

**PUBLIC FINANCING:
FEDERAL FAIR MARKET
VALUE COAL LEASES IN
THE POWDER RIVER
BASIN ARE A PUBLIC
SUBSIDY.**

Institute for Energy Economics and Financial
Analysis

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FEDERAL FAIR MARKET VALUE COAL LEASES IN THE POWDER RIVER BASIN ARE A PUBLIC SUBSIDY.

- ▶ Since 1982 the FMV lease process administered by the Bureau of Land Management (BLM) provided a \$28.9 billion subsidy to coal producers and utilities.
- ▶ 9 billion tons of coal were mined.
- ▶ There is no evidence the leases with coal companies were for fair market value.
- ▶ There is evidence the coal was leased for below fair market value.
- ▶ 12 billion more tons are slated to be mined between 2011 and 2035.

FEDERAL FAIR MARKET VALUE COAL LEASES IN THE POWDER RIVER BASIN ARE A PUBLIC SUBSIDY.

▶ Here's how:

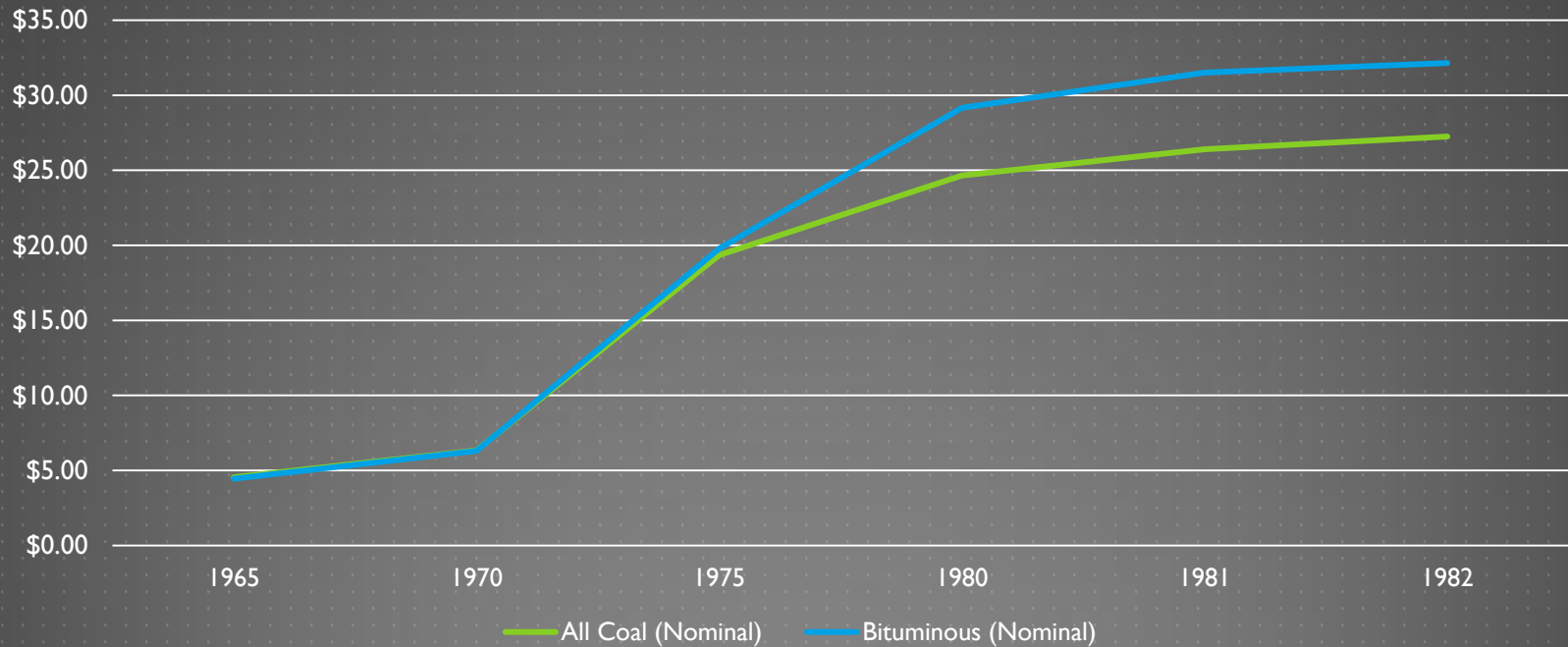
- ▶ Federal government owns coal in the PRB. Has monopoly of western coal. It is the “price leader”
- ▶ In 1982, BLM circumvented rules and sold 1.6 billion tons of coal for below fair market value.
- ▶ The timing flooded market with cheap coal and drove prices down for over almost two decades.
- ▶ Past and current leases reflect the market distortions.
- ▶ Oversight of the FMV lease program is nonexistent. No audits, no Congressional studies, no independent reports, no public interest studies, no DOI inspector general studies on the FMV lease process in almost thirty years. DOI decertified the PRB as a coal producing zone based on faulty data. BLM reneged on promises to release financial information on the lease process.
- ▶ Current markets show long term rising prices driven by exports, change in domestic coal production and market factors. Not reflected in BLM's formal decisions on leases.
- ▶ Current lease awards: sweet heart deal and continued pricing below fair market value.
- ▶ Loss of revenues from below fair market value sale of coal to coal producers over the last thirty years is estimated at \$28.9 billion.
- ▶ Continued failure to correct process exposes federal and state government to loss of revenue. Also has significant federal energy policy implications and raises concerns for any proposal to use PRB coal in new or retrofitted coal plant proposals.

FEDERAL MONOPOLY OVER WESTERN COAL

- ▶ Nature of Federal Monopoly Control
 - ▶ Ownership of Western Coal Resources
 - ▶ Price Leader
- ▶ Operational Decision
 - ▶ Coal Mining Companies Control Mine Site Selection, Timing and Reserve Management
 - ▶ DOI/BLM administers FMV Lease Program – statutory required to obtain Fair Market Value for coal.
- ▶ Brief History of Western Production
 - ▶ Nation relied on Central Appalachia prior to 1960's
 - ▶ Less than 5% out of PRB. Rising interest – '60's and '70's.
 - ▶ Production soared from 33 million tons in early 60's to almost 500 million tons currently.

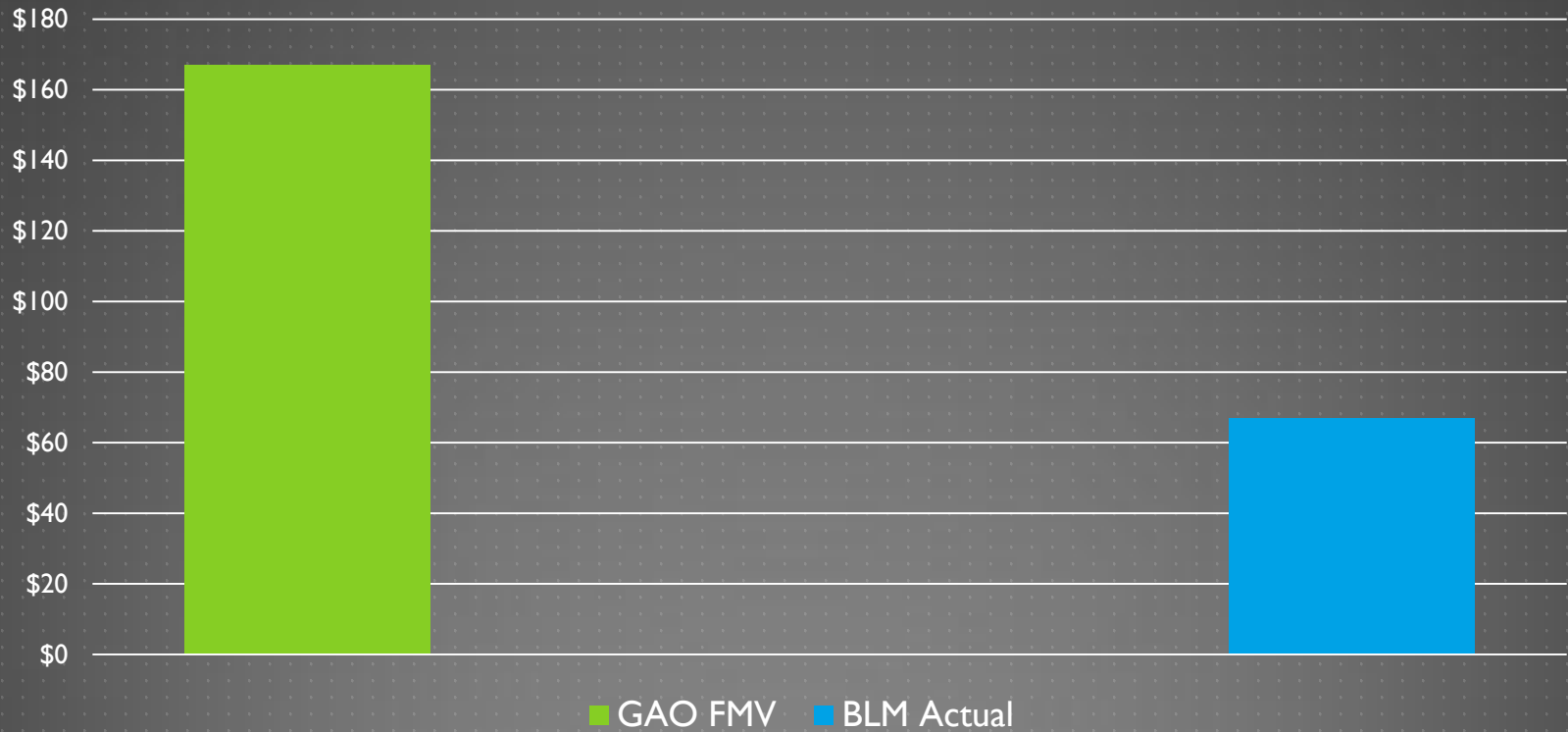
1965-1982 COAL MARKETS: RISING PRICE ENVIRONMENT

1965-1982 Coal Prices
(dollars per ton)



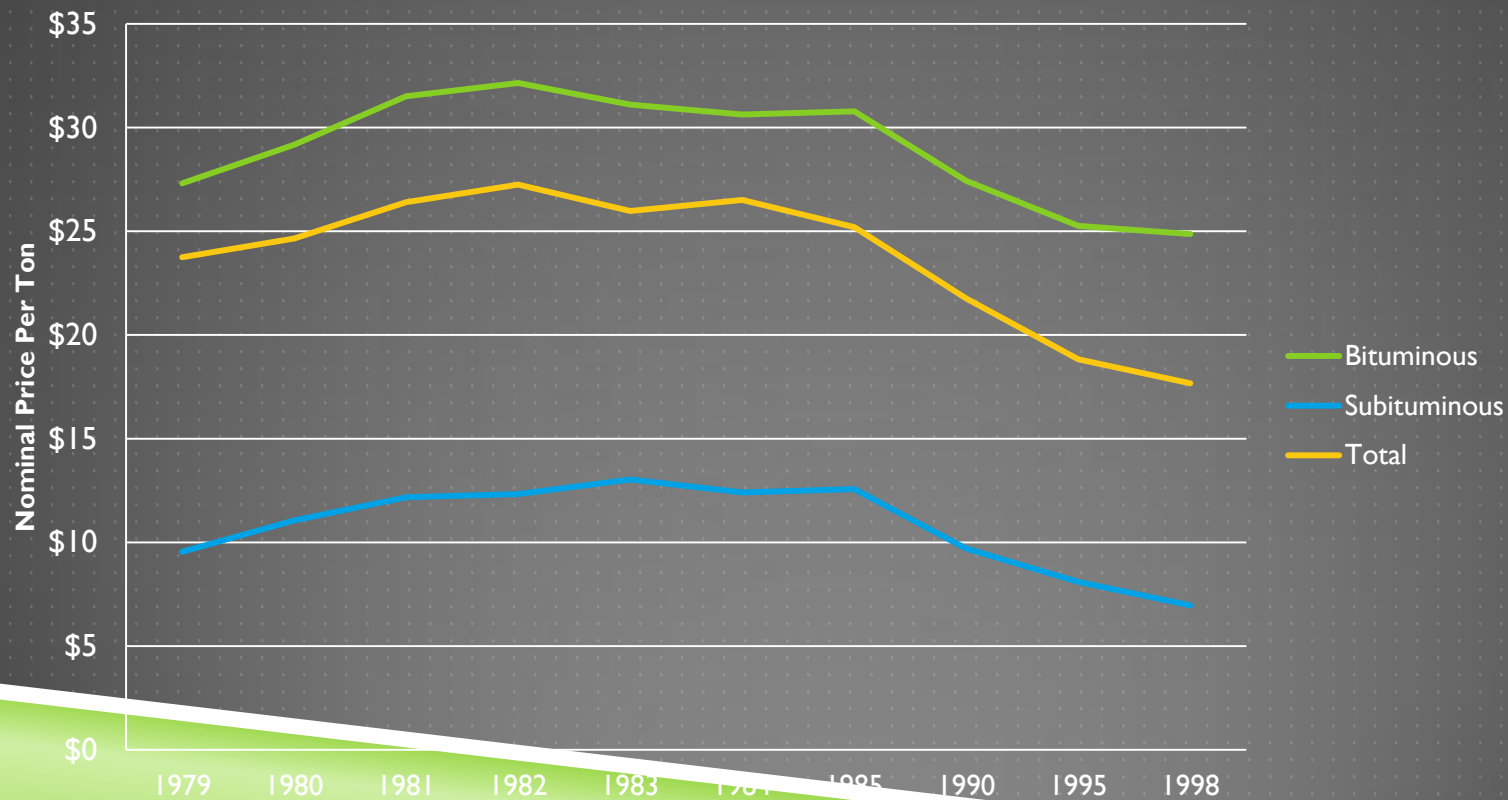
1982 PRB COAL TRACT SALE, 1.6 BILLION TONS, ELEVEN TRACTS: GAO FAIR MARKET VALUE VS. BLM "BELOW MARKET" ACTUAL LEASE VALUE

(IN MILLIONS \$)



POST 1982-1998: DECLINING PRICE ENVIRONMENT

1979-1998 Coal Prices: Bituminous, Subbituminous and All Coal



IMPLICATIONS

- ▶ Monopoly Control - “Price Leader” – 1994 Audit and BLM Comments
- ▶ Scandal
 - ▶ Ignored appraisal
 - ▶ Set pattern for future prices
- ▶ BLM Defense
 - ▶ Did not violate FMV standard
 - ▶ Jobs and Cheap Electricity
- ▶ Checks on the Process Broke Down
 - ▶ Appraisals Problematic - Inherent
 - ▶ Competition Needed – never took place
 - ▶ Secretary’s Authority – an agenda?
 - ▶ Ethics – Senior management, internal committee, general counsel
 - ▶ Internal Checks not enough – external review needed

THE NEW BLM FAIR MARKET LEASE PROGRAM: HOW ITS DONE TODAY

- ▶ Reaffirm Coal Producers select sites and apply
 - ▶ Drive Reserve Management
- ▶ BLM Conducts FMV Appraisal
 - ▶ New Mines/Adjacent Extensions
 - ▶ Mine Plan
 - ▶ Economics of Tract: Comparable or Income Approach
 - ▶ Cost of Coal Scenario
- ▶ FMV Secret
- ▶ Bids Public
- ▶ Bids at Auction must be at or above secret FMV
- ▶ Post Auction BLM Meeting and Award Announcement
- ▶ Promise of External Review and Public Information

POST SCANDAL PROGRAM

- ▶ **Current Oversight**
- ▶ **Current Coal Markets**
- ▶ **Current Leases**

CURRENT OVERSIGHT

- ▶ From mid 1970's to 1982 and Post Scandal:
 - ▶ 25 Audits and Report from the General Accounting Office (a/k/a Government Accountability Office)
 - ▶ Pre/Post Scandal Congressional reports including a full Congressional Commission (Linowes) on Fair Market Value Leasing.
 - ▶ Frequent Policy Papers from Department of Interior
 - ▶ Other quasi-federal and think tank substantive policy treatment. Books on federal coal policy.
 - ▶ Review of Agency personnel behavior by DOI Inspector General in wake of scandal. Three investigative studies. Department of Justice review.

POST 1982 OVERSIGHT:

NO EVIDENCE THAT FMV STANDARDS ARE FOLLOWED

- ▶ One GAO audit of BLM coal program since 1983, with only tangential relation to scandal issues.
 - ▶ Confirms flooding of coal markets with low cost coal drove prices down per BLM.
- ▶ No publicly released inspector general reviews.
- ▶ No Congressional studies.
- ▶ No major reports from think tanks or quasi-governmental entities on FMV leasing/related issues.
- ▶ BLM reporting to Congress – misleading at best.
- ▶ BLM refusal to release promised public information on FMV leases.

POST 1982 OVERSIGHT

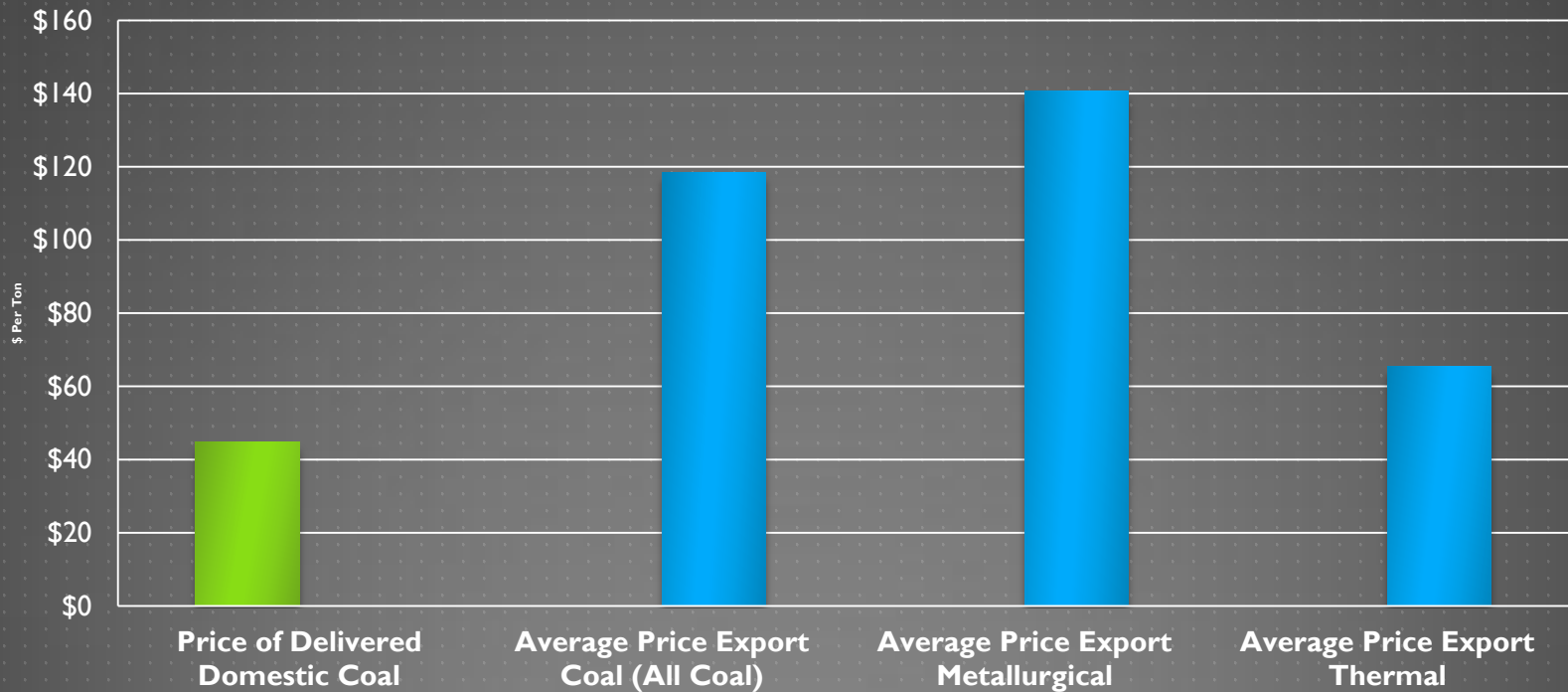
- ▶ Decertification of Coal Production Zones
 - ▶ Started in 1980's to address problem of too much coal on market. Planning and market analysis.
 - ▶ Opposition by BLM and coal industry.
 - ▶ Early 1990 BLM decertifies zone. Tells GAO no interest in leasing. Four months after decertification, four applications for 800 million tons of coal received.
 - ▶ Current litigation to reinstate zones.

CURRENT MARKETS: RISING DEMAND AND RISING PRICE ENVIRONMENT FOR PRB COAL

- ▶ **Shifts in Coal Markets**
 - ▶ Loss of Central Appalachian Coal
 - ▶ Decline in Natural Gas Prices
 - ▶ Clean Air Implications
 - ▶ Exports
- ▶ **Macro Shifts in Power Generation**
 - ▶ No new plants
 - ▶ Retirements

2010 EXPORT PRICES VERSUS DOMESTIC SALE TO UTILITIES

2010 Domestic Price of Coal vs. Export Price of Coal



EXPORTS: “THE SALVATION”

- ▶ General Solution for CAPP/NAPP/ILB
 - ▶ Metallurgical and Thermal – overcome loss of price competitiveness in utility markets
- ▶ PRB Exports - Current
 - ▶ Enhances margins squeezed by cost of production.
 - ▶ Super-premium on top of domestic demand.
 - ▶ Cloud Peak – 3.5% of productive output; 12.7% of revenues.
 - ▶ Peabody Scenario: all-in \$26.00 per ton versus \$14.35.
 - ▶ Terminal Expansion: West Coast, Gulf, Great Lakes
- ▶ Aggressive Lease Activities Tied to Exports

CURRENT LEASES: BLM STILL NOT GETTING FAIR MARKET VALUE

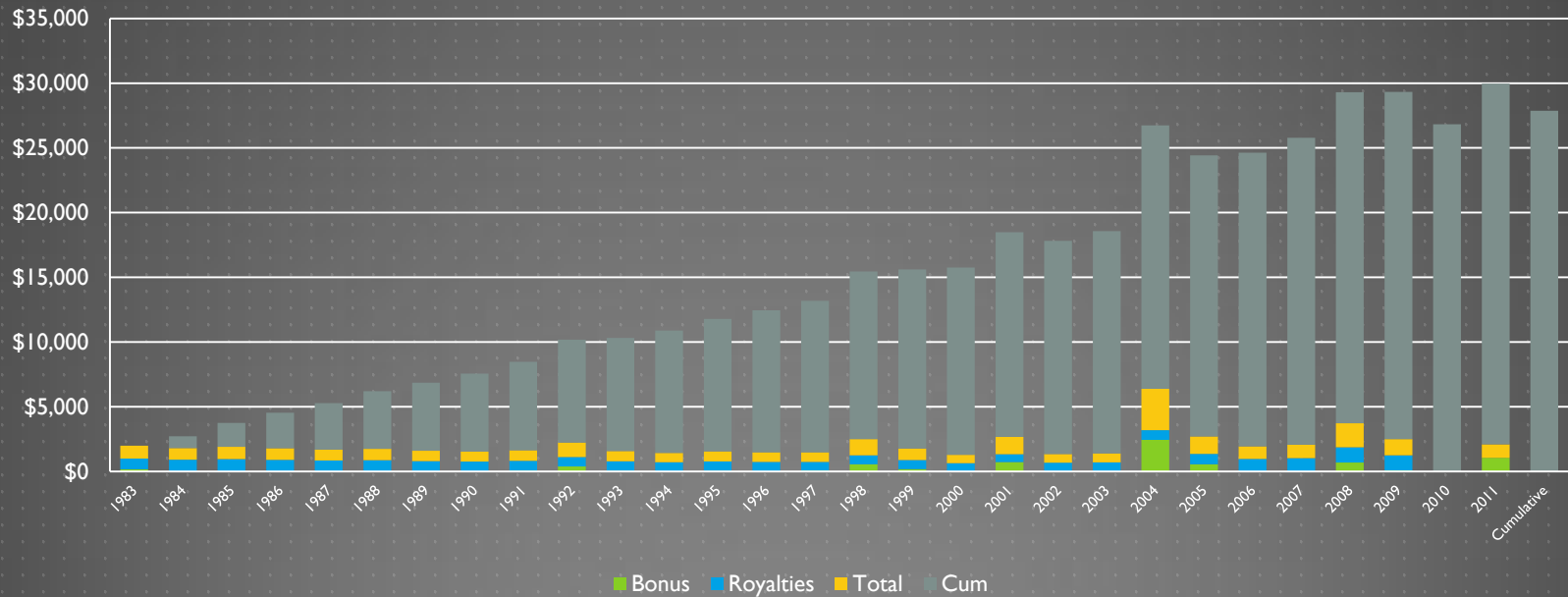
- ▶ Background
 - ▶ Market signals rising long-term prices
- ▶ Three lease deals
 - ▶ Cloud Peak – Caballo – sweet heart deal
 - ▶ Peabody – Belle Ayr – record high bid
 - ▶ Alpha Natural Resources – record high bid

IMPLICATIONS OF CURRENT LEASE ACTIVITY

- ▶ Red-Flag Warnings: Not Receiving Fair Market Value
 - ▶ Cloud Peak Energy – Market reaction and subsequent bids
 - ▶ Alpha and Peabody – not reflective of rising value. Prices still far below scenario offered by coal producers re: export markets.
 - ▶ BLM Records of Decision defective – no acknowledgement of exports, no acknowledgement of changes in domestic coal markets, out dated information and analysis.

\$28.9 BILLION IN LOST REVENUE FROM FAILURE TO FOLLOW FMV STANDARD

Lost Annual and Cumulative Bonus, Royalties:
1983-2011
(in millions - 2011 constant dollars)



FORWARD LOOKING: RISING PRICES GROWING SPECULATION

- ▶ Current Markets are down.
- ▶ Some competition on recent FMV lease bids.
 - ▶ Higher bids, still too low. Global Markets.
 - ▶ BLM recently rejected one as too low.
- ▶ New entrants – foreign investors and private equity developers. Totally Export driven.
- ▶ Different financial model. Higher returns, shorter time periods, broader business vision.

IMPLICATIONS FOR PRB COAL

- ▶ Prices Rising, FMV administration unprepared to address issues.
 - ▶ Continued loss of revenue
 - ▶ Unraveling of business consensus
 - ▶ Selling coal overseas
 - ▶ PSC implications
 - ▶ State and local intensified mining and appeals for lower royalty and bonus payments
 - ▶ No plans for oversight