably successful under this streamlined system as very few tracts received more than one bid. Even with the coal leasing moratorium now in place, the coal industry has enough coal reserves to last another 20 years at current production rates.[3] In fact, production rates are continuing to decline[4] and federal coal reserves currently under lease might last well beyond the current 20-year projection. Why in the world would the federal government lease more coal given the current glut of federal coal reserves already under lease?

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[2] The rules actually provide for leasing <u>on</u> application. 43 C.F.R. § 3425.1-5.

[3] *See Coal PEIS Scoping Meeting Presentation*, *available at* http://www.blm.gov/wo/st/en/prog/energy/coal_and_non-energy/details_on_coal_peis.html.

[4] Taylor Kuykendall, *DTE Coal Plant Retirements Further Shrink Demand for Troubled Coal Sector*, June 8,2016, *available at* https://www.snl.com/interactivex/article.aspx?id=36773405&KPLT=6&s_data=si%3d0%26kpa%3df9487b09-8614-4b65-98ad-42073918e233%26sa%3d

A related and important question concerns FCLAA's requirement that the federal government receive fair market value for any federal coal lease.[5] While the federal government repeatedly insists that it does receive fair market value it refuses to release the details of its analyses. Moreover, the utter lack of competition for most of the sales and the multiple leasing decisions that have flooded the market with federal coal belie the government's claim. Market forces cannot work where, as here, the system is essentially designed to yield a single bidder, and the market is deliberately saturated in a way that creates a severe oversupply problem.[6]

Sadly, with the collapse of coal markets[7] efforts to restore a competitive leasing system might be difficult or impossible unless demand for coal recovers and federal coal reserves under lease are reduced. What the federal government can and should do, however, is set a minimum bid price for federal coal that reflects its real value in the markets where the coal might be sold. Historically, the BLM has seemed to assume that market prices should be determined based upon local sales only, even though the federal coal at issue was being sold regionally, nationally, and internationally at a significant price premium over the mine mouth price. A minimum bid price of one, two, or even three dollars per ton could easily be justified as fair market value if the BLM were committed to looking at the markets where the coal is likely to be sold. To give an example, if coal is mined in the Powder River Basin of Wyoming and sold in Ohio, the sale price will be much greater than the price that might be paid at the mine mouth. While transportation and processing costs will be incurred, the transaction should be easily able to accommodate another two or three dollar per ton charge given the significant disparity in mine mouth prices.[8]

In addition to yielding far higher returns for state and federal coffers, a reasonable minimum bid price that better reflects national and international markets, would also help the BLM to ensure that marginal coal is not leased. Coal might be marginal because of low Btu content, lack of efficient transportation infrastructure, or high sulfur content. Ultimately, however, a minimum bid price would shift production to the most profitable and most logical coal resources for any future federal leasing activity.

The negative consequences of abandoning major parts of the federal coal leasing program have been devastating. It has led to a system in which many of the leases are obtained with no competition. Since 1990, 96 of the 107 leased tracts have received only one bid.[9] Coal is often sold for pennies per ton to the lone bidder/applicant and the surfeit of federal coal available to any willing applicant ensured that vast quantities of federal coal would flood the market, keeping federal coal prices artificially low. In North Dakota, bonus bids of $.01/ton for its marginal coal

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[5] FLCAA provides that "[n]o bid shall be accepted which is less than the fair market value, as determined by the Secretary…." 30 U.S.C. § 201(a)(1).

[6] The Government Accountability Office identified eight reforms that the BLM should institute to improve its procedures for determining fair market value, including giving the public greater access to information. *See BLM Should Enhance Appraisal Process, More Explicitly Consider Coal Exports, and Provide More Public Information*, GAO-14-140 (2013).

[7] The EIA recently reported that coal production in 2016 will see its largest drop since records have been kept. Jenny Mandel, *Coal Production Drop this Year will be Largest Ever Recorded – EIA* (June 8, 2016, *available at* http://www.eenews.net/energywire/2016/06/08/stories/1060038440

[8] The most recent Energy Information Administration figures show mine mouth prices for $8.80 per short ton in the Powder River Basin. Its closest price competitor is the Illinois Basin where prices last stood at $31.70 per short ton as of June 3rd, 2016. While Illinois Basin coal has a higher Btu content on average, PRB coal is far lower in sulfur content thus largely offsetting any Illinois coal basin advantage. See http://www.eia.gov/coal/markets/ accessed June 7th, 2016.

[9] U.S. Government Accountability Office, Coal Leasing Report (December 2013) at 16.

resources are the norm. In states like Colorado and Oklahoma with more valuable coal resources, sales of $.02-.03/ton were still common. Even in the rich coal deposits of the Powder River Basin, a surface coal lease at the Black Thunder Mine, one of the largest in the world, sold for $.15/ton. A few recent sales have finally moved past the $1/ton threshold, with a later Black Thunder lease going for $1.35/ton.[10] Had the government demanded $1.35 at the earlier sale, it would have yielded a bonus bid of more than $649 million rather than the comparatively paltry $72 million that the government received. One study estimated that the federal government's failure to demand fair market value has cost taxpayer $28.9 billion over the past 30 years in the Powder River Basin alone.[11] The coal industry will no doubt point to the recent spate of bankruptcies to suggest that they could not possibly absorb a higher bid price. In fact, these bankruptcies are more reflective of poor management by the coal industry rather than bad luck.[12]

Royalty rates raise an additional issue under the federal coal leasing program. These rates are nominally set at 12.5% for surface coal and 8% for underground coal.[13] The BLM has the discretion to raise those rates but has never done so. That is one of the issues that will presumably be considered in the programmatic EIS. The BLM also has the discretion to reduce royalties in individual cases to maximize the development or operation of coal mines.[14] The BLM has been far more willing to invoke this provision, having reduced royalties on more than a third of leases since 1990. Headwaters Economics has estimated that these royalty reductions have cost taxpayers $294 million over a 24 year period.[15] A fair question to ask is why the BLM is leasing federal coal for mere pennies per ton and then reducing royalty rates. At least part of the answer surely relates to the BLM's failure to consider and set regional leasing levels to reflect demand, competition, and other factors as contemplated by the agency's own rules.

The direct loss of revenues are just one part of the story. Coal imposes significant external costs on public health and the environment that are not fairly accounted for in the leasing process. A recent study from the Institute for Policy Integrity estimated that the royalty rates would have to rise from the current 12.5 percent to 82.6 percent just to offset the external impacts from methane emissions and transportation from coal mined in the Powder River Basin in Wyoming.[16] This does not even include the significant health costs associated with conventional air pollution from coal combustion.[17] While accounting for the full external costs may seem impractical it is equally

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[10] *Id* at Appendix II.

[11] Tom Sanzillo, *The Great Giveaway: An Analysis of the Costly Failure of Federal Coal Leasing in the Powder River Basin,* available at, https://docs.google.com/file/d/0B_qWeYLAqoq1V2YyX3hnR25lcXM/edit.

[12] Mike Scott, *Peabody Bankruptcy Offers Stark Warning To Oil And Gas Groups Of Risks Of Ignoring Climate Change*, FORBES, APR 14, 2016. Scott notes that "Peabody is the 50th coal company to file for bankruptcy since 2012 and a startling example of the industry's failure to anticipate how future markets might be limited by tighter environmental regulations."

[13] 30 U.S.C. § 207.

[14] "The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal, oil, gas… is authorized to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold… whenever in his judgment it is necessary to do so in order to promote development." 30 U.S.C. § 209

[15] Headwaters Economics, *An Assessment of U.S. Federal Coal Royalties Current Royalty Structure, Effective Royalty Rates, and Reform Options*, (2015), *available at* http://headwaterseconomics.org/energy/coal-royalty-valuation. The Headwaters study suggests that losses could be as high as $37 million annually or $860 million in total. *Id*. at 14.

[16] Jayni Foley Hein & Peter Howard *Illuminating the Hidden Costs of Coal* (2015), *available at* http://policyintegrity.org/files/publications/Hidden_Costs_of_Coal.pdf. More than 90% of Wyoming's coal is shipped out of state.

[17] *See generally* National Institutes of Health, Tox Town, *Why are Coal-fired Power Plants a Concern?, available at* https://toxtown.nlm.nih.gov/text_version/locations.php?id=155.

untenable to simply ignore these costs and Interior would be well within its authority to raise coal royalty rates to better reflect the external costs associated with federal coal leasing.[18] T a minimum, this important issue must be fully vetted during the PEIS process.

While the federal government bears the lion's share of the blame for the failure of the current federal coal program, the States were not innocent partners. They were members of the Regional Coal Teams that approved decertification of the coal production regions and, for the most part, they have been strong advocates for approving every coal lease application that the BLM has received at the bargain basement prices that the applicants were offering. Thus, it would be a mistake to assume that involving the States more fully in federal leasing policy is going to solve the problem.

Section-by-Section Analysis of H.R. 5259

Section 2. Reconstituting the Royalty Policy Committee. I am a firm believer in the importance of public process but I also recognize that process is not free. Reinstating the Royalty Policy Committee (RPC), as this bill would do, adds a layer of bureaucracy and expense that can only be justified if it is likely to yield a better outcome. In my opinion, the RPC does not offer a useful vehicle for increasing revenues or reaching better decisions. States and tribes are already well-represented in rulemaking proceedings and they have exceptional access to government officials during the rulemaking process. Moreover, their views are well-respected by department officials and they do not need a special advisory committee to ensure that their views are thoroughly considered by the federal government. The only possible reason for reconstituting the RPC is to try to strong–arm the Secretary or perhaps even force the Secretary's hand. If that is the goal, then the RPC will have likely received an unconstitutional delegation of authority as described in the review of Section 3 below.

Furthermore, as proposed, the Royalty Policy Committee (RPC) is heavily and inappropriately weighted toward development interests. Section 2(b)(3) requires the RPC to include *at least* five state representatives with significant royalty revenues, up to five Tribal representatives from Tribes with significant royalty interests, and as many as seven representatives of mineral interests. The Charter, which presumably would be redrafted, also provides for up to three representatives of public interest groups. Even assuming that three public interest group representatives would remain on the RPC it is not at all clear that RPC will include a sufficient number of people appropriately skeptical view of federal mineral development in light of climate change and other environmental and economic concerns. Moreover, three public interest representatives will be easily overwhelmed by the 17 or more members who favor more mineral development.

Section 3. The RPC's Advisory Activities. This section prevents any federal mineral policy rule from becoming final until a State and Tribal Resources Board, which is a subcommittee of the RPC, publishes its findings on the impact of the rule. If the Board determines that the rules would have a negative economic impact they can request a delay of the issuance of the final rule

[18] "A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12 ½ per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations." 30 U.S.C. § 207.

and demand that the Secretary revise the proposed regulation to avoid any negative State or tribal economic impact determined by the Resources Board.[19]

This is perhaps the most troubling provision in the bill. It raises a serious constitutional question and it promotes bad policy. The constitutional problem involves the effort to delegate legislative power to a subcommittee of a Federal Advisory Committee. Congress may delegate such power to an executive branch agency so long as it provides an intelligible principle to guide the exercise of the agency's discretion. *J. W. Hampton, Jr. & Co. v. United States,* 276 U.S. 394 (1928). But it cannot delegate such power to a committee comprised largely of non-federal members that on its face is supposed to serve only an advisory role. *Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936).

From a policy perspective, the decision to elevate State and tribal economic impacts over all other impacts, no matter how important, would deprive the federal government of its ability to exercise its best judgment. So, for example, if a decision to lease federal coal were to adversely impact public health or the environment, or unduly exacerbate climate change, perhaps even triggering violations of international law, the Secretary might nonetheless be obliged to consummate the lease to prevent adverse economic impacts as determined by the Review Board.

Section 4. Special Review of the PEIS. Section 4 of the bill establishes yet another Review Board – this time for the Coal PEIS – that is again weighted heavily toward development interests. In particular, it includes representatives from each of the States with significant federal mineral leasing revenues. The only apparent role for this Board is to confer with the Secretary. But the States can – individually or collectively – confer with the Secretary without the benefit of this legislation. As noted previously, States and Tribes are pretty effective at wielding their influence in agency proceedings, and they simply do not need the benefit of this legislation to exercise an appropriate level of political influence over the PEIS. Adding this layer of bureaucracy to the process will do nothing to improve the ultimate decision.

As for the deadline for completing the PEIS I agree with the goal of pushing agencies to complete their NEPA review within a reasonable time. Nonetheless, it is not clear to me how this will play out if the deadline is missed. If the government PEIS process is not fully completed by January 15, 2019, then they may still move into an implementation/rulemaking phase that could take several more years.

The proposed termination of the moratorium poses a couple of additional problems. First, it prejudges the outcome of the NEPA process by assuming that continuing the moratorium is not the right decision. Given the dramatic and continuing decline in coal production and use over the past decade,[20] and the substantial federal coal reserves already under lease, it is not hard to imagine that the Secretary might want to retain the moratorium in some form for an additional period of time. Moreover, it will be difficult to enforce a termination of the moratorium. Section 6 tries to force the Secretary's hand by insisting that a lease sale be held and a lease issued within one year after the NEPA process is complete, but what is to stop the BLM from holding up the NEPA process until a new leasing program is in place?

[19] The reference in Section 3(c)(1) is to the Committee but it was probably meant to refer to the Review Board.

[20] *See* footnote 5, which references the EIA's assessment that 2016 will see the largest drop in coal production ever recorded.

Section 5. Grandfathering Coal Lease Applications. This is an odd provision. It simply states that the Secretary is not prohibited from issuing coal lease for lease application otherwise subject to the moratorium where the NEPA review process has commenced. On the other hand, it does not seem to require the issuance of those leases or the completion of the NEPA process, and thus it would not seem to preclude the Secretary from simply deciding not to act on these applications. For all of the reasons stated in the discussion of the current leasing program, the Secretary would be well advised not to act on these applications, at least until she has completed the PEIS process and decided how to proceed with future federal coal leasing.

If the government were to use this provision to justify new federal coal leasing it could greatly undermine later efforts to reform the leasing program. As previously described, current federally-leased coal reserves will last for at least 20 years and probably much longer. In light of this, it would be foolish to issue any new coal leases until Interior has decided how to proceed with federal coal leasing going forward. That is the whole point of the PEIS.

Section 6. Deadline for Coal Lease Sales and Modifications. This provision would require the Secretary to act on coal lease applications within one year after the NEPA review process is complete. This provision betrays a willingness to accept the bankrupt coal leasing system that currently exists. For all of the reasons previous laid out, the Secretary should not be leasing federal coal merely because someone asks for it. Rather, the Secretary should first decide on appropriate regional and national lease sale levels thereby proactively deciding how much new coal, if any, the market can reasonably accommodate without unduly depressing prices. This was how the 1982 rules were supposed to work. By essentially accepting an applicant-driven leasing program the bill invites the very abuses that led to the massive revenue losses that have occurred over the past several decades and it prejudges the outcome of the PEIS.

A reformed leasing program should, at a minimum, restore proactive management policies that help ensure a fair return to the public and that authorize new leases only if warranted by the coal markets. Such a program would, however, make the lease by application process that is assumed by this provision wholly irrelevant. If this provision were to somehow remain relevant it would still be problematic because it could force the Secretary to lease federal coal so long as the applicant wants it. This would effectively preclude fair consideration of the "no action" alternative as required under the NEPA process. 40 CFR § 1502.14. As suggested above, the Secretary might choose not to lease federal coal because the market is soft and the likely bid is going to be too low, or where the bid does not reflect fair market value. Yet the bill seem to force a lease sale.

Thank you for the opportunity to submit these comments on H.R. 5259. I urge the Subcommittee to reject this bill as unnecessary, ill-advised, and possibly even unconstitutional.

Sincerely,

Mark Squillace