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The Catholic University of American

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CURRENT ISSUES RELATING TO EMERGENCY FEDERAL COAL LEASING

DAVID B. PARISER*

I. INTRODUCTION

Since the early 1970s, considerable controversy has surrounded the Department of the Interior's program for leasing publicly-owned coal lands to private mining companies for development. As a result, there have been two moratoriums on the issuance of new federal coal leases, the first spanning the decade of the 1970s, the second from 1983 to the present. In addition, major legislative changes have occurred and, in 1983, the Congressional Commission on Fair Market Value Policy for Federal Coal Leasing was established. Following the conclusion of a two-year departmental review of coal leasing policies and procedures in February 1986, the Secretary of the Interior unveiled a new federal coal leasing program, indicating that the earliest probable date for resuming competitive leasing would be in late 1987.

In the recent moratorium, as in the earlier one covering the 1970s, federal coal leasing has been limited to emergency or noncompetitive situations. As administered

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The views expressed in this Article are those of the author and not necessarily those of the General Accounting Office.

1 See REPORT OF THE COMM’N ON FAIR MARKET VALUE POLICY FOR FEDERAL COAL LEASING (Feb. 1984) [hereinafter cited as REPORT OF THE COMM’N]. Congress established the Commission on Fair Market Value Policy For Federal Coal Leasing by enacting the Supplemental Appropriations Act of 1983, Pub. L. No. 98-63, 97 Stat. 301, 328, signed into law by President Reagan on July 30, 1983. The purpose of the Commission was to study the federal coal management program and resolve controversies surrounding the Interior Department’s coal leasing procedures to ensure receipt of fair market value. The controversies arose from criticisms of the Interior Department procedures and the April and October 1982 federal coal lease sales in Montana and Wyoming, in an area known as the Powder River Basin. The key controversy was that, by design or through incompetence, the Government had realized less than fair market value on the sale of coal leases to lands containing about 1.6 billion tons of federal coal, at a total lease price of $67 million. See infra note 118.


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under the Interior Department’s emergency leasing process, such leasing serves two objectives: (1) maintaining current production levels of existing mines where operations are heavily dependent on the acquisition of adjacent federal coal lands, thus avoiding mining disruptions and premature mine closing, and (2) preventing operating mines from bypassing, or mining around, unleased federal coal deposits that are unlikely to be mined by another company in the foreseeable future. 3

This Article discusses recent issues relating to the administration of emergency federal coal leasing under the Federal Coal Leasing Amendments Act of 1976 ("FCLAA"). 4 Basically, the law makes no distinction between leasing to promote the development of new competitive mining operations and leasing to meet emergency needs of existing operations. The former type of leasing is essentially competitive, as envisioned by the law, while the latter is noncompetitive and not specifically covered under the law. In light of the uncertainty and controversy surrounding the competitive coal leasing program, emergency leasing very well could emerge as the primary type of federal coal leasing.

II. THE FEDERAL COAL MANAGEMENT PROGRAM

Federal coal lands account for a significant portion of the country's known coal reserves. 5 Federal lands contain about sixty percent of western coal reserves and an estimated thirty percent of total domestic coal reserves. In addition, the federal government influences about twenty percent of nonfederal western coal because many of the western coal areas are characterized by intermingled ownership patterns. Production from federal coal lands in 1985 amounted to 162 million tons, accounting for more than fifty percent of western coal production and about twelve percent of total United States coal production. 6

The Department of the Interior's Federal Coal Management Regulations incorporate provisions of FCLAA and other laws protecting the environment and controlling surface mining and reclamation activities. The regulations, initially issued in 1979 and revised several times since then, 7 establish a comprehensive leasing program for conveying federal coal lands to private mining companies by competitive bidding. These regulations provide for two components of the leasing system: normal competitive leasing and leasing-by-application.

Normal competitive leasing is the primary mechanism through which the Interior Department makes federal coal available to private mining companies. Under this

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5 See BUR. OF LAND MGMT.; DOI, FINAL ENVTL. STATEMENT, FED. COAL MGMT. PROGRAM 2-1 (Apr. 1979) [hereinafter cited as FINAL ENVTL. STATEMENT (Apr. 1979)].
component, the Interior Department establishes schedules within designated federal coal production regions\(^8\) for leasing specific tracts of its choosing. Coal program activities in each region are guided by a Regional Coal Team,\(^9\) an advisory group chartered under the Federal Advisory Committee Act.\(^{10}\) Team members include the Governors of states in the region involved and officials of the Interior Department's Bureau of Land Management ("BLM") in the states.

Before any decision is made to hold a regional lease sale, the Interior Department, through the Regional Coal Teams, must complete several coal activity planning tasks. These tasks include assessing the need for leasing, screening coal company expressions of leasing interest in specific tracts, establishing (i.e., delineating) boundaries of proposed lease tracts, appraising individual lease tracts, preparing comprehensive environmental impact statements covering lands proposed for leasing, and selecting a limited number of tracts from the lands considered for leasing.

The competitive leasing process takes about three to five years to complete before a regional lease sale is held. From 1981 through 1985, forty-six federal coal leases were sold at regional sales.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Tracts</th>
<th>Acres</th>
<th>Recoverable Reserves (Mil. Tons)</th>
<th>Total High Bonus Bids</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>24</td>
<td>42,352</td>
<td>326.3</td>
<td>$27,540,486</td>
</tr>
<tr>
<td>1982</td>
<td>19</td>
<td>28,312</td>
<td>1,677.0</td>
<td>95,964,705</td>
</tr>
<tr>
<td>1983</td>
<td>2</td>
<td>6,421</td>
<td>82.1</td>
<td>706,310</td>
</tr>
<tr>
<td>1984</td>
<td>1</td>
<td>4,999</td>
<td>36.7</td>
<td>9,542,041</td>
</tr>
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</table>

Total 46 82,084 2,122.1 $133,753,542

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</tr>
</tbody>
</table>

Total 46 82,084 2,122.1 $133,753,542

These sales are the result of coal activity planning in designated Federal Coal Regions. These figures do not include emergency or lease by application sales.


The second component, leasing-by-application, allows the Interior Department to respond to a need for federal coal at specific locations more rapidly than the normal

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\(^{10}\) 5 U.S.C. App. §§ 1-17 (Supp. II 1984). The authority to create these committees within the Bureau of Land Management is codified at 43 C.F.R. § 1784 (1986).
competitive leasing process permits. These locations include coal lands in designated federal coal production regions where a producing mining operation can demonstrate a need for unleased federal coal in accordance with emergency leasing criteria included in the Federal Coal Management Regulations. These criteria are intentionally restrictive in that they were designed to limit leasing to legitimate emergencies while preventing potential lessees from circumventing the competitive leasing process by submitting emergency applications.

In addition to emergency situations, the Interior Department conducts leasing-by-application outside designated federal coal production regions where federal coal deposits are limited and scattered. In these areas, it is not cost-effective to conduct extensive land-use and activity planning before holding a lease sale. Emergency criteria do not apply in these areas and unlimited amounts of federal coal may be leased to any applicant.

From 1978 through mid-1986, fifty-nine coal federal leases were sold in lease-by-application sales. Of the fifty-nine, fifty were emergency leases and nine were leases-by-application outside designated federal coal regions.

Table 2
FEDERAL COAL LEASES SOLD THROUGH LEASING-BY-APPLICATION FROM 1978 TO MID-1986

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Tracts</th>
<th>Acres</th>
<th>Total Recoverable Reserves (Mil. Tons)</th>
<th>Total High Bonus Bids</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>6</td>
<td>2,351</td>
<td>13.0</td>
<td>$132,094</td>
</tr>
<tr>
<td>1979</td>
<td>9</td>
<td>6,352</td>
<td>65.5</td>
<td>295,272</td>
</tr>
<tr>
<td>1980</td>
<td>9</td>
<td>3,744</td>
<td>18.1</td>
<td>440,773</td>
</tr>
<tr>
<td>1981</td>
<td>8</td>
<td>4,852</td>
<td>69.7</td>
<td>1,033,553</td>
</tr>
<tr>
<td>1982</td>
<td>7</td>
<td>2,801</td>
<td>12.8</td>
<td>2,774,803</td>
</tr>
<tr>
<td>1983</td>
<td>4</td>
<td>697</td>
<td>2.3</td>
<td>357,918</td>
</tr>
<tr>
<td>1984</td>
<td>1</td>
<td>78</td>
<td>.7</td>
<td>7,951</td>
</tr>
<tr>
<td>1985</td>
<td>10</td>
<td>5,849</td>
<td>23.0</td>
<td>1,857,241</td>
</tr>
<tr>
<td>1986</td>
<td>5</td>
<td>3,206</td>
<td>21.0</td>
<td>1,106,323</td>
</tr>
<tr>
<td>Total</td>
<td>59</td>
<td>29,930</td>
<td>226.1</td>
<td>$8,005,928</td>
</tr>
</tbody>
</table>

Includes 50 emergency leases and 9 leases-by-application outside designated Federal Coal Regions.

Source: DOI, Federal Coal Management Report (various years).

See Final Envtl. Statement (Apr. 1979), supra note 5, at 3-67 to -3-68.

Id. at 3-67.
III. THE HISTORY OF EMERGENCY FEDERAL COAL LEASING POLICY

Emergency coal leasing has evolved from a temporary measure in the early 1970s to a major component of today's federal coal leasing program. From a public policy perspective, the history of emergency coal leasing policy provides insight into the administrative and legislative events shaping the economic and regulatory environment currently governing the emergency leasing process.

The Department of the Interior, under the Mineral Lands Leasing Act of 1920, has the responsibility for leasing federal coal deposits to private mining companies for development. Prior to 1970, the Interior Department's coal leasing policy was reactive; coal lands were leased in a haphazard fashion to almost anyone who sought a lease. Between 1955 and 1970, the general practice of the Bureau of Land Management was to issue federal coal leases without much consideration to the total coal reserves under lease, the need for additional leasing and production, and the environmental impact of leasing.

A 1970 BLM study reported that leased coal acreage on public lands in six western states—Colorado, New Mexico, North Dakota, Montana, Utah, and Wyoming—rose sharply from about 80,000 acres in 1945 to more than 780,000 in 1970, but that federal lease production declined from 10 million tons of coal to 7.4 million tons during the same period. Furthermore, the BLM report noted that less than ten percent of the total leased acreage was producing coal. In May 1971, in response to the 1970 BLM report, Secretary of the Interior Rogers B. Morton took a series of informal actions that resulted in a moratorium on all federal coal leasing and prospecting permits. In February 1973, Secretary Morton replaced the informal moratorium with a new federal coal leasing policy that embraced both long-term and short-term actions. The short-term actions marked the beginning of an emergency federal coal leasing policy.

A. Secretary Morton's Short-Term Leasing Policy

Secretary Morton's short-term action consisted of the establishment of interim leasing criteria until a new competitive leasing program was developed. The criteria were used for ensuring that applications from coal companies constituted a legitimate short-term need for federal coal. This marked the first time the Interior...
Department adopted a policy to ensure that production at existing mines could continue until a new competitive coal leasing program was developed. All coal lease applications, including preference right lease applications, were to be reviewed on a case-by-case basis in accordance with the following criteria:

(a) the coal is needed to maintain an existing mining operation, or
(b) coal is needed as a reserve for production in the near future; and in all cases
(c) the land to be mined will be reclaimed in accordance with lease stipulations that will provide for environmental protection and land reclamation, and
(d) where required by the National Environmental Policy Act, an environmental impact statement covering the proposed lease has been prepared.\(^{19}\)

In July 1973, BLM directed its field offices to implement Secretary Morton’s short-term leasing policy.\(^{20}\) The instructions called for leasing decisions to be based on sufficient indications that a prospective applicant needed coal to satisfy an existing market and intended to begin development within three years.

In May 1974, BLM released a draft programmatic environmental impact statement describing the Energy Minerals Allocation Recommendation System ("EMARS").\(^{21}\) The purpose of EMARS was to enable the Interior Department to resume competitive leasing through a market-oriented mechanism that would help establish an environmentally acceptable program. BLM released the final environmental impact statement ("EIS") with some modifications.\(^{22}\) A noticeable change was the renaming of the preferred program, to Energy Minerals Activity Recommendation System. A controversial aspect of the EMARS program was that it relied upon industry and public nominations to identify tracts for meeting coal development needs from federal lands.

Shortly after the adoption of EMARS as departmental policy, Natural Resources Defense Council, Inc. v. Hughes was filed in the United States District Court for the District of Columbia alleging that the final EIS was legally inadequate.\(^{23}\) The plaintiffs argued that the statement was defective because of its failure to: (1) Sufficiently describe the EMARS program and disclose reasons for the changes in the program between the draft and final EISs; (2) adequately consider the need for leasing more federal coal; (3) fully discuss the environmental impacts; and (4) sufficiently consider energy conservation and alternative sources of energy.

\(^{19}\) Id.

\(^{20}\) BUR. OF LAND MGMT., INSTRUCTIONAL MEMORANDUM 72-231 (July 6, 1973).

\(^{21}\) See BUR. OF LAND MGMT., DRAFT ENVTL. IMPACT STATEMENT, PROPOSED COAL LEASING PROGRAM (1974).

\(^{22}\) See BUR. OF LAND MGMT., FINAL ENVTL. IMPACT STATEMENT, PROPOSED COAL LEASING PROGRAM (1975).


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B. Secretary Kleppe’s Revisions to Short-Term Leasing Policy

In 1976, the Interior Department made two adjustments to its short-term leasing policy. In January, Secretary Thomas Kleppe announced that the Department would retain Secretary Morton’s short-term leasing policy until the new competitive leasing system (i.e., EMARS) was fully operational and the leasing moratorium lifted.24 A month later, in February 1976, Secretary Kleppe informed BLM that it should process preference right leases that complied with short-term leasing criteria until new regulations governing preference right leases were issued. These regulations were issued in May 1976, and allowed preference right leasing without regard to short-term criteria.25 Thus, from that date until July 1977, short-term leasing criteria applied only to leases offered at public auctions while preference right leases could be issued without limitation.

C. New Legislation Affecting Federal Coal Policy

From 1974 through 1977, while the Interior Department was developing a long-term coal leasing policy, Congress was investigating the Department’s management of public lands and its coal leasing activities under the Mineral Lands Leasing Act of 1920. Congressional hearings focused on the alleged speculative holding of federal coal leases acquired noncompetitively through preference right lease applications, the adequacy of financial returns to the public, environmental protection, and public participation. Under the 1920 Act, the Secretary of the Interior had broad discretionary authority to offer federal coal deposits for lease sale to qualified applicants. The Secretary was authorized to award federal coal leases by the use of competitive bidding or such other methods as adopted by general regulation. About half of all the federal coal leases issued through 1970 were awarded noncompetitively without the government receiving any bonus bids.

In August 1976, over President Ford’s veto, Congress enacted the Federal Coal Leasing Amendments Act of 1976 (“FCLAA”).26 The FCLAA, among other provisions, abolished all noncompetitive leasing.27 The Act required that new federal coal leases be awarded through competitive bidding28 and that no lease be

24 DOI, Office of the Secretary, Memorandum (Jan. 26, 1976).
27 Two exceptions are permitted from the requirement of competitive bidding. The first exception is a provision allowing a modification to an existing lease of up to 160 acres, not resulting in a lease sale nor issuance of a new lease. Id. at § 203. The second exception is a provision allowing the Interior Department to sell federal coal, based on a negotiated fair market value, the removal of which is necessary and incidental to the exercise of a right of way permit. Id. at § 201(a)(1). FCLAA also abolished the issuance of prospecting permits and preference right leases for coal. However, valid existing preference right lease applications issued prior to the enactment of FCLAA were not affected.
28 Competitive bidding means that otherwise qualified potential bidders cannot be prevented from bidding by limiting participation at public lease sale auctions to a particular class of potential bidders.
issued at a price less than fair market value, as determined by the Secretary. In addition, FCLAA did not distinguish between leasing to encourage the development of new competitive mining operations and leasing to meet short-term, or noncompetitive, needs of existing mines. The former type of leasing is essentially competitive, as envisioned by the Act, while the latter form of leasing, which the Interior Department has been conducting since the early 1970s, is noncompetitive and not covered under the Act. Further, FCLAA established no authority to allow the Secretary of the Interior to negotiate fair market value in leasing situations in which competitive bidding procedures are not appropriate. Since the enactment of FCLAA, there has been considerable debate concerning the effects of its provisions on federal coal leases acquired before FCLAA.

In addition to FCLAA, Congress enacted the Federal Land Policy and Management Act of 1976. The Act requires BLM and the Interior Department to ensure that all resource development decisions related to public lands, including coal leasing, are made in cooperation with state and local governments as part of a comprehensive planning process.

In 1977, Congress enacted the Surface Mining Control and Reclamation Act ("SMCRA"). SMCRA requires the Secretary of the Interior to review public lands to determine whether they contain areas unsuitable for all, or only certain types, of surface coal mining operations. In addition, section 714 of SMCRA, protection of qualified surface owners, prohibits the Secretary of the Interior from leasing any federal coal underlying privately-owned surfaces for surface mining until the surface owner’s written consent has been obtained.

Subsequent to the enactment of FCLAA, the Interior Department, in May 1977, promulgated revised coal leasing regulations describing the EMARS coal leasing program and incorporating the requirements of FCLAA. The regulations included revised short-term leasing criteria similar to those included in the 1973 BLM instructional memorandum. The criteria required applicants for short-term coal leases to demonstrate that the coal was needed to maintain an existing mine or as a reserve for maintaining near term production. However, the regulations did not require the applicant to begin mining within three years, as provided under the 1973 criteria.
D. Secretary Andrus' Revisions to Short-Term Leasing Criteria

Under the Carter Administration, the Interior Department developed a new coal leasing program in which emergency leasing played a major role. On July 25, 1977, Secretary of the Interior Cecil Andrus revised the short-term leasing criteria. The memorandum explaining the Secretary's decision states that neither the 1973 BLM instructions nor Secretary Morton's short-term leasing policy placed any limitation on the amount of acreage or reserves which could be included in a short-term lease. Secretary Morton's policy allowed the Interior Department to grant a lease of any size, provided the applicant could begin operations within three years. The critical factor was the time at which production was to commence, not the size of the lease. The memorandum provided the following rationale for revising Secretary Morton's short-term policy:

While, in general, the short-term criteria have served their intended purpose, alleviation of particular coal supply problems during the consideration of a revised coal program, the short-term standards adopted by Secretary Morton are subject to "abuse" because they do not contain any limits on the amount of reserves that can be included in a lease. The original short-term standards serve not only their intended function of alleviating short-term problems but also serve to satisfy long-term needs.

Satisfaction of long-term needs under the short-term system is undesirable. To eliminate the possibility of abuse of short-term leasing and to ensure that only leases for legitimate short-term situations are issued, I recommend revising the short-term standards.

The short-term policy adopted by Secretary Andrus contained separate criteria for existing mines and for new mine openings. Existing mines, awarded leases by competitive bidding, and noncompetitive preference right lease applicants had to meet the following criteria:

1. Federal coal reserves are needed to give a contiguous mining area of an operating mine a reserve of coal that can meet contracted-for rates of production for the next 8 years or expected rates of production for the next 8 years whichever is higher; or

2. the Federal lease area sought is so small, or so located in relation to an operating mine on adjacent lands that failure to issue a lease will preclude mining of the Federal reserve in the foreseeable future.

On the other hand, applicants requesting lease sales for new mine openings were subject to the short-term criteria:

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34 DOI, Office of the Secretary, Memorandum, Short-Term Leasing Standards (July 25, 1977).
35 Id. at 1.
36 Id. at 2.
37 Id.
The Department may grant short-term applications for competitive or preference right leases for new mines to serve existing power plants or other existing coal users if the new mine can be operated, related facilities constructed, and the coal delivered without the construction of major new transportation facilities.

Leases issued under this criteria shall require the lessee to submit a complying mining and reclamation plan within one year from lease issuance and to begin mine development within six months from the date of approval of the mining plan. The lease would automatically terminate if those conditions were not met.

The lease may be issued for no more than 8 years of reserves at contracted-for or expected levels of production, and must form, with lands already controlled by the applicant, an economic mining unit.38

E. Natural Resources Defense Council, Inc. v. Hughes: Court Order and Short-Term Criteria

On September 27, 1977, the United States District Court for the District of Columbia ruled in *Natural Resources Defense Council, Inc. v. Hughes*39 that the Department of the Interior’s 1975 final EIS for a new program was inadequate. The court found that the Interior Department had violated the National Environmental Policy Act of 1969 in formulating and adopting EMARS as its new coal leasing program. As a result, the court ordered the Interior Department not to implement the EMARS leasing program. It also ordered the Department to evaluate its coal leasing policy and to develop a new EIS for deciding whether there was a need to implement a new program. The court, however, allowed the Interior Department to conduct short-term leasing, subject to strict criteria, until a new program was adopted. The court imposed two short-term leasing criteria: (1) the proposed coal lease was needed to maintain an existing coal supply contract, and (2) the amount of coal leased was not to exceed three years of production.40

Like short-term criteria previously established by the Interior Department, the court’s criteria clearly limited leasing to noncompetitive situations. The court order subsequently was amended to allow more leasing.41 In short, the criteria had the

38 Id. at 2-3.
40 Id. at 993-94. The court did not adopt the Interior Department’s July 25, 1977, revised short-term criteria. It rejected the criteria on the grounds that the criteria allowed the Department to award preference right leases without meeting the otherwise applicable requirements of the criteria for short-term leases.
41 *Natural Resources Defense Council, Inc.*, v. Hughes, 454 F. Supp. 148 (D.D.C. 1978). The amended order permitted the Interior Department to lease limited amounts of reserves to existing mining operations for meeting binding contracts and for maintaining production for up to eight years. The amended order also allowed the Department to lease up to five years of reserves to an adjacent operator to avoid the bypass or loss of federal coal unlikely to be mined by another operator.
effect of precluding competition at lease sales since existing operators requesting
the lease for adjacent lands had a clear competitive advantage over other potential
bidders.

F. Adoption of the Federal Coal Management Program and Establishment of
Emergency Leasing

On April 30, 1979, the Interior Department issued a final EIS for a new coal
leasing program called the Federal Coal Management Program. The program
embraced emergency leasing as a major component, set apart from the normal
competitive leasing process. Emergency leasing was governed by criteria designed
to maintain the integrity of the competitive leasing process. This marked the
first time the Interior Department recognized emergency leasing as a major type
of leasing rather than as an interim measure.

Within the framework of the Federal Coal Management Program, emergency
leasing had the following goals:

1. To serve as the leasing process outside the western federal coal production
regions—i.e., mid-western and eastern coal production regions—where limited
federal coal ownership makes full-scale planning impractical;

2. To prevent the bypass of federal coal, unemployment due to mine dis-
ruption, or coal contract failures;

3. To prevent prospective operators from opening mines on insufficient pri-
vate holdings and then forcing the federal government into granting emergency
leases because of resulting bypass or unemployment possibilities; and

4. To avoid issuing multiple emergency leases for the same operation prior
to consideration under the activity planning procedures.

After adopting the Federal Coal Management Program, the Interior De-
partment issued final regulations in July 1979 governing competitive coal leasing
and emergency leasing. The emergency leasing regulations contained several cri-
teria which required the following: (1) The applicant had to demonstrate a short-
term need for federal coal either to maintain production of an existing mine at
its current annual rate of production, or to avoid the bypass of coal unlikely to
be mined by another operator in the foreseeable future; (2) some portion of the
tract had to be mined within three years; (3) the need for the coal had to result
from circumstances beyond the applicant’s control; (4) the amount of coal leased

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42 See Final Env'tl. Statement (Apr. 1979), supra note 5.
43 2 FED. COAL MANAGEMENT PROGRAM (1979), supra note 15, at 95.
44 Id. at 115-16.
46 Id. at §§ 3425.0-2 to -3425.5.
could not exceed eight years of recoverable reserves, based on the applicant's production rate; (5) no more than one emergency lease could be issued to the same operation; and (6) the successful bidder had to meet the emergency criteria.\cite{47} Thus, despite the statutory requirement of competitive bidding, the criteria limited bidding to the applicant requesting the emergency lease sale.

In developing the emergency regulations, the Interior Department sought to curb potential abuses of the competitive leasing program. The preamble to the July 1979 regulations stated the following:

Although it does not appear as a part of the rulemaking, the Secretary of the Interior has adopted a policy to discourage a company very strongly from opening a mine which has insufficient reserves to operate successfully unless it subsequently obtains a Federal coal lease upon application under this subpart. This policy will be enforced by the Department of the Interior. . . . in the exercise of the Secretary of the Interior's discretion not to lease in response to any coal lease application. As an example, . . . any application may be rejected if leasing in response to the application would violate the normal competitive leasing process . . . . All potential lessees of Federal coal should be aware that attempts to pressure the Department to lease by opening a mine with insufficient reserves will be unsuccessful.\cite{48}

G. Secretary Watt and Emergency Leasing Policy

Shortly after the Reagan Administration assumed office, Secretary of the Interior James G. Watt, in April 1981, initiated a comprehensive review of the federal coal management program "to identify opportunities to streamline the existing rules and ultimately to make the leasing process more efficient."\cite{49}

On November 13, 1981, Secretary Watt approved several proposed changes to the coal leasing regulations issued by the previous administration.\cite{50} With regard to emergency leasing criteria, Secretary Watt approved the elimination of three restrictions: (1) The requirement that the applicant must have been in production for two years prior to application; (2) the provision limiting a mining operation to one emergency lease; and (3) the restriction of bidding to those able to show an emergency need for the coal.\cite{51}

\begin{itemize}
\item \cite{47} Id. at § 3425.1-4.
\item \cite{48} 44 Fed. Reg. 42,594 (1979).
\item \cite{50} DOI, Office of the Secretary, Decision Sheet at F-2 (Nov. 13, 1981) (attachment to Memorandum (Oct. 26, 1981)) [hereinafter cited as Decision Sheet].
\item \cite{51} Memorandum (Oct. 26, 1981), supra note 49, at 8-9; and Decision Sheet at F-2.
\end{itemize}
On December 16, 1981, the Interior Department issued proposed regulations including the above changes to the emergency leasing criteria approved by Secretary Watt. The purpose of the emergency leasing process, however, remained unchanged. It was to be used only in situations when the need for coal could not be timely accommodated under the normal competitive leasing process.

The Interior Department issued final regulations on July 30, 1982, containing the previously discussed changes to the emergency leasing criteria. According to the preamble, several commenters opposed the elimination of the criterion which required applicants to have been mining coal for two years or more before applying for an emergency lease. They believed such elimination would encourage speculation and the opening of new mines without sufficient reserves. The Interior Department’s decision to eliminate the two-year production criterion was based on the following reasons:

The elimination of the two year requirement will not encourage speculation, but rather will allow legitimate operators access to Federal coal where there is a need, particularly in situations where the coal would have to be mined early in the sequence of operations or else would be bypassed. No operator who opened a mine with insufficient reserves in the expectation of acquiring a Federal lease would be considered to have a legitimate need for the coal.

In addition, several commenters opposed the elimination of the criterion limiting a mining operation to one emergency lease while others supported it. Those opposing elimination believed such a change would encourage abuse of the emergency leasing process and circumvent the competitive leasing program. Others supporting such elimination argued that the move would help reduce the waste
of federal coal resources and introduce needed flexibility to the emergency leasing process.\textsuperscript{57} The Interior Department justified elimination of the criterion by stating that other provisions of the regulations provided sufficient safeguards to prevent abuses to the competitive leasing process.\textsuperscript{58}

IV. Issues Related to the Administration of Emergency Leasing Under Current Law

As previously mentioned, the Interior Department conducts emergency leasing for the purpose of preventing the bypass of unleased federal coal and maintaining production levels of operating mines. Although these objectives are appropriate from a public policy perspective, certain issues have caused the Interior Department to encounter difficulties administering emergency leasing within the current legal framework.\textsuperscript{59} These issues, often interrelated in the way they affect leasing and mining decisions, include the following:

(1) The emergency leasing regulations, designed to avoid abuses to the emergency leasing process, require applicants to show a legitimate need for the coal, but in doing so, limit leasing to situations in which competitive bidding is unlikely to exist.

(2) Emergency lease tracts, because they are noncompetitive in nature, are of little or no interest to other coal producers. As a result, their value on the open market is low although they may have substantial economic value to the applicant. Thus, competitive bidding procedures may not be appropriate for emergency leasing situations since they do not assure that the government will obtain a fair price for the coal.

\textsuperscript{57} Id.

\textsuperscript{58} Id.

\textsuperscript{59} Emergency federal coal leasing currently is governed by the following criteria:

(a) An emergency lease sale may be held in response to an application under this subpart if the applicant shows:

(1) That the coal reserves applied for shall be mined as part of a mining operation that is producing coal on the date of the application, and either:

(i) The Federal coal is needed within 3 years (A) to maintain an existing mining operation at its current average annual level of production on the date of application or (B) to supply coal for contracts signed prior to July 19, 1979, as substantiated by a complete copy of the supply or delivery contract, or both; or

(ii) If the coal deposits are not leased, they would be bypassed in the reasonably foreseeable future, and if leased, some portion of the tract applied for would be used within 3 years; and

(2) That the need for the coal deposits shall have resulted from circumstances that were . . . beyond the control of the applicant . . .

(b) The extent of any lease issued under this section shall not exceed 8 years of recoverable reserves at the rate of production under which the applicant qualified in paragraph (a)(1) of this section. If the applicant qualifies under both subparagraphs (A) and (B) of paragraph (a)(1) of this section, the higher rate applies.

\textsuperscript{43} C.F.R. § 3425.1-4 (1986).
(3) Minimum royalty rates on federal coal leases, as required under the Federal Coal Leasing Amendments Act of 1976, may be excessive and adversely affect the development of federal coal lands. A case in point is Appalachia, where the federal government's coal holdings are small and interspersed with private coal lands having lower royalty rates.

A. Regulations Limit Leasing to Noncompetitive Situations

The emergency leasing criteria limit leasing to situations in which competitive interest in a proposed lease tract is unlikely to occur. To enable the Interior Department to respond quickly to the unique leasing needs of operating mines, planning for emergency lease sales must be applied site-specifically, rather than on a regional basis, as practiced under the competitive leasing process. For example, of the sixty emergency lease sales conducted through September 1986, thirty-seven were held for the purpose of preventing the bypass of federal coal and the loss of royalty revenue to the government. The other twenty-three lease sales were held to provide existing operations additional reserves so they could maintain current production levels and avoid mine disruptions.

Table 3
SUMMARY OF EMERGENCY LEASE TRACTS OFFERED
BY TRACT TYPE
MARCH 1977 - SEPTEMBER 1986

<table>
<thead>
<tr>
<th>Year</th>
<th>Bypass</th>
<th>Production Maintenance</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>1978</td>
<td>2</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>1979</td>
<td>8</td>
<td>6</td>
<td>14</td>
</tr>
<tr>
<td>1980</td>
<td>7</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>1981</td>
<td>2</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>1982</td>
<td>1</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>1983</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>1984</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>1985</td>
<td>11</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>1986</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>37</td>
<td>23</td>
<td>60</td>
</tr>
</tbody>
</table>

Source: Bureau of Land Management, Department of the Interior.

Of the sixty emergency tracts offered at public auctions, fifty leases have been issued and another was in the process of being issued. Forty-seven, or ninety-two percent of these fifty-one leases, attracted one bidder—the applicant—and the other four attracted more than one bidder. In these four auctions, the applicant requesting the sale was the highest bidder and obtained the lease. Nine auctions resulted in leases not being issued for various reasons. In five of the nine cases, BLM rejected the applicant’s bids on the grounds that they were for less than fair market value. In one lease sale, the sole bidder, the applicant, refused to accept the lease because the sale was delayed and the applicant had bypassed the federal coal. And, in three cases, the applicants or other parties did not bid on the proposed leases.

1. Application must be from an Existing Operation

Current emergency criteria require that the applicant be producing coal at the time of application and that the requested coal lands be mined as a part of the applicant’s operation. The lease must be needed to maintain current production or avoid the bypass of federal coal.\(^{61}\)

Supporters of emergency leasing view such leasing as serving a particular public interest, that is, emergency leases maintain ongoing operations and avoid the loss of resources, and generally must be developed within a limited time period.\(^{62}\) They also point out that because emergency leases serve a particular public interest and are not acquired for speculative purposes, they are distinct from tracts offered at regional competitive lease sales. Therefore, they believe emergency leases should be excluded from diligent development requirements.\(^{63}\) Diligent development provisions originally were aimed at eliminating speculation in federal coal leases and increasing production from federal coal leases to reduce the nation’s dependence on foreign oil.\(^{64}\)

Emergency lease tracts, under the criteria, must be located next to an operating mine.\(^{65}\) Thus, the applicant has an economic advantage over other bidders who generally would have to incur substantial front-end costs, such as acquiring an existing operation and property rights to nonfederal coal and overlying surfaces.

2. Three-Year Mining Requirement and Eight-Year Reserve Limits

The emergency criteria require that applicants for bypass and production maintenance leases must start mining the coal within three years from the date

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\(^{61}\) 43 C.F.R. § 3425.1(a)(1)(i).
\(^{63}\) Id.
\(^{64}\) H.R. REP. No. 628, 99th Cong., 2d Sess. 7 (1986).
\(^{65}\) 43 C.F.R. § 3425.1(a)(1).
of application.\textsuperscript{66} "Interior's rationale for adopting this 3-year production rule was to discourage companies from creating 'artificial by-pass' leasing situations by . . . opening mines with insufficient reserves on nonfederal coal lands adjoining unleased federal coal and then attempting to qualify for the federal coal under the emergency leasing process."\textsuperscript{67} The Department, however, believed that if an applicant could show that it legitimately needed the coal within three years of the application date, then holding an emergency lease could be a possibility.\textsuperscript{68} When considering the long lead-time and substantial costs associated with opening a new mine, it is reasonable to expect that few producers other than the applicant would be able to start mining the emergency lease within three years of the application date. Thus, from an economic and technological standpoint, the applicant can be regarded as being in a superior competitive position relative to other potential bidders in satisfying the three-year requirement.\textsuperscript{69}

In addition to the three-year production requirement, the emergency criteria also limits the amount of coal leased to a production maintenance lease applicant. The amount is limited to the equivalent of eight years of production, as determined by the applicant's average annual rate of production.\textsuperscript{70} This restriction was adopted because the Interior Department believed that if it leased unlimited quantities of reserves under the emergency process, coal companies would use emergency leasing applications to avoid competitive bidding situations under the normal competitive leasing program.\textsuperscript{71}

The emergency criteria, however, do not expressly limit the amount of coal leased to an applicant requesting a bypass lease because the criteria do not specify how the average annual level of production is to be determined for bypass lease tracts.\textsuperscript{72} In the past, the Bureau of Land Management determined the average level of production for bypass tracts in a manner similar to the practice used for production maintenance tracts (i.e., the average annual level of production was the average of the twelve months of production immediately preceding the application date).\textsuperscript{73} The Bureau's position on this issue is that "[b]ecause the Regulations (at 43 CFR 3425.1-4) do not specify the manner in which the average annual level of production for bypass tracts would be calculated, they do not

\textsuperscript{66} Id. at § 3425.1(a)(1)(i).
\textsuperscript{67} GAO, LEGISLATIVE CHANGES ARE NEEDED TO AUTHORIZE EMERGENCY FEDERAL COAL LEASING 10 (Aug. 2, 1984) [hereinafter cited as LEGISLATIVE CHANGES].
\textsuperscript{68} Id.
\textsuperscript{69} Id. at 11.
\textsuperscript{70} 43 C.F.R. § 3425.1(b).
\textsuperscript{71} 47 Fed. Reg. 33,124.
\textsuperscript{72} Bur. of Land Mgmt., Office of the Director, Memorandum, Medicine Bow Emergency Coal Lease Application (May 29, 1985).
\textsuperscript{73} Id. at 1.
prohibit alternate definitions of ‘average annual levels of production.’ """4

B. Competitive Bidding Procedures and Emergency Lease Tracts

The Interior Department has recognized the low value that emergency lease tracts have on the open market and that competitive interest in these tracts is unlikely to exist.74 Because such tracts usually contain relatively limited quantities of coal and are situated next to an operating mine, they are not capable alone of supporting a new operation independent of the adjacent operator. Furthermore, since the objective of emergency leasing is to respond to the unique needs of existing mines rather than to make lease tracts available that may be of interest to the general market, few, if any, producers other than the applicants would be inclined to bid for emergency leases. Therefore, the Interior Department’s use of competitive bidding for awarding emergency leases may not be an appropriate way of awarding these tracts when only the applicant is able to mine the coal.

In its study of emergency leasing, the General Accounting Office questioned whether the Interior Department’s emergency leasing regulations and process comply with the statutory requirement that leases be issued on the basis of competitive bidding.76 The GAO report stated that:

Specifically, what is brought into question is the legality of a procedure which permits bidding by any otherwise qualified bidder but limits leasing to situations in which the applicant has such a clear economic and competitive advantage over other potential bidders as to make the competitive bid process illusory.77

Nonetheless, the Federal Coal Leasing Amendments Act of 1976 mandates that all federal coal leases are to be awarded by competitive bidding.78 Consequently, the law does not provide an alternative to competitive bidding for awarding emergency leases. As a result, the Interior Department has experienced difficulties appraising emergency leases awarded by competitive bidding.

1. Appraising Emergency Lease Tracts

In the past, the Interior Department relied on public auctions to attract bidding competition and lease appraisals to set minimum acceptable lease prices in

" Id. at 2. For example, if another year with production greater than the immediately preceding year was used to compute the amount of coal to be included in a bypass tract, it is possible that an applicant could qualify for, and be awarded, a bypass lease containing a greater amount of coal without violating the emergency criteria.

74 Bur. of Land Mgmt., Office of the Director, Memorandum, Background Material Relating to Fair Market Value for Federal Coal Leases (July 22, 1983).

76 See LEGISLATIVE CHANGES, supra note 67, at 12.

77 Id.

implementing the statutory mandate of assuring the receipt of fair market value.\textsuperscript{79} In the context of emergency leasing, however, almost all lease sales to date have attracted only one bidder, the applicant requesting the lease sale. Thus, such noncompetitive circumstances have caused the Interior Department to rely on appraisals to obtain fair market value for emergency leases.

Some of the most difficult appraisal issues arise because of situations involving one seller (the government) and one buyer (the operator situated next to the offered coal tract).\textsuperscript{80} Market structures of this type are referred to as bilateral monopolies.\textsuperscript{81} Economic theory provides no precise answers as to how the division of economic rent will be shared between the buyer and the seller under conditions of bilateral monopoly.\textsuperscript{82} Theoretically, the sharing of economic rent can vary substantially with the bargaining power and negotiating skills of the individual parties.

When market imperfections limit leasing interest to a single firm, the bid received in an auction may not be a meaningful estimate of the tract’s true economic value.\textsuperscript{83} The share of economic rent captured by the government is likely to be small. Furthermore, the economic rent associated with a tract may be captured by a monopolist or monopsonist in other ways.\textsuperscript{84} For example, this could occur if surface owner consent is difficult or costly to obtain; market access is controlled by an aggressive price-discriminating transportation monopolist, or the coal is under monopsonistic control by a utility.\textsuperscript{85}

Over the years, the Interior Department has used various appraisal methods of setting minimum acceptable bids for emergency lease tracts, as measures of increasing the likelihood of successful lease sales, \textit{i.e.}, receiving fair market value in situations in which competition was unlikely to occur.\textsuperscript{86} In 1982, the Interior

\textsuperscript{79} \textit{REPORT OF THE COMM’N}, \textit{supra} note 1, at 243.
\textsuperscript{80} See Gulley, \textit{The Fair Market Value of Federal Coal}, 86 W. VA. L. REV. 741 (1984); \textit{REPORT OF THE COMM’N}, \textit{supra} note 1; \textit{BUR. OF LAND MGMT.}, \textit{FINAL REPORT AND RECOMMENDATIONS FOR THE SECRETARY ON FAIR MARKET VALUE AND MINIMUM ACCEPTABLE BIDS FOR FEDERAL COAL LEASES} (Dec. 1979); \textit{LEGISLATIVE CHANGES, supra} note 67 and \textit{infra} note 117.
\textsuperscript{81} J.M. Henderson & R.E. Quandt, MICROECONOMIC THEORY 244-49 (2d ed. 1971).
\textsuperscript{82} \textit{REPORT OF THE COMM’N}, \textit{supra} note 1, at 268. Economic rent is a concept from microeconomic theory. It refers to compensation of factors of production in excess of the level necessary (\textit{i.e.}, the opportunity cost) to keep the factors in the present occupation.
\textsuperscript{83} Rothkopf & McGuire, \textit{Assessment of Negotiation Options for Coal-Lease Sales} (Aug. 23, 1985).
\textsuperscript{84} \textit{Id.}
\textsuperscript{85} \textit{Id.} A recent study of the Wyoming coal market measures the allocation of potential rent earned by firms involved in the extraction, transportation, and consumption of low-sulfur Wyoming coal. \textit{See} Atkinson & Kerkvliet, \textit{Measuring the Multilateral Allocation of Rents: Wyoming Low-Sulfur Coal}, \textit{17 RAND J. OF ECON.} 416 (1986). The study indicates that railroads and coal producers each capture about 23\% of potential rent, while the State of Wyoming and purchasing utilities capture 7\% and 47\%, respectively. \textit{Id.}
\textsuperscript{86} \textit{LEGISLATIVE CHANGES, supra} note 67, at 17-19.
Department adopted new coal appraisal and lease sale procedures requiring, in part, sealed bidding and the offering of all tracts at a minimum bid of at least $100 (rather than $25) per acre. The Interior Department views such a regulatory minimum bid as a reservation price, bearing no relation to fair market value. According to Bureau of Land Management records, fewer than half of the winning bids at emergency sales held since 1979 were in excess of the regulatory minimum bid.

2. Appraising the Incremental Value of Emergency Tracts to the Adjoining Mine

The Commission on Fair Market Value Policy for Federal Coal Leasing was critical of the Interior Department's coal lease appraisal function. It found that the Department had not accorded the coal appraisal function the high priority it required, noting that Interior's appraisers were seriously handicapped by limited training and inadequate resources. The Commission also reported that Interior's appraisal methods—i.e., the comparable sales and income approaches—have never been spelled out in a single document. As a result, past appraisals suffered from lack of uniformity and inadequate data and documentation.

In response to these criticisms, the Interior Department recently made several improvements in its coal appraisal programs. For example, on the recommendation of the Commission, the Interior Department adopted a new guide to federal coal property appraisal. A principal concern of the guide is the valuation of federal coal property offered for lease by competitive bidding. It provides BLM field personnel guidelines for performing appraisals to promote a uniform approach to federal coal property appraisal, and to encourage consistent and replicable application of standard appraisal procedures. One application of the guide is in determining the adequacy of bids received at a coal lease sale.

The guide describes appraisal procedures for situations involving emergency lease tracts in which a single tract constitutes an increment to an adjoining mine operation. According to the guide, such a tract does not contain sufficient reserves to independently support a mining operation; however, the reserves can be mined economically in conjunction with the existing mine. The guide calls for such tracts to be appraised, or valued, according to their incremental value to

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87 47 Fed. Reg. 33,123.
88 Id.
89 Id.
90 DOI, SECRETARIAL ISSUES DOCUMENT: FEDERAL COAL MGMT. PROGRAM II-134 (1986).
91 REPORT OF THE COMM’N, supra note 1, at 245-77.
92 Id. at 276.
93 BUR. OF LAND MGMT., A GUIDE TO FEDERAL COAL PROPERTY APPRAISAL (1986).
94 Id. at III-48-58.
the adjoining operation. The incremental value of an emergency lease tract to an adjoining mine can be estimated using the comparable sales and the income approaches, depending on the adequacy of available data. Basically, incremental value represents the net present value added to the existing mine by the addition of the federal lease tract.95

The Interior Department's policy of appraising emergency leases according to their value to the adjoining operator may seem reasonable, at least on the surface. However, the value attributed to the federal property depends upon the adequacy of geologic data for estimating reserves, timing of production occurring on federal leases, mining costs and revenues over the life of the project, and the risk-adjusted discount rate for reducing future cash flows to their present value.96 These determinations, of course, are subject to considerable uncertainty, and involve many assumptions and estimates, making it difficult to perform such appraisals before conducting lease sales.97 In addition, it is questionable whether the Interior Department is authorized under current law to appraise nonfederal land belonging to an adjoining mine.98

C. Federal Royalty Rates—Affect on Appalachian and Western Coal Development

Royalty provisions of federal coal leases differ from those of fee coal leases because of various statutory and administrative requirements.99 The Federal Coal Leasing Amendments Act of 1976 requires lessees of surface-mined federal coal to pay a minimum royalty rate of 12.5 percent of the value of the coal.100 Under the Act, the royalty rate on underground mined federal coal is left to the discretion of the Secretary of the Interior and is currently eight percent.101

95 Id. at III-50. Incremental value is determined by subtracting the net present value of the existing mining operation, excluding the proposed federal lease, from its net present value when combined with the proposed federal lease. Id. Thus, incremental net present value represents the present value added to the existing mine attributable to the adjacent federal coal property.

96 See GAO, ISSUES FACING THE FUTURE OF FED. COAL LEASING (June 25, 1979); GAO, ADEQUACY OF GEOLOGIC DATA FOR PROPOSED LEASE TRACTS IN CENTRAL UTAH AND WESTERN COLORADO (Nov. 5, 1984).


99 See LEGISLATIVE CHANGES, supra note 67, at 33. See also GAO, MAPPING PROBLEMS MAY UNDERMINE PLANS FOR NEW FED. COAL LEASING 57-58 (Dec. 12, 1980).

99 Errebo, Coal Royalties, 26 ROCKY MT. MIN. L. INST. 75, 104-05 (1980).

100 30 U.S.C. § 207. Congress selected the 12.5% royalty on surface-mined coal because this rate long had been the permissible minimum royalty for federal oil and gas. See R. NELSON, MAKING OF FEDERAL COAL POLICY 225 (1983).

An important issue is whether the minimum royalty is excessive and, if so, the extent to which it adversely affects the timing and efficiency of production of federal coal leases. In some cases, federal coal leases are unprofitable to mine because of the minimum royalty, thereby causing operators to deviate from an otherwise optimal production schedule by mining adjacent private coal lands available at a lower royalty. The implication is that bidders at federal coal lease sales reduce their bids or refuse to bid, opting to bypass unprofitable federal coal or shift production to nonfederal lands having lower royalty rates.

The impact of minimum royalty on federal coal is a major concern in Appalachia where the federal royalty rate exceeds royalty on private coal lands. The federal government’s coal holdings in Appalachia are small and scattered, and coal production patterns in the region are not dependent on federal coal lands. In contrast, in many parts of the West where the federal government has a monopoly position in coal reserves, the prevailing royalty rate is set by the federal government, causing owners of adjacent private coal lands to increase their royalties to match the federal royalty. In Appalachia, federal coal leasing generally occurs in areas where private coal is being developed adjacent to small tracts of unleased federal coal having royalty rates below the federal minimum. For example, Table 4 shows a comparison of private and federal coal royalty rates in southern Appalachia in 1984. In 1985, none of the seventeen federal coal leases in the southern Appalachian region reported any production.

Table 4
PRIVATE AND FEDERAL COAL ROYALTY RATES, SOUTHERN APPALACHIA, 1984

<table>
<thead>
<tr>
<th>Type of Lease</th>
<th>Minerals Only</th>
<th>Surface Only</th>
<th>Minerals and Surface</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>6-8</td>
<td>6-8</td>
<td>12-16</td>
</tr>
<tr>
<td>Federal</td>
<td>12.5</td>
<td>—</td>
<td>18.5-20.5¹</td>
</tr>
</tbody>
</table>

¹ Includes the royalty paid to surface owners over federal minerals.

1. Interior Department Coal Royalty Reduction Policy

Because the federal royalty in southern Appalachia exceeds private royalty rates in the region, the Department of the Interior adopted a policy of encouraging...

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102 REPORT OF THE COM'MN, supra note 1, at 315.
103 Id.
104 FED. COAL MGMT. REPORT: FISCAL YEAR 1985, supra note 6, at 53.
lessees in the area, immediately after lease issuance, to apply for royalty reductions to the level of the prevailing private rates in the region.\textsuperscript{105} The impact of the federal minimum royalty was reviewed by the Commission on Fair Market Value for Federal Coal Leasing which recommended that Congress give the Secretary of the Interior administrative discretion to reduce federal royalty rates for coal tracts prior to a lease sale when current royalties would have adverse effects on production.\textsuperscript{106} The Commission found that many bypass tracts are uneconomical to mine because of the excessive federal royalty rate.

Furthermore, the Commission felt that the primary reason for royalty reductions should not be lessee "hardship," but rather should be for keeping federal royalty rates competitive with surrounding private and state royalties.\textsuperscript{107} The Interior Department agrees with the Commission's recommendation.\textsuperscript{108} It believes that administrative discretion to reduce federal royalty rates enhances competition and bidding for many tracts which would not otherwise be bid upon.\textsuperscript{109}

2. Royalty Reduction Guidelines

On February 13, 1985, the Bureau of Land Management issued draft royalty reduction guidelines for federal coal and other solid minerals.\textsuperscript{110} To date, BLM has not issued final royalty reduction guidelines. The draft guidelines were issued because previous guidelines were inadequate; they failed to clearly define the Interior Department's reduction policy and procedures and were inconsistently applied.\textsuperscript{111}

The draft guidelines provide stringent criteria for the purpose of ensuring that royalty reductions are granted only in those cases in which a reduction is required.

\textsuperscript{105} 46 Fed. Reg. 28,956 (1981). The Interior Department's authority to grant reductions in federal coal royalties is provided for in \textsection 39 of the Mineral Lands Leasing Act of 1920, 30 U.S.C. \textsection 209. Royalty reductions can occur only after a lease sale is held and a lease has been issued. Section 39 provides that:

The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal . . . and in the interest of conservation of natural resources, 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, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein . . . .

\textit{Id.}

\textsuperscript{106} \textsc{Report of the Comm'n, supra} note 1, at 319.

\textsuperscript{107} \textit{Id.}


\textsuperscript{109} \textit{Id.}


\textsuperscript{111} \textsc{GAO, Need for Guidance and Controls on Royalty Rate Reductions for Federal Coal Leases} (Aug. 10, 1982).
to allow continuing production. For example, the guidelines state that:

A royalty reduction may be granted to prevent bypass [of federal coal] only where it is shown in the application that alternative reserves are available at an economic advantage. The applicant must conclusively demonstrate that mining the alternative reserves would provide a competitive profit advantage due to a royalty rate differential compared to the lease upon which a royalty reduction [is sought].

Recently, the House Interior Committee reviewed BLM's draft royalty reduction guidelines and concluded that the Interior Department should reexamine the guidelines. According to the Committee report, the guidelines limit the usefulness of section 39 as a remedy when circumstances exist which justify some relief from the statutory minimum royalty rate. In addition, the Committee report noted that when the House was considering the 1976 coal leasing amendments, members expressed concern that the proposed minimum royalty of 12.5 percent could be too high in some cases. Assurances were given, however, that the Secretary of the Interior could afford lessees relief in such circumstances under section 39. The 12.5 percent minimum royalty was approved in reliance on those assurances.

V. ALTERNATIVE LEASE SALE MECHANISMS FOR AWARDING EMERGENCY LEASES

Existing law governing federal coal leasing does not specifically authorize emergency leasing or provide an appropriate lease sale mechanism to award emergency leases in a manner consistent with the circumstances. In view of the incompatibility between emergency leasing and the statutory requirement of competitive bidding, researchers need to evaluate alternatives to competitive bidding for awarding emergency leases. One alternative approach would be for Congress to authorize the Secretary of the Interior to conduct emergency leasing and to use negotiated lease sales, when appropriate, as a mechanism for awarding emergency leases apart from the normal competitive leasing program. Such an approach would introduce flexibility to the emergency leasing process and enhance the Interior Department's ability to deal with the uncertainties related to estimating the presale value of emergency leases.

A. GAO Study Recommending Negotiated Lease Sales—In the Context of the Regional Leasing Program

In two recent studies, the General Accounting Office discussed negotiated lease sales as an alternative to competitive bidding in the context of the normal

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114 H.R.-REP. No. 628, supra note 64, at 14-15.
115 Id.
116 Id. at 14.
117 See LEGISLATIVE CHANGES, supra note 67.
EMERGENCY FEDERAL COAL LEASING

In reporting on the Powder River Basin coal lease sales in April and October 1982, the GAO reviewed coal development patterns surrounding federal lease tracts in the lease sale areas of Wyoming and Montana. In planning the Powder River lease sale, the Interior Department selected for competitive leasing several maintenance-type tracts of interest only to adjacent mines. Unlike lease tracts offered under the emergency leasing regulations, production maintenance tracts offered at regional sales are not subject to emergency criteria, even as to their size. Such tracts are identified early in the planning process (two to three years before a lease sale) so as to permit the necessary time for evaluation and consideration for leasing. Because such maintenance tracts are of little or no competitive interest to other companies, the GAO recommended that Congress amend the Mineral Lands Leasing Act of 1920 to authorize the Interior Department to negotiate maintenance-type leases offered at regionally scheduled sales when circumstances justify negotiated sales.

The GAO report suggested that any negotiation approach should include strong controls for ensuring adequate public participation and coal industry protection. The principal advantage of negotiating production maintenance-type leases under the approach suggested by GAO is the fairness of the negotiating process to all parties concerned. Improved mining cost and revenue data, for example, could help reduce many of the uncertainties presently troubling lease valuations to reasonable levels and result in more reliable information for making leasing decisions.

B. GAO in Negotiated Lease Sales—In the Context of Emergency Leasing Process

In its study on emergency leasing, GAO recommended that Congress amend the Mineral Lands Leasing Act of 1920 to specifically authorize the Secretary of the Interior Department to conduct emergency leasing and to authorize the Secretary to use negotiated lease sale procedures for carrying it out.

Furthermore, the GAO study recommended that such legislation should provide for: (1) A statement of objectives to be achieved through emergency leasing;

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118 GAO, ANALYSIS OF THE POWDER RIVER BASIN FED. COAL LEASE SALE: ECONOMIC VALUATION IMPROVEMENTS AND LEGISLATIVE CHANGES NEEDED (May 11, 1983).
119 Id. at 74.
120 Id. at 78.
121 Id. The GAO report points out that authority to negotiate captive tracts would appear to broaden the Secretary of the Interior's discretion in determining the reasonableness of prices paid for federal coal. However, it notes that with improved valuation data, the Department's latitude in these matters may actually decrease. Id. at 78-79.
122 See LEGISLATIVE CHANGES, supra note 67, at 30.
(2) an opportunity for public comment and expressions of competitive leasing interest before conducting negotiated sales; (3) development of guidelines by the Secretary of the Interior for negotiators to follow which, at a minimum, would provide for access to economic and geologic data, disclosure and protection of proprietary information, factors to consider in negotiating lease terms and reasonable value for the federal coal, and public disclosure of lease sale results; and (4) promulgation of regulations by the Secretary of the Interior for designing and implementing an emergency coal leasing program consistent with its objectives and the above standards.12

The GAO report points out the importance of the distinction between leasing situations occurring under the regional leasing process, which takes three to five years to complete, and those occurring under the emergency leasing process, which takes place on short notice. Such a distinction is important because the two processes differ in their objectives, timing, and procedures for screening and offering lease tracts. In view of this distinction, negotiation objectives and procedures suitable for tracts offered at regional sales may not be appropriate for awarding federal coal leases under emergency leasing situations.

C. The Commission on Fair Market Value for Federal Coal Leasing and Negotiated Coal Lease Sales

In its report to Congress in 1984, the Commission on Fair Market Value Policy for Federal Coal Leasing recommended that the Interior Department should have statutory authority to negotiate a fair price for bypass and production maintenance coal leases when reasonable efforts to obtain competitive bids have failed.124 The Commission also recommended that such tracts should be appraised in terms of value to the adjoining operator rather than value in the open market.125 Two significant factors influenced the Commission’s decision to recommend negotiated coal lease sales: fragmentation of mineral and surface rights which reduce competition for federal leases, and the Interior Department’s procedures for leasing bypass and production maintenance lease tracts.126

In regard to the fragmentation of mineral and surface rights as a factor limiting competition for federal coal leases, the Commission stated that:

Due to ownership patterns and other factors, the Government seldom reaps the benefit of being able to offer all the mineral rights needed for an entire economic mining unit. Were the Government able to do so, it could guarantee to each potential bidder an opportunity to invest in a lease without uncertainty about whether additional private rights could be acquired, and at what cost, after the

123 Id.
124 REPORT OF THE COMMISSION, supra note 1, at 234.
125 Id. at 273.
126 Id. at 231-32.
lease sale. Typically, however, economic mining units consist of private, State, or previously leased Federal coal interspersed with or adjacent to the Federal lease tract. In other instances the Government may own the coal mineral rights while a private party owns the surface. Frequently the net result of all this is to reduce the field of potential competitors to one dominate bidder who—through ownership of adjoining land and minerals or rights to them—holds the Federal tract "captive." 27

In the case of bypass and production maintenance leases, the Commission observed that the Interior Department’s leasing procedures resemble negotiations. The Commission report stated that:

For example, setting a minimum bid at the reservation price on a maintenance or bypass tract to be offered for sealed bidding is similar to an opening offer in a negotiation. Submission of a sealed bid amounts to acceptance of the offer. Receipt of no bid means rejection of the offer in hopes of a new offer. Use of a minimum bid substantially below the reservation price while keeping the reservation price confidential is like opening a negotiation by forcing the other party to make an offer first. Rejection of a bid followed by reoffering parallels the rejection of the first offer in a negotiation. 128

Competition for bypass leases is unusual because of the small size of the tracts and their location in the midst of an ongoing mine. Production maintenance tracts, on the other hand, are designed either to extend the life of an adjoining mine, or to permit expansion of the coal mine’s annual production. 129 The Commission noted that the only hope of competition for such tracts would be from parties who think they can negotiate a better price with the adjoining operator than the government would accept through its lease sale procedures. The Commission concluded that if any profit is to be made from negotiation it would be better for them to be realized by the government rather than by speculators.

Thus, the Commission concluded that there might be situations in which negotiation would facilitate the leasing of federal coal. Of concern to the Commission, however, was public mistrust of negotiated lease sales and the ability of the Interior Department to establish negotiation procedures that would earn public confidence. 130

The Commission also found that many, if not most, private coal lease transactions are arrived at through negotiation rather than auctions. 131 In addition to the Commission’s findings, a recent article published by the Eastern:

27 Id. at 155.
128 Id. at 231.
129 Id. at 161.
130 Id. at 233.
131 Id. at 231.
Mineral Law Foundation discusses concepts introduced during coal lease negotiations between private parties. The article considers numerous contractual issues affecting the lessor and lessee and the economic and regulatory environment in which the coal is mined and sold.

Subsequent to the Commission's report, four bills were introduced in the 99th Congress to amend the Federal Coal Leasing Amendments Act in several ways. One provision of three of the four bills authorized the Secretary of the Interior to negotiate the sale of bypass and production maintenance coal lease tracts on an experimental basis. The bills also required the Interior Department to publish regulations governing experimentation within six months of the date of enactment.

D. The Interior Department's Response to the Commission's Recommendation on Negotiated Lease Sales

On April 5, 1984, the Senate Committee on Energy and Natural Resources held hearings on the Commission's report, at which time Secretary William P. Clark presented the Interior Department's initial response to the Commission's report and recommendations. With regard to the recommendation of authorizing the Interior Department to negotiate a fair price for federal coal leases, Secretary Clark stated that important public policy concerns make negotiation less than desirable. His reasons were similar to those expressed by the Commission (i.e., public trust and the ability of the Interior Department to establish a workable negotiation procedure, and charges of inside dealings).

Subsequently, on March 19, 1984, the Interior Department released a report including Secretary Clark's formal responses to the Commission's recommendations. As to the issue of negotiated lease sales, the report noted that Secretary Clark accepted the Commission's recommendation in principle. The Secretary also agreed to work with Congress to determine whether a feasible approach for negotiating the sale of single bid (i.e., captive) tracts could be defined.

To initiate discussion with Congress and the public, the report outlined three conceptual approaches to negotiating the sale of federal coal leases. In a subsequent Federal Register notice, the Interior Department requested public comments on the negotiation concept, the three negotiated lease sale approaches, and

132 Vish, Private Coal Leases, 6 E. Min. L. Found. 2-1 (1985).
133 The three bills introduced in the 99th Congress, 1st session, containing provisions relating to negotiated federal coal lease sale authority were H.R. 1898, S. 372, and S. 570.
135 Id.
issues related to their implementation. Conceptually, negotiation could be entered into directly or after a lease sale is held. Of the three approaches identified in the notice, only the first avoids a competitive sale and represents a direct negotiation. The others are slight variations of the normal competitive sale procedure but would be useful in situations in which the only bid received is below the predetermined amount. To introduce adequate flexibility to the leasing process, the Secretary of the Interior should have authority to use all three approaches.

In the first approach, the government would identify the tract which it expected to be of interest to only one bidder. The government would then announce in the Federal Register its intent to negotiate with the identified company for that tract unless it received indications from other companies of their intention to submit bids. If no bids were received, the government and the identified coal company would negotiate a final price for the tract. This price would be published and higher bids would be solicited. If any company indicated an intention to bid, the government would drop its intention to negotiate, and offer the tract at a lease sale, awarding the lease to the highest bidder, providing the bid represented fair market value.

The second approach provided that the tract would be offered in a competitive sale with an undisclosed value approximating the full value of the lease tract to the adjoining operator. If the tract received only one bid and if the bid were under the undisclosed value, the government and the bidder would negotiate a price through a post-sale process operated similarly to that used by the government for awarding contracts. The lease would be awarded if a sale panel approved the negotiated result.

Under the third approach, the tract would be offered in a competitive sale with an undisclosed value approximating the full value of the lease tract to the adjoining operator. After initial bids were submitted, the sale panel would announce a preliminary decision to accept or reject the high bid. The sale would be kept open and the preestablished value would remain undisclosed. The highest bidder would be allowed one opportunity to adjust his bid. After this opportunity, the sale would close.

VI. Negotiation Issues Identified by the Interior Department

A Department of the Interior staff study identified various issues and policy implications related to the previously discussed negotiated lease sale options. The
staff study also addressed implementation issues, partly based on public comments received in response to the Federal Register notice.\footnote{Fed. Coal Mgmt. Program (1986), supra note 2, at II-54, III-133.}

A fundamental issue is whether the Secretary of the Interior should support the granting of authority from Congress to negotiate the sale of federal coal leases. Basically, if such authority is not granted by Congress, the other issues relating to implementation would not arise. The staff study identified seven implementation issues.\footnote{Id. at II-133, II-143.} These issues include:

(1) Degree and timing of public participation (\textit{e.g.}, public participation could occur at the beginning, throughout, or at the end of the negotiation process);  

(2) types of negotiation,\footnote{See H. Raiffa, \textit{The Art and Science of Negotiation} (1982).} (\textit{i.e.}, (a) cooperative negotiation in which representatives of the Interior Department and a coal company negotiate a fair price for a federal coal lease tract; (b) bargaining, in which each side tries to drive the other side’s minimum price up or down, using bargaining strategies and tactics to do so; and (c) binding or nonbinding arbitration);  

(3) the mechanism that should be used to initiate the negotiation process (\textit{e.g.}, company applications, Interior Department selection of lease tracts considered appropriate for negotiated lease sales, Regional Coal Team selection of lease tracts, or some combination of these);  

(4) whether the Interior Department should negotiate with more than one applicant at the same time;  

(5) the degree of reliance that should be placed on presale appraisals in determining a fair price for the coal;  

(6) whether the high bid submitted in a negotiated lease sale should or should not be binding; and  

(7) whether the competition should be by sealed or oral bidding, in the event more than one party is interested in negotiating with the government for a particular lease tract.

\section*{VII. Interior Department’s Policy Option on Seeking Negotiated Lease Sale Authority From Congress}

As to the issue of whether the Secretary of the Interior should seek authority from Congress to negotiate the sale of federal coal leases, the Departmental staff study identified three policy options for secretarial decision making. The policy options include:
(1) Support the granting of negotiation authority by Congress and propose a specific negotiation method;

(2) support the granting of negotiation authority without proposing a specific method; or

(3) do not support the granting of negotiation authority.\textsuperscript{144}

A. Option 1: Support for Congressional Grant of Negotiation Authority—Proposal of a Specific Method

Under the first option, the Interior Department would support the granting of negotiated lease sale authority from Congress, and provide a suggested negotiation method. Basically, this option would implement the recommendation of the Commission on Fair Market Value Policy for Federal Coal Leasing. According to the staff study, the Department would probably suggest a negotiation approach based on BLM's experience in negotiating fee title and lease exchanges involving federal coal.\textsuperscript{145} These exchanges represent the Department's only experience negotiating coal leases under current law.

With regard to BLM's current negotiation procedures for exchanges involving coal, the staff study states that:

In current exchange negotiations the BLM estimates the land's market value by obtaining from the exchange proponent and other sources detailed information about the tract to be given to the Government and the tract to be given to the exchangee. Negotiations are conducted over the geologic and mining information to be used in the appraisal process and the conduct of the appraisal itself, not over the land values determined by the evaluation process. The rationale is that if both parties can agree on the factors to be considered in the appraisals and on the appraisal method itself, then both parties automatically agree to accept the results of the appraisals.

The appraisals are conducted using \textit{A Guide to Federal Coal Property Appraisal}. The exchange proponent's information is considered and used where the BLM finds it to be an improvement. The appraisal values themselves are not subject to negotiation.\textsuperscript{146}

This option offers the advantage of allowing the Interior Department and others that would be affected by negotiated coal lease sales to design feasible

\textsuperscript{144} \textit{FED. COAL MGMT. PROGRAM} (1986), \textit{supra} note 2, at II-145-49.

\textsuperscript{145} \textit{Id.} at II-55. Coal lease exchange procedures are codified at 43 C.F.R. § 3435 (1985). Fee title exchanges are authorized by section 206 of the Federal Land Policy and Management Act of 1976. Coal lease exchanges must be authorized by specific statute because the Federal Coal Leasing Amendments Act of 1976 abolished the Secretary's general authority to issue federal coal leases non-competitively.

\textsuperscript{146} \textit{FED. COAL MGMT. PROGRAM} (1986), \textit{supra} note 2, at II-143.
negotiation methods. On the other hand, the option has its drawbacks. The chosen method may not be the most appropriate one because information may be limited at the time of the decision to negotiate. Furthermore, some believe that no procedure based on pure negotiation would work because all results would be suspect unless verified by a follow-up lease sale to determine the existence or absence of competition.

B. Option 2: Support for Congressional Grant of Negotiation Authority—No Specific Method Proposed

The second option would require the Secretary of the Interior to inform Congress that the Department supports the granting of authority to negotiate coal lease sales. The Department also would identify at least one feasible negotiation method, but it would not necessarily be an advocate of the method. The Department, however, would continue to work with Congress on the negotiation issue, conducting additional studies of negotiation methods.

The advantage of this option is that it allows ample time for the Interior Department to review thoroughly issues and concerns related to the negotiation of captive federal coal lease tracts. In addition, it could help the Interior Department improve negotiation procedures currently used in processing coal land and lease exchanges. A disadvantage of this option is that it would require additional time, money, and personnel to carry it out.

C. Option 3: No Support for Congressional Grant of Negotiation Authority

Under the third option of not supporting the authority to negotiate the sale of federal coal leases, the staff study identified three advantages. First, recent changes made to the Department's coal lease appraisal and sale procedures have been designed to ensure the receipt of fair market value for captive lease tracts, making negotiation redundant. Second, it is uncertain that negotiation would result in increased mineral leasing revenues. Based on past experience, negotiations can be costly and lengthy, especially if the parties become involved in litigation. Third, the option could help eliminate the public perception that the Interior Department sells coal leases for captive tracts at prices less than their worth.

On the other hand, the Interior staff study identified three disadvantages associated with this option. First, its selection by the Interior Department could

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147 Id. at 56. See also GAO, How INTERIOR SHOULD HANDLE CONGRESSIONALLY AUTHORIZED COAL LEASE EXCHANGES (Aug. 10, 1982).
148 Id. at 55-56.
149 Id. at 56.
150 Id.
151 Id.
152 Id. at 56-57.
be taken to mean that the Department is backing away from its efforts to eliminate the perception that captive federal coal lease tracts are being given away at lease sales. Second, its selection would require the Interior Department to oppose pending legislation. Third, its selection could be interpreted by some to indicate a reversal of the Department's recognition of and responses to the recommendation of the Commission on Fair Market Value Policy for Federal Coal Leases regarding negotiated coal lease sales.153

On February 21, 1986, Secretary of the Interior Donald Hodel selected this third option of not supporting the granting of coal lease sale negotiation authority from Congress.154

VIII. LAWRENCE BERKELEY LABORATORY STUDY ON NEGOTIATED COAL LEASE SALE OPTIONS

In a recent study, the Lawrence Berkeley Laboratory addressed issues related to negotiated coal lease sale options.155 The study focused on the captive coal lease tract situation, in which a federal coal tract is of substantial value to only one private party, and the government is unlikely to obtain more than one bid. The report acknowledges that estimating the value of such tracts is difficult, particularly in view of the quality of government information about tract value.

The study analyzes negotiations as an alternative to competitive sales and identifies a number of situations in which negotiations of an appropriate kind could be advantageous. The report's analysis applies various criteria in evaluating negotiation alternatives, including economic efficiency, government revenue, fairness, and administrative workability. The report concludes that there are advantageous ways for the government to negotiate federal coal leases when there is only one serious bidder for a lease. One way examined would be for the Interior Department to negotiate coal lease exchanges that give the government an economically logical potential mine that could be sold competitively at a future lease sale. For some other one-bidder lease tracts, the report concludes that there are potential advantages to coal lease negotiations, provided that all negotiations are tentative subject to "validation" of their one-bidder nature in a post-negotiation formal lease sale process.

The report suggests that the Interior Department should develop a negotiation program, but limit it to cases in which competition is highly unlikely, such as bypass and maintenance leases. Furthermore, the report notes that development of such a program would require new legislation and new regulations. The report identifies what it considers to be the major components of such a negotiation program.
program. The report states that:

First, the program should have a defined scope. Based on our analysis, negotiated sales should be limited to cases in which competition is highly unlikely. All by-pass and maintenance leases are good candidates for negotiation.

Second, the program should have a clear goal. This should be to obtain both the substance and appearance of fair market value for leases through using negotiation to create competitive and other incentives for bidders to offer fair market value. For a negotiation program to work, industry cannot be leased all the coal in which it expresses interest. While satisfying national requirements for coal remains a valid goal, satisfying individual company objectives cannot be one.\textsuperscript{156}

IX. FUTURE RESEARCH NEEDS—NEGOTIATED COAL LEASE SALES AND RELATED ISSUES

Many of the issues discussed in this Article are in need of resolution. In view of coal development patterns of existing mines, emergency leasing probably will continue to be a major coal leasing activity for many years into the future. The issues, therefore, will be of continuing interest to Congress, the coal industry, and the Department of the Interior. Thus, researchers need to direct their attention to these public policy issues and their implications.

Future research efforts should examine relationships among various issues affecting emergency leasing. For example, an area worthy of consideration relates to the objectives and scope of any negotiation process, for emergency leasing and for the competitive leasing program as well. Should negotiation processes be narrowly or broadly defined: What effect would this have on the construction of lease terms such as royalty rates and other factors? Closely related to this area is the need for experimental negotiated lease procedures and regulations along the lines proposed in several bills introduced in the 99th Congress.\textsuperscript{157} How should such experimental procedures be designed and implemented, and to what extent should regional differences in mining patterns, land ownership, and other such considerations be taken into account? And, to what extent should the Interior Department's current procedures for negotiating exchanges involving coal leases serve as guidelines for developing general lease negotiation procedures?

X. CONCLUSION

Emergency federal coal leasing evolved from an interim measure to a major component of the Interior Department's federal coal leasing program. Such leasing is recognized as being in the public interest. If past events are any indication of
the future of federal coal leasing, emergency leasing may become the primary type of leasing, particularly in view of the uncertainty surrounding the future of the competitive leasing program and the coal development patterns associated with existing mines dependent on adjacent federal coal lands. Many of the issues discussed relate to the basic conflict between the objectives of emergency leasing and the requirements under current law governing federal coal leasing. Since emergency leasing is noncompetitive in nature, competitive bidding is not an appropriate lease sale mechanism for administering such leasing. Alternatively, negotiated lease sales would be a more appropriate lease sale mechanism in the context of emergency leasing.