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Part IV

Department of the Interior

Bureau of Land Management

43 CFR Part 3470

Fees, Rentals, and Royalties; Proposed Rulemaking

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

43 CFR Part 3470

[A-660-08-4121-02]

Fees, Rentals, and Royalties

AGENCY: Bureau of Land Management, Interior.

ACTION: Proposed rulemaking.

SUMMARY: Subpart 3473 of Title 43 of the Code of Federal Regulations sets out, among other things, the royalty requirements for all Federal coal leases. The proposed rulemaking would eliminate the latitude the Secretary now has when setting the royalty rate for underground coal leases by requiring that the royalty rate for all underground coal leases be set at a flat percent of the value of coal removed. Additionally, the proposed rule will remove the requirement that Federal coal lease royalty rates be set on an individual case basis. The proposed changes would decrease the Bureau's administrative workload and analytical costs at the time of lease readjustment.

The final rulemaking effecting these changes will be published after the close of the 60-day comment period provided for herein. All comments received during the comment period will be carefully considered and addressed in the final rulemaking, with any changes made as result of the comments on the proposed rulemaking being made part of the final rulemaking.

DATE: Comments on the proposed rulemaking should be submitted by September 27, 1988. Comments received or postmarked after this date may not be considered in the decisionmaking process on the issuance of a final rulemaking.

ADDRESS: Comments should be sent to: Director (140), Bureau of Land Management, Room 5555, Main Interior Building, 1800 C Street NW., Washington, DC 20240.

Comments will be available for public review in Room 5555 at the above address during regular business hours (7:45 a.m. to 4:15 p.m.) Monday through Friday.

FOR FURTHER INFORMATION CONTACT:

Paul W. Politzer, (202) 343-7722

or

Phillip C. Perlewitz, (202) 343-7753.

SUPPLEMENTARY INFORMATION: Section 6 of the Federal Coal Leasing Amendments Act of August 4, 1976 (FCLAA), amended section 7 of the Mineral Leasing Act of 1920, as amended (MLA), and states in part: "A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12½ 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." Departmental regulation 43 CFR 3473.3-2(a)(1) provides that: "Royalty rates shall be determined on an individual case basis", and the following provision of 43 CFR 3473.3-2(a)(3) states: "A lease shall require payment of a royalty of not less than 8 percent of the value of coal removed from an underground mine, except that the authorized officer may determine a lesser amount, but in no case less than 5 percent if conditions warrant."

In 1985, the application of 8 percent to a readjustment was challenged in the United States District Court of Utah (Coastal States Energy Co. vs. Watt, 629 F. Supp. 9). The Court found the application appropriate. However, upon appeal the United States Court of Appeals for the 10th Circuit, while affirming that conclusion, held that the Department of the Interior was required to consider the flexibility of regulations allowing for a lesser amount than 8 percent if conditions warranted (816 F.2d 502 (1987)) and remanded it back to the Department. The Court stated:

> * * * it is error for the Bureau of Land Management to automatically fix the readjusted rate for all underground coal at 8%. Such completely ignores the ensuing proviso in the same regulation that a lesser amount, but not less than 5%, may be set, "if conditions warrant."
>
> * * * That part of the judgment only is reversed, and that particular matter only shall, by order of the district court, be remanded to IBLA with direction that further proceedings be in accord with this opinion.

Given this mandate, the Assistant Secretary for Lands and Minerals Management requested a study to analyze the various factors that should be considered in assessing the proper underground royalty rate for coal and also how to avoid the ambiguity inherent in the current regulations. The Bureau of Land Management has recently completed a draft study of the issues associated with the underground royalty rate. The results of the draft study indicate that considerable changes have occurred in market conditions and expectations for underground Federal coal.

The Findings and Observations of this draft study entitled "Review of Issues for Setting Royalty Rates on Federal Underground Coal Leases" are contained in Chapter VII which reads:

The current royalty rate for underground coal was determined more than 10 years ago through a process which included legislative direction, technical analysis, public review and comment, and formal rule-making. Care was taken to achieve a balance between the various Federal Coal Management Policy objectives, considerations, market conditions and expectations at that time. For the purposes of this analysis, it is assumed that the Congressional response to the prevailing conditions was appropriate, and that the Department's analysis and rule-making that led to a prescription of an 8 percent royalty for underground coal was also correct at that time. However, in 1987, the 10th Circuit Court mandated the Department to review whether or not 8 percent was still appropriate. The Department has responded by reviewing policies and regulations in light of a possible change in the relevant market conditions underlying the initial balance between objectives. If conditions were found to be largely unchanged, no further action would be necessary. Materially different market conditions, however, may signal a need for regulatory action.

It should be stressed that the most important issue for the Department to consider is future coal development, not current and short-term profitability. In order to predict future development, we must ask what a mine could earn, given current costs, under new contracts, or under contracts likely to exist when the mine could earn, given current costs, under new contracts, or under contracts likely to exist when the mine investment is committed. The analysis in Chapter V, "Market Changes and Expectations," indicates that there are underground mines operating profitably. It also indicates, however, that as many as 50 percent of the presently-operating mines may not have been opened if the investment decision were to be made under current market conditions and expectations—and this assumes no further cost increases or market price declines. Further, it assumes that contracts could be negotiated even though no new contracts have been let since 1982 as noted in Chapter VI.

For a variety of reasons, the current market situation for underground coal may not be attractive, from the point of view of new investment, as it once was. A comparison of the current market and market outlook to those characteristic of the mid-to-late 1970s, when the question of the appropriate underground royalty rate was last examined, suggests:

- From an overall industry perspective, production forecasts are significantly lower than those made in mid 1970s through the early 1980s, though the projections for underground coal were relatively accurate for the time period analyzed.
- Although contract prices initially increased, as expected, no new long term contracts have been negotiated since 1982 and spot market contract prices have been falling since the early 1980's.
- Although production and delivery of underground coal under existing long-term contracts gives the perception of continuing market recovery, the minimal interest in

negotiating new long-term contracts for the purchase of underground coal suggests the recovery has leveled off.

- Relative differences in the delivered prices of various coals, including new transportation competition in the Powder River Basin, may have reduced the effective geographic market size for underground coal.

The profitability of the on-going operations, stemming from old contracts, contrasted with the apparent lack of profitable opportunities based on the lack of any demand for current contracts indicates there may be an incremental trade-off between current royalty revenues and future development. At present it is unclear what the magnitude of this trade-off would be. It is diffucult to determine with any exactitude such small margins in this environment. Careful consideration should be given to these issues in any determinations regarding underground coal royalties.

Although our analysis has dealt primarily with efficiency issues, the changing market conditions that we outline also raise an equity issue which the Secretary is authorized to consider. Existing operations utilizing state of the art technology and having already acquired long term contracts negotiated under market expectations of early 1980's can make adequate profits at the current royalty rate (see Chapter VI). However, a Market demand for new underground coal contracts has not existed since 1982 and new mine operators may find it very difficult to obtain a contract and the negotiated price given spot market trends could be considerably lower. The profits under such contracts would also be lower. If the 8 percent royalty represented an equitable division of the profits in the mid-to-late 1970s, it is now appropriate to consider whether the distribution continues to be equitable.

Issues to consider in adopting a regulatory policy establishing a flat royalty rate for underground coals leases at the time of lease issuance or readjustment, as opposed to the current regulations which allow flexibility 'if conditions warrant,' are as follows:

- The mining of less economic reserves as the result of the royalty rate.
- The relationship between the risk of mining underground coal and increased competition in the industry.
- Certainty as to what royalty rate would be applied to all underground coal leases for the lease term, and its impact on administrative burden and industry planning.
- The impacts associated with disruption of the socioeconomic infrastructure resulting from premature mine closure.
- The equitable sharing of revenues between the public and private sectors from coal production given the change in market conditions and expectations.
- States' share of Mineral Leasing Act revenues.
- The potential number of appeals and court challenges to lease readjustments.
- The potential for royalty rate reduction requests under Section 39 of the MLA.

As custodian of the nation's Federal coal resources, the Department of the Interior has an obligation to see that these resources are developed to the greatest mutual benefit of the nation, the coal-producing regions and the coal industry. There has been sufficient change in market conditions to suggest that a prudent land manager consider the propriety of a royalty rate set more than 10 years ago. Given the lack of a demand for long term contracts and the anticipated change toward low or falling prices in the future market for coal, new profit margins may be smaller than existing profit margins. If this is true, then the net (after royalties are paid) return to the producer may be declining, both absolutely as well as relative to required capital investment. Such a decline would certainly result in a reduction in coal development investment. Therefore, it may be appropriate to consider the option of a lower royalty rate for underground coal, consistent with prevailing and expected market conditions. Such consideration should be based on an evaluation of the objectives of the Federal Coal Management Program, as discussed in Chapter III, the effect of lowering the royalty rate on those objectives, and indications of what royalty rate the market is setting in similar, non-Federal regions.

Copies of the entire study can be obtained from the Bureau of Land Management, Office of Public Affairs, 1800 C Street NW., Room 5600, Washington, DC 20240.

The proposed rulemaking would: (1) Eliminate the current process the Bureau of Land Management now utilizes of setting Federal coal lease royalty rates on an individual case basis; and (2) remove the current provision under which the Secretary of the Interior can now set a lower underground coal lease royalty rate at the time of lease issuance or readjustment. The proposed changes would decrease the Bureau's administrative workload and analytical costs at the time of lease readjustment. It costs approximately $30,000 to $50,000 per workyear per underground coal lease to conduct an individual case analysis of the lease royalty rate at the time of lease readjustment. There are at present 334 underground Federal coal leases. Only 53 of these Federal coal leases issued prior to FCLAA have not yet had their terms and conditions readjusted. Of these 53 leases, 5 are in production at this time. The cost savings to the Federal Government of not having to conduct an individual case analysis on these 53 leases to determine whether conditions warrant a lease royalty rate of less than 8 percent, but not less than 5 percent at the time of lease readjustment, would be approximately 2.24 million dollars.

The Department is considering alternatives for a flat royalty rate to be applied to coal removed from Federal lease by underground methods: 8 percent or 5 percent of the value of the coal. This flat rate would be applied to all newly issued coal leases and to existing coal leases upon their next regularly scheduled readjustment.

Should a rate other than 8% be deemed appropriate, the Department is also considering whether the flat rate should be made available to leases which have been issued, or readjusted after FCLAA or which are in the readjustment process. This rate would only be available prospectively, subsequent to final rulemaking, and would require submittal of a request for modification of the royalty rate from each lessee.

Comments and associated rationale are invited from the public on whether either of the two flat rates or any flat rate in between these limits should be applied to Federal underground coal leases and whether the flat rate, if less than 8%, should be applied to existing leases which have an 8% royalty rate prior to their next readjustment. After consideration of the comments, a determination will be made as to what the fixed rate will be and to which leases it will be applied. That rate will be set in the final rulemaking without further notice.

Regardless of which rate is set, Federal coal lessees seeking further temporary short-term royalty relief when and if economic conditions warrant may do so by applying for a royalty rate reduction in accordance with section 39 of MLA (30 U.S.C. 209 (1982)), codified at 43 CFR 3485.2(c) and 3473.3–2(d).

The principal author of this proposed rulemaking is Pamela J. Lewis, assisted by the staff of the Division of Legislation and Regulatory Management, Bureau of Land Management, and the staff of the Office of the Solicitor, Department of the Interior.

It is hereby determined that this rulemaking does not constitute a major Federal action significantly affecting the quality of the human environment and that no detailed statement pursuant to section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)) is required.

The Department of the Interior has determined that this document is not a major rule under Executive Order 12291 and that it will not have a significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). The economic impacts of this proposed rulemaking would not exceed the economic threshold of Executive Order 12291 and the rulemaking would affect all underground lessees equally, regardless of their size.

This rulemaking contains no information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3507.

List of Subjects in 43 CFR Part 3470

Coal management provisions and limitations, Lessee qualification requirements, Fees, rentals, and royalties, Bonds, Lease terms.

Under the authority of the Mineral Leasing Act of 1920, as amended and supplemented (30 U.S.C. 181 *et seq.*), the Mineral Leasing Act for Acquired Lands of 1947, as amended (30 U.S.C. 351–359), the Multiple Mineral Development Act (30 U.S.C. 521–531), the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 *et seq.*), it is proposed to amend Part 3470, Group 3400, Subchapter C, Chapter II of Title 43 of the Code of Federal Regulations as set forth below:

PART 3470—[AMENDED]

1. The authority citation for Part 3470 continues to read:

Authority: 30 U.S.C. 181 *et seq.*, and 30 U.S.C. 351–359 and 99 Stat. 1266.

2. Section 3473.3–2 is amended by removing paragraph (a)(1), by redesignating paragraphs (a) (2) through (4) as paragraphs (a) (1) through (3), and by revising redesignated paragraph (a)(2) to read as follows:

§ 3473.3–2 Royalties.

* * * * *

(a) * * *

(2) A lease shall require payment of a royalty of [Number to be inserted upon final rulemaking] percent of the value of coal removed from an underground mine.

* * * * *

James E. Cason,

Deputy Assistant Secretary of the Interior.

June 13, 1988.

[FR Doc. 88–17155 Filed 7–28–88; 8:45 am]

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