

United States Senate
WASHINGTON, DC 20510

January 3, 2013

The Honorable Ken Salazar
Secretary
Department of the Interior
1849 C Street, N.W.
Washington DC 20240

Dear Secretary Salazar:

We write to you regarding federal coal royalty management. Recent press reports raise troubling questions about whether taxpayers are missing out on millions of dollars in royalties from coal mined on federal and tribal lands, especially in the Powder River Basin of Wyoming and Montana.¹ Because royalties from federal coal are shared with the states in which that coal is mined, affected states may also be losing millions of dollars of revenue.

In addition to our own concerns, as members of Congress, others have weighed in – on a bipartisan basis – including the administrations of both Montana Governor Brian Schweitzer and Wyoming Governor Matt Mead. In a recent interview,² Governor Schweitzer said that “we need to collect on the actual value” of coal exported overseas. Wyoming’s Department of Audit commented on federal coal royalty collection regulations in 2011 when Office of Natural Resources Revenue (“ONRR”) sought comments to update these rules for the first time since 1989.³ The Mead administration proposed that the regulation’s definition of “lessee” include “the lessee and its affiliates, partners, marketing agents, and trade and export associations, and establish royalty value based on the first sale to a buyer who is not included in the definition of ‘lessee’ and is a bona fide arms-length transaction.”

The allegations made in press reports and states’ concerns are particularly pertinent as coal exports from federal and tribal lands increase. As companies seek to ship more coal overseas, taxpayers must be confident that the Bureau of Land Management (“BLM”) and the ONRR have stringent royalty collection and auditing controls in place as coal markets become increasingly oriented toward international buyers. We know that the Department is reviewing

¹ Energy Information Administration, *U.S. Coal and Foreign Coal Distribution by State of Origin*, 2011, http://www.eia.gov/coal/distribution/annual/pdf/o_11foreign.pdf. Coal mines in Montana and Wyoming exported 13.2 million and 4.5 million tons of coal, respectively, in 2011.

² Patrick Rucker, “U.S. coal export trade raises alarms for Western states,” *Thomson Reuters*, December 20, 2012, <http://www.reuters.com/article/2012/12/20/usa-coal-royalty-idUSL1E8NJLAP20121220>.

³ State of Wyoming Department of Audit, Letter to Office of Natural Resources Revenue re: Federal and Indian Coal Valuation (Regulation Identifier Number 1012-AA00), July 26, 2011, http://www.onrr.gov/Laws_R_D/PubComm/PDFDocs/AA00/AA00%20Wyo%20%20Dept%20of%20Audit.pdf.

this matter; we are writing to ask that you provide certain information that may have been generated to date.

The story published December 4, 2012, by *Thomson Reuters*⁴ alleges that coal companies may be violating provisions of the Mineral Leasing Act of 1920 (as amended)⁵ and applicable regulations⁶ that set out royalty payment and valuation requirements for coal produced from federal leases. Based on a review of company financial statements and interviews with royalty experts, the story alleges that coal companies are selling coal to in-house trading affiliates, which in turn sell the coal to buyers on the international market for a premium. The *Reuters* story alleges that coal producers are using this arrangement to report a lower sales price that does not reflect the actual value of coal that is ultimately exported to overseas buyers and sold at a premium.

The *Reuters* article further alleges that U.S. taxpayers could have missed out on millions of dollars in royalties for those exports alone. If this practice is occurring as alleged, and export trends continue to grow, taxpayers, states and tribes could end up losing hundreds of millions of dollars annually. If any violations of the law have occurred, companies should be required to cure any gap in royalty payments and, if misconduct has occurred, civil penalties should be levied.⁷ If the Department's regulations are inadequate to ensure that full royalty value is returned, those regulations must be reformed.

Congress made clear when it passed the Federal Coal Leasing Amendments Act that federal coal was meant to "meet the nation's energy needs" and that coal royalties were put in place so that "people ... receive a fair return on their coal, particularly when coal values are increasing rapidly."⁸ Accordingly, we request that your Department provide the following information:

- 1.) Hundreds of millions of tons of coal are mined every year from federal and tribal lands; the ONRR conducts audits and compliance reviews on royalty payments three years after the payments are due:
 - a. Please provide a detailed list of any violations of applicable law or regulations – and resulting fines – related to royalty payments for coal mined on federal and tribal lands that occurred during the five most recent audit years.
 - b. Please provide a detailed list of any violations of applicable law or regulations – and resulting fines – related to royalty payments for coal mined on federal and tribal lands that occurred in years that are not yet subject to audit or compliance reviews.

⁴ Patrick Rucker, "Asia coal export boom brings no bonus for U.S. taxpayers," *Thomson Reuters*, December 4, 2012, <http://www.reuters.com/article/2012/12/04/us-usa-coal-royalty-idUSBRE8B30IL20121204>.

⁵ 30 U.S.C. 181-287.

⁶ 30 C.F.R. 1206, Subparts F and J.

⁷ 30 U.S.C. 1720 (a) provides the Secretary of Interior with authority to levy penalties up to \$25,000 per violation per day for violations of federal coal leases.

⁸ Committee on Interior and Insular Affairs, Federal Coal Leasing Amendments Act of 1975, S. Rep. No. 94-296, at 16 (1975).

- 2.) BLM reports that more than 94% of federal coal is produced by mines in Wyoming, Montana, Colorado and Utah; Energy Information Administration data show exports from these states have more than tripled to 21.2 million tons between 2009 and 2011.
 - a. What steps will the ONRR take to ensure that federal and tribal coal lessees (royalty payors) are reporting the proper product value for coal sold internationally?
 - b. What steps will the ONRR take to ensure that, in a case where the royalty payor sells coal to an affiliated trading entity, the entire consideration received by the royalty payor is reflected in the reported gross proceeds?
- 3.) The *Reuters* story raised questions about whether sales prices reported to the ONRR reflect the true arms-length value of federally leased coal sold on the international market. What steps will the ONRR take to ensure that, in cases where the royalty payor sells coal to an affiliated trading entity, the reported sales price reflects proper product values, including any premium received in the case of an international sale?
- 4.) In fiscal year 2012, the ONRR conducted 325 audits and 891 compliance reviews on federal mineral leases that accounted for \$3.1 billion in revenue for U.S. taxpayers, equal to nearly one-third federal energy royalties collected in fiscal year 2011. What percentage of these audits and compliance reviews pertained to coal leases, and what amount of under-collection was identified?
- 5.) The 2009 Omnibus Appropriations Act (P.L. 111-88) codified civil and criminal penalty authority that the ONRR may use against lessees of Federal and Indian coal that violate federal leasing laws.⁹
 - a. Has the ONRR used its civil and criminal penalty authority in the past?
 - b. Please provide a detailed list of instances when the civil and criminal authority has been used.
 - c. How does the ONRR plan to use its civil penalty authority with future violators?
- 6.) Concerns over royalty collections in the case of exports have only recently come to light; however, more than 118 million tons of coal produced in Utah, Colorado, Wyoming and Montana were exported between fiscal years 2001 and 2011. Does ONRR plan to audit previous fiscal years to ensure that the public received the full royalty payments that they were owed in cases where the coal was exported?
- 7.) When a royalty underpayment has occurred, it is critical that the Department has the proper tools to recover funds for American taxpayers and affected states.
 - a. If underpayment of royalties has occurred, what recourse is available to the Department?
 - b. Specifically, does current law and regulation permit remedying such underpayments in a way that accurately reflects the time-value of the money that should have been collected but was not?

⁹ 30 U.S.C. 1720 (a).

We know you share our commitment to ensuring that the public receives a fair return on these resources. It would be helpful if the Department could provide the requested information and its plan for addressing this important matter by February 4, 2012. Please contact Peter Gartrell (peter_gartrell@wyden.senate.gov or 202-224-5244) or Colin Hayes (colin_hayes@energy.senate.gov or 202-224-4797) on our staffs with any further questions.

Sincerely,



Sen. Ron Wyden



Sen. Lisa A. Murkowski

Cc: Acting Director Mike Pool, Bureau of Land Management
Director Gregory J. Gould, Office of Natural Resources Revenue
Acting Inspector General Mary Kendall, Department of Interior Office of Inspector General