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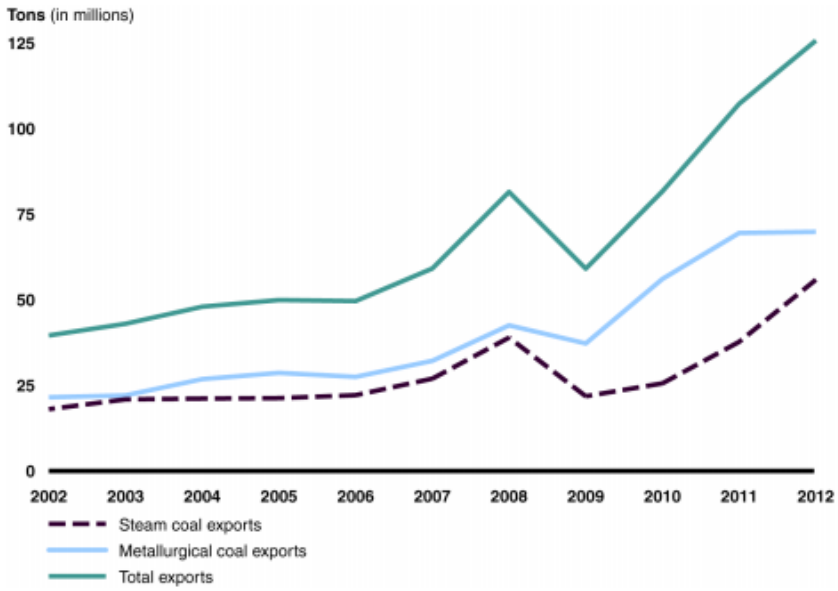
Are coal companies paying fair market value for leases on public lands?

Ben Goldfarb | Mar 07, 2014 05:00 AM

Coal boosters are fond of decrying the Obama Administration's supposed "War on Coal" – and to be sure, U.S. Environmental Protection Agency regulations limiting carbon emissions from power plants aren't doing industry any favors. But if there truly exists a federal campaign to depose King Coal, somebody in the administration forgot to tell the Bureau of Land Management.

The BLM, of course, is the branch of the Department of the Interior that administers America's public lands – and leases out the resources, including coal, that lie beneath the surface. Around a billion tons of coal are extracted from federal lands annually (98 percent of which comes from Western states), and leases on those tracts generate around $1 billion in public revenues. That might sound like a good deal for citizens, but according to two recent government investigations, BLM's coal leasing program is actually riddled with flaws – nearly all of which benefit mining companies at taxpayers' expense.

The first investigation, a February 4 report from the Government Accountability Office (GAO), depicts a BLM that has failed to fully consider the global market. The agency is supposed to account for export potential in setting the value of leases, which stands to reason: If companies are bringing in extra revenue by shipping resources overseas (and despite an incipient downturn in international markets, coal still fetches higher prices abroad than domestically), they should pay more for the opportunity. As the GAO report reveals, however, most BLM offices don't consider exports when establishing the value of tracts.



American coal exports tripled from 2002 to 2012. Source: GAO.

Agency officials in many states, including Colorado, Utah and New Mexico, say that's because exports are insignificant. But that's a dubious claim: In 2013, for example, a full 50 percent of the coal removed from the West Elk Mine in Colorado's North Fork Valley wound up being shipped abroad. Driven by Asian demand, coal exports have spiked in recent years; in 2012, 126 million tons, or around 12 percent of all coal produced in the U.S., left the country. (There are signs that the export explosion was predicated on a Chinese bubble that has since burst, forcing companies to scale back plans. But while exports have come down from their peak, they're still very high by historic standards.)

"Taxpayers are losing out so that coal companies can reap a windfall and export that coal overseas where it is burned, worsening climate change," said Massachusetts Senator Ed Markey, who estimates the leasing program's flaws have cost the public up to $200 million since 1990. "This is a bad deal all around."

The failure to account for exports is symptomatic of a broader problem: the BLM's propensity to sell leases for below fair market value, which is a violation of the federal Mineral Leasing Act. That issue is identified in another noteworthy report that appeared last month, a letter by the Interior Department's Deputy Inspector General Mary Kendall to Oregon Senator Ron Wyden, a critic of the leasing program. Kendall's letter, published February 6, describes how, in a sample of 15 sales, 2 in Colorado and 2 in New Mexico were sold at prices below market value. Between them, those four illegal leases cost the public around $2 million.

"Recovering fair market value for the American public is the key underpinning of the entire coal leasing program," says Jeremy Nichols, Climate and Energy Program Director at environmental group WildEarth Guardians. "These are extremely disturbing revelations."

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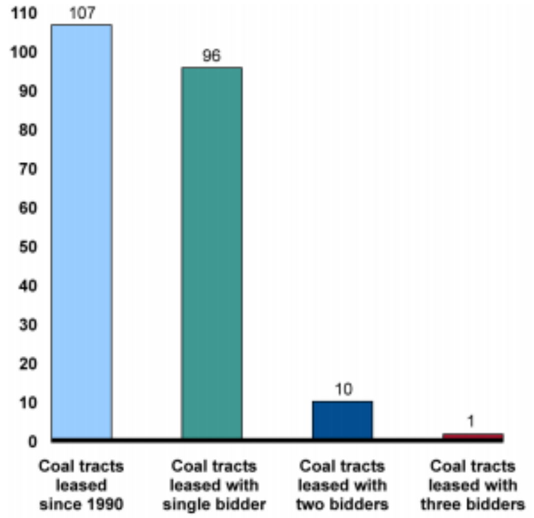
So where is the BLM going wrong? And what should the agency do to rehabilitate its ailing program?

Let's consider how the BLM calculates the value of coal tracts. The agency uses two methods for estimating fair market value: the comparable sales approach – which estimates value based on the price of other, similar coal tracts – and the income approach, which calculates value by projecting the mining operation's lifetime costs and revenues. The GAO advises that the two methods be employed together when possible; in practice, some states' BLM offices only use comparable sales.



Around 90 percent of coal lease auctions on federal land receive only one bid. Source: GAO.

But both methods are gravely flawed. "I call the comparable sales approach the 'garbage in, garbage out' approach," says Mark Squillace, director of the Natural Resources Law Center at the University of Colorado Law School. Comparing new sales to existing ones, says Squillace, is only valid if those old leases were themselves priced fairly. But in the Powder River Basin, for instance, the formation spanning Montana and Wyoming that produces more coal than any other region in the country, companies apply to lease tracts where they're the only ones that can profitably operate. The result is a rash of single-bidder auctions that have historically suppressed prices. According to the GAO, 90 percent of lease sales since 1990 have received only one bid.

Under a comparable sales approach, those single-bidder leases are used as precedent for new coal prices. "The way we determine fair value in a free market is competition, ideally robust," says Squillace. "We've never really had any in the Powder River Basin." Other coal-producing areas have suffered from a similar lack of competition.

Is the income approach any better? Hardly. When government figures the future value of resources, it applies a *discount rate*, a calculation that accounts for the fact that goods are worth less in the future than they are in the present (just like you'd rather have $100 today than ten years from now). But because the coal leasing program uses an atypically high discount rate, explains Squillace, companies may pay very little now for coal properties that could be worth a ton down the line. Once again, the public loses.

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What's the solution? The GAO report offers a number of conservative recommendations for reforming leasing practices, like making more information public, setting better guidelines for export accounting, and hiring independent analysts to look over BLM lease appraisals. Squillace suggests that the government experiment with setting minimum bid prices. "On average, the government has sold Powder River Basin coal for around 50 cents a ton," he says. "If you'd increased that to five dollars, we're talking about billions of additional dollars in public revenue."

The Powder River Basin produces more coal than any other region in the U.S. Photo courtesy of Bureau of Land Management.

Bumping up lease prices would surely eat into the profits of coal companies, which is why groups like the National Mining Association have been quick to minimize the report's findings. And given the uncertainty surrounding coal's future, you can't blame the industry for bridling against anything that would hike the cost of doing business. As Squillace points out, though, making it slightly more expensive to mine coal could help alleviate the current glut, thereby boosting the black rock's sagging market value.

To Jeremy Nichols' mind, the situation calls for dramatic action: a full timeout to review and reform leasing policies. "There's a lot of coal currently moving forward toward being sold, and it's doing so under a broken system," he says. Indeed, the present moment, with international markets stumbling and plenty of coal already leased, could be an ideal time to pump the brakes.

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