CHAPTER 5

ALTERNATIVE LEGISLATIVE OPTIONS FOR PROMOTING TIMELY DEVELOPMENT OF FEDERAL COAL LEASES

How long and under what conditions a lessee should be allowed to hold a Federal coal lease without producing is fundamentally a political decision. The decision largely depends on one's views on the relative importance of sometimes conflicting policy goals underlying the Federal coal leasing program and on how vigorously the diligent development requirements should be enforced for a resource that is abundant and an industry that historically suffers chronic overcapacity. In the 1976 amendments, Congress firmly asserted a policy that Federal coal leases are to be held for production and that production should begin within a reasonably short period of time. New leases must produce in 10 years or they are terminated. Congress left the production requirements imposed by the 1976 regulations and lease terms for pre-FCLAA leases untouched. Congress did, however, restrict future acquisition of new leases by nonproducing lessees by adding section 3. This nonproduction penalty was aimed directly at the old pre-FCLAA leases and particularly at the holdings of large energy companies and other conglomerates.

In the "normal" competitive structure of western coal operations there is a significant excess of production capacity over current production. There is simply more coal under lease than can reasonably be mined and sold or committed under long-term contract in the next 5 to 15 years. This situation is unlikely to change because leasing policies over several administrations have tended for various reasons to favor leasing of coal reserves well in excess of the amounts needed to meet projected demand. For this reason there will be many Federal leaseholders that will not be able to mine their leases despite even their most "diligent" efforts at marketing and development. It is not surprising therefore, that Federal coal lessees, including many major companies, are seeking legislature relief as section 3 production dates approach. But section 3 relief raises a number of difficult issues concerning the management of Federal mineral resources and energy competition.

In evaluating various proposals for amending the Federal coal leasing laws, the preceding two facts should be kept in mind. Under current law a Federal coal lease has an initial term of 20 years, but any lease that is not producing after 10 years is terminated. This schedule includes a reasonable allowance for the time and efforts necessary to market coal and to plan, permit and construct a mine. OTA has previously testified that 10 years provides ample time to bring a lease into production, but attaining full operating capacity can take much longer.

OTA has examined a range of possible legislative options for amending section 3. The options, their advantages and disadvantages are discussed in this section. OTA found the contributions of the participants at its May 1985 section 3 workshop were extremely useful in evaluating these options. The major legislative options for amending section 3 that we have analyzed include the following:

Option 1: Keep section 3 unchanged.
Option 2: Repeal section 3.
Option 3: Limit section 3 to new coal leases only.
Option 4: Extend the time to comply with section 3.
Option 5: Modify section 3 to allow achievement of alternative lease development milestones to satisfy the producing in commercial quantities requirement.

Option 6: Remove the 10-year holding period for section 3 and make disqualification applicable to anyone holding a nonproducing lease that is more than 10 years old.

Option 7: Allow noncomplying lessees to make annual payments in lieu of production on old leases to qualify for new leases.

Option 8: Impose a surcharge on all new leases acquired by a noncomplying lessee.

Option 9: Require turnback of an equivalent amount of noncomplying lease reserves or acreage to qualify for each new lease.

Option 10: Allow relinquishment of all noncomplying old leases in exchange for section 3 relief and a preferential option to purchase a new lease for the same lands if they are reoffered after being subject to land use planning, environmental screening, and surface owner consent requirements for new leases.

Several options have parallels in legislation that has been introduced in the 99th Congress. OTA's discussion of the options does not deal with the specifics of individual bills, but rather seeks to contrast different generic approaches. In evaluating each option, OTA considered several factors: 1) how well each option provides relief from section 3 disqualification for the different classes of noncomplying lessees; 2) how well the option advanced the policies inherent in section 3 of encouraging production, deterring speculation, and discouraging the extensive holding of nonproducing coal leases by large energy conglomerates; and 3) how easily and predictably the option can be implemented and administered. (See Table 32.)

Several options are more or less likely to promote the various goals of section 3 legislation depending on which goal is given priority. Several options would assist nonproducing lessees in complying with the producing in commercial quantities requirement, while at the same time maintaining the policy that leases are to be held for development and production, but the balance between these two goals is struck differently in each. For example, if a major goal is providing flexibility for section 3 compliance, holding fees would offer this benefit to all lessees, while maintaining an economic incentive for development. It would also be possible to combine several options, such as a holding fee or lease surcharge and a turnback requirement to give lessees a choice of alternative compliance mechanisms.

Option 1 - keeping and enforcing section 3 unchanged - is most consistent with the purposes for which section 3 was enacted, particularly since the Department of the Interior has substantially relaxed, or even nullified, most production requirements for pre-FCLAA leases. OTA's analysis in Chapter 4 shows that the Department has ample discretion to resolve most compliance difficulties for those lessees that are producing or have produced coal from their leases or that have experienced unusual delays in mine development. Keeping section 3 would maintain fairness for lessees who have already relinquished or sold leases or made substantial investments in mining operations in order to comply.

Option 1 and Option 10 appear likely to return a significant number of nonproducing leases to the government so that environmentally unsuitable lands are removed from the threat of mining and the remaining valuable coal tracts may be reoffered for lease at fair market value. Option 10, the lease rollover option, would give the relinquishing leaseholder priority in obtaining the new lease for fair market value.

Option 7 maintains the underlying policies of section 3 but gives the greatest degree of flexibility to lessees and the Department in avoiding the section 3 disqualification. Option 7 holding fees would allow a lessee to make qualifying annual payments on all noncomplying leases in order to retain eligibility for new leases. An economic penalty would be imposed for nonproduction, but lessees would be allowed to keep old leases and acquire new ones. This option could be reinforced by an additional amendment that would apply similar nonproduction payments to all old leases on the next lease readjustment. Substantial holding fees would force some leases to be relinquished and would lessen the assignment value of others, thus discouraging speculation. In addition, the qualifying payments would provide some pre-production revenues to the Federal and state governments.

Repeal of section 3 (Option 2) or limiting it to coal leases only (Option 3) would provide the greatest relief from the effects of section 3 enforcement. These two options also remove or lessen the only statutory incentive for the major nonproducing lessees to begin mining coal from their leases or get rid of them before the mid-1990s when current diligence requirements might be enforced. Given the uncertainty over what diligence requirements are applicable to pre-FCLAA leases and when, if ever, they must be enforced, these options may effectively remove the only restraint on continued holding of these leases. These two options therefore appear to be inconsistent with some of the fundamental policies underlying section 3 and the rest of FCLAA.

The lease turnback approach (Option 9) offers the greatest benefit to leaseholders that have large amounts of nonproducing acreage or reserves (that is, next to repeal). These lessees could hold nonproducing reserves until and unless a new coal lease is sought. Turnback is only workable if section 3 is applied to coal leases only.

Option 8, would impose a surcharge on new coal leases sought by a noncomplying leaseholder and would also be attractive to some major noncomplying lessees, particularly if only a small amount of additional acreage or reserves is needed.

Lessees that for some reason cannot satisfy the section 3 commercial quantities test as currently structured by the Department, but that are producing or close to production would be aided by three options: Option 4, an extension of the section 3 holding period; Option 7, qualifying payments on any noncomplying leases; and Option 5, acceptance of achievement of alternative mine development milestones to comply with section 3.

Option 6 would magnify the impact of section 3 by making it apply to all nonproducing leases by removing the ten year holding period. This would advance the original purposes of section 3 to encourage production and deter speculation, and reverse in part the Department's relaxation of diligent production rules. A more stringent disqualification penalty would, however, would mean continued pressure for legislative relief, unless additional exceptions were allowed.

These options were evaluated primarily as alternatives for section 3, but several options could also be used to provide an alternative compliance mechanism for the MLA's section 7 diligence requirement for new and readjusted leases. Among alternative options for the existing section 7 diligence requirements are: 1) an extension of the 10-year period, 2) the use of alternative development milestones to satisfy the initial diligent production obligations, 3) the use of a holding fee to extend the 10-year diligence period for nonproducing leases.

TABLE 32

OPTIONS FOR PROMOTING TIMELY PRODUCTION FROM FEDERAL COAL LEASES
COMPARISON OF SECTION 3 OPTIONS AND POLICY OBJECTIVES

POLICY GOAL OR EFFECT	OPTION 1	OPTION 2	OPTION 3	OPTION 4	OPTION 5	OPTION 6	OPTION 7	OPTION 8	OPTION 9	OPTION 10
Requires legislation	YES	YES	YES	YES	MAYBE	YES	YES	MAYBE	MAYBE	YES
Encourage production	YES	NO	NO	YES	YES	YES	YES	MAYBE	MAYBE	MAYBE
Encourage turnback	YES	NO	NO	MAYBE	YES	YES	YES	MAYBE	MAYBE	MAYBE
Deter speculation	YES	NO	NO	YES	YES	YES	YES	MAYBE	MAYBE	MAYBE
Generate revenue	NO	NO	NO	NO	NO	NO	YES	YES	NO	YES
Promote diligence policy	YES	NO	NO	YES	YES	YES	YES	YES	NO	YES
Ease of administration										
increases burden	YES	NO	NO	YES	YES	YES	YES	YES	YES	YES
decreases burden	NO	YES	YES	NO	NO	NO	NO	NO	NO	NO
Provide flexibility										
to Department	NO	N/A	NO	YES	YES	NO	YES	NO	NO	YES
to Lessees	NO	N/A	NO	YES	YES	NO	YES	YES	YES	YES
Give additional time										
to all lessees	NO	N/A	NO	MAYBE	NO	NO	YES	YES	NO	NO
to leases under development	NO	N/A	NO	YES	YES	NO	YES	YES	NO	NO
Provide relief from penalty										
to all lessees	NO	YES	NO	NO	NO	NO	YES	YES	NO	YES
to oil and gas lessees	NO	YES	YES	NO	NO	NO	YES	YES	YES	YES
to producing lessees needing time to meet CQ	NO	YES	NO	YES	YES	NO	YES	YES	NO	NO
to lessees with many noncomplying leases	NO	YES	NO	NO	NO	NO	YES	MAYBE	YES	MAYBE
Make lease retention an economic decision	NO	YES	NO	NO	MAYBE	YES	YES	NO	MAYBE	MAYBE
Reduce lease inventory	YES	NO	NO	MAYBE	MAYBE	NO	MAYBE	MAYBE	NO	YES
Maintain lease inventory	NO	YES	YES	MAYBE	MAYBE	YES	MAYBE	MAYBE	YES	NO
Improve quality of lease inventory	YES	NO	NO	MAYBE	MAYBE	YES	MAYBE	MAYBE	YES	YES
Maintain fairness for complying lessees	YES	NO	NO	YES	YES	YES	YES	YES	NO	MAYBE
Create incentive for holding leases for resale or exchange	NO	YES	YES	MAYBE	NO	NO	NO	NO	YES	NO
Eliminate potential bidders	YES	NO	YES	YES	YES	YES	NO	NO	MAYBE	MAYBE

NOTES:
- YES = Option has effect or advances policy goal.
- NO = Option does not have effect or hinders policy goal.
- MAYBE = Overal impact of option not certain and/or depends on response of essee.
- N/A = Not applicable.

SOURCE: Office of Technology Assessment

Option 1:

No Action - Keep Section 3 Unchanged.

This option maintains the status quo. Section 3 would be left unchanged. After August 4, 1986 the Secretary could not issue new onshore Federal mineral leases for coal, oil and gas, oil shale, gilsonite, sodium, phosphate, sulfur and potash to any Federal coal lessee (or its affiliates) if the lessee has held a coal lease for 10 years and is not producing coal in commercial quantities. OTA assumes that the Interior Department will follow the Solicitor's opinion of February 12, 1985 in implementing section 3.[1] It is not known how the Department will exercise any of its residual discretion in interpreting key terms such as: "producing in commercial quantities," "affiliate" or "controlled by or under common control with," or "except as provided for in section 7(b)." These interpretations could be used to reduce the potential impacts of section 3 enforcement. Third parties will aid section 3 enforcement for oil and gas leases by protesting or appealing any lease awards or issuances to possible noncomplying leaseholders and related entities.

The noncomplying lessee, its parent company and any affiliates and subsidiaries, will be foreclosed from onshore mineral leasing as long as they hold the nonproducing leases. The MLA permits a noncomplying lessee to obtain additional Federal coal through lease modifications and assignments; however, DOI has decided that it will also apply the section 3 disqualification to coal lease assignments. Oil and gas activities will be limited to assignments of leases or operating interests. It is unlikely that the Department would extend the section 3 disqualification to oil and gas lease assignments because of the different statutory and lease provisions on such assignments.

The section 3 penalty could force the sale or relinquishment of nonproducing coal leases. However, many pre-FCLAA leases were originally acquired at very low cost and the investments in them have been minimal compared to cost of opening a new mine or acquiring new leases. For these lessees, any loss due to relinquishment would largely be of a competitive advantage rather than of past expenditures. It is likely that some of the better quality noncomplying leases could be sold for substantially more than the Federal Government was originally paid for them, even taking into account the effects of inflation in intervening years.

The section 3 disqualification could reduce the number of potential bidders for Federal coal leases and other onshore competitive mineral leases. The impacts of these disqualifications may not be as significant as the section 3 noncompliance figures suggest.

Several factors limit potential impacts on coal leasing. There are normally few bidders for any given coal tract because interest in individual tracts is usually limited to only a few firms. The fair market value requirement, if strongly administered, can assure that the acceptable bid reflects a fair return to the public for coal leases. Reduction in the number of potential bidders could have little or no effect on lease sales or revenues unless the lessee was a likely bidder for a particular tract. On the other hind, it is possible that the additional bonus premiums might be reduced on tracts where there would have been intensively competitive bidding between parties that might drive up the auction price of the coal over its fair market

[1] Solicitor's Opinions are generally binding on the Department, however Solicitor's Opinions can be changed or modified. There is recent precedent for revisions and even reversals of Solicitor's conclusions of law concerning the interpretation of various provisions of the governing coal leases. Among the most notable were the 1981 opinion on applicability of the 1976 diligence regulations, and an earlier series of opinions on the effects of mining claims on the validity of coal prospecting permits. See the discussion of the later issue in chapter 9 of OTA's 1981 coal leasing report.

value if the disqualified bidder could compete. In these cases, reliance on sale competition as an indicator or guarantee that the highest bid is fair market value becomes even less tenable than previously. Moreover, fewer tracts might be leased if the most likely or only bidders are disqualified. The currently available excess production capacity in mines held by complying lessees also makes it unlikely that coal supplies to consumers will be affected or that Federal production royalties would be lost.

Overall impacts on competition for Federal oil and gas leases also should be minimal. Most onshore oil and gas leases are not awarded by competitive bidding, but are awarded through the lottery system or over the counter noncompetitive leasing. Many competitors for oil and gas leases are unlikely to have any involvement in coal leasing and would be unaffected by section 3. It is also doubtful that a major oil and gas producer would abandon participation in Federal onshore oil and gas leasing to preserve nonproducing coal reserves, particularly since coal operations typically contribute only a minor share of corporate revenues. One major avenue of lease acquisition remains unaffected; noncomplying coal lessees and their affiliates can secure onshore mineral leases by assignments.

Advantages:

1. No legislative action is required.

2. Congressional inaction would be interpreted as reaffirming FCLAA's policy that Federal coal leases are to be held for timely production.

3. Keeping section 3 preserves the only remaining FCLAA-era requirement that might force development, turnback, or divestiture of nonproducing old leases in 1985-90s rather than 20 or more years after passage of FCLAA. Moreover, the firms most affected by potential section 3 disqualification are large energy companies with other coal and mineral leasing interests which were the particular targets of Congress in passing section 3.

4. Section 3 enforcement maintains fairness for lessees who have already brought leases into production, or relinquished, or traded old nonproducing leases to comply.

5. Assignments, or sales of new leases on relinquished tracts could make leases available for development by new parties.

6. Relinquished leases can be subjected to land use planning and screening and surface owner consent requirements before reoffering for sale by competitive bid. Resale could generate revenues for State and Federal government. Surface owners of lands leased before FCLAA without surface over consent might be eventually freed from the threat of dispossession if leases are relinquished.

7. The quality of the leased reserves inventory could be improved through relinquishment of leases with poor development potential. The accompanying reduction in the total amount of leased reserves might make future new lease sales easier to justify politically.

Disadvantages:

1. Disqualification could be imposed for only one old nonproducing lease. Companies with many noncomplying leases would be treated the same as a company with one.

2. Delays by the Department in issuing guidelines interpreting section 3 and specifying procedures for qualifying for exceptions to it have left many lessees with producing mines with

uncertain prospects for obtaining approvals of LMUs or changes in operations before August 4, 1986.

3. Lack of flexibility in interpreting commercial quantities under existing rules could lead to a harsh disqualification for lessees with large tracts that have begun lease development and production but have not yet reached a production rate of 1 percent of reserves. Some parent companies have threatened that they might sell or abandon a subsidiary's developed coal property rather than risk section 3 impacts on oil and gas activities.

4. Administrative uncertainties and delays in leasing coal and other minerals would be created if effective procedures are not introduced to determine section 3 compliance status of lease applicants and bidders.

5. Section 3 can prevent issuance of coal and other preference right lease applications (PRLA's) to prospectors who had invested time, effort, and money in discovering commercially valuable deposits.

6. Companies could turn back leases on which some preparation for development has occurred, possibly increasing the development time for the same tract if it is later resold and reissued to same or different company.

7. The inventory of existing leased reserves available to be mined could be reduced at a time when the potential for additional future leasing is highly uncertain because of delays, and reorganization of the coal program. This impact could negligible if the Federal coal program resumes operations with more predictability and greater public confidence.

8. Some operators might prematurely mine areas of existing mines at added cost or stockpile coal with no purchasers to comply with section 3 guidelines. (If a mine is producing or near to production, the potential period during which section 3 would apply may be very short —. a couple of months or a year or two at most. The disqualification could nevertheless be disruptive and restrictive of other mineral leasing activities, particularly oil and gas operations.

9. States would lose annual rental payments through relinquishment of leases with poor development potential, For States with significant acreage under lease but little production, the loss of one source of annual revenue would be small but nevertheless significant.

10. Many nonproducing lessees are left unaffected by section 3 because it creates a penalty only for those noncomplying lessees seeking new leases directly from the Government.

11. Disqualifications could reduce the number of coal tracts leased and the competitive bonus revenues where the noncomplying lessee is the most likely or only bidder.

Option 2:

Repeal Section 3

Repeal of section 3 in its entirety would eliminate most of the future impacts of section 3 if passed on before August 4, 1986. The other production-forcing provisions of the MLA would remain in effect. New leases would still have to produce in 10 years or be terminated. Existing leases would continue to be subject to the diligence provisions of the MLA, specific lease terms, and the 1982 diligence regulations (or whatever requirements the DOI may in the future apply to such leases.) (Changes to the diligence requirements of section 7 of the MLA imposed by section 6 of FCLAA are not considered here; see the discussion in Chapter 4.) The fairness issue would be raised by lessees who have already moved to bring operations into compliance with section 3 by relinquishing, developing or selling nonproducing reserves.

Repeal of section 3 might make old leases even more valuable than new leases because the old leases would no longer carry the potential for lease disqualification. To a very large extent, the 1982 changes in diligence regulations which gave lessees an additional 2 to 20 years to comply with the diligent production requirement have already widened the disparity between old and new leases. Market conditions may have partially offset any increase in value.

Advantages:

1. Repeal provides maximum relief from section 3 penalty for all lessees.

2. The potential administrative burden in ascertaining qualifications of lessees and applicants is lifted from coal and other leasing programs

3. The need for accelerated review and approval of LMU applications for producing mines is reduced because it is no longer necessary to satisfy section 3 production requirement. Some lessees can avoid additional production requirements imposed with LMU approval that would otherwise be needed to comply with section 3.

4. Penalties on noncoal leasing activities resulting from noncompliance with coal program requirements are eliminated.

5. Lessees could continue holding most nonproducing leases as an inventory to meet potential increases in future demand until diligence provisions might be enforced.

6. Lease readjustment to include the 1982 diligent production requirements (assuming it is timely and effective) and subsequent enforcement will gradually force old leases to begin producing or be terminated in the mid-to late-1990s.

7. The overhang of old lease reserves could dampen demand for additional large scale leasing in many areas and would allow the coal management program to resume leasing at low levels and to devote more time, and resources to tract evaluation and environmental review for the few lands that are leased.

Disadvantages:

1. Repeal would be interpreted as congressional approval of 1982 changes in diligence requirements for existing leases and as a reversal of the FCLAA policies against nonproductive holding of old leases, particularly by large energy companies and conglomerates.

2. Repeal effectively would remove last reform of the mid- 1970s aimed at a resolution of the overhang of nonproducing old leases.

3. Action on section 3 relief does not aid new and readjusted leases with 10-year diligent production deadlines. Pressure for legislative relief from these provisions would continue. Other critics of the leasing program would press for legislative action to deal with old leases because simple repeal of section 3 does not address the problems with arguably inadequate diligence provisions and enforcement mechanisms for existing nonproducing leases.

4. Repeal would eliminate an early opportunity to bring more old leases under the production requirements of FCLAA and 1982 diligence system by requiring modification of lease terms as a condition of LMU approval to comply with section 3.

5. Repeal would preserve until the 1990s and beyond the competitive advantage of old leases carrying minimal royalty and production requirements and few, if any, discretionary environmental protection stipulations.

6. Repeal would be viewed by some as ''rewarding" noncomplying, nonproducing lessees over lessees that brought leases into production or sold or relinquished nonproducing leases in anticipation of section 3 enforcement.

Option 3:

Limit Section 3 to Issuance of Coal Leases.

Section 3 would be amended to provide that the Secretary shall not issue a coal lease to a noncomplying lessee or any related entities.[2] This option would eliminate the impacts on oil and gas and other mineral leases, but would retain many of the other advantages and disadvantages of option 1. Limiting section 3 to coal leases substantially undercuts the effectiveness of the provision as an incentive for the few major lessees with many nonproducing leases to develop, sell or relinquish their noncomplying leases if the threat to the companies oil and gas operations are removed. Disqualification would then have very little impact unless the noncomplying lessee needed more coal for an existing mine (in excess of the 160 acres per lease available through noncompetitive lease modification.)

Advantages:

1. Limiting the provision to coal leases only removes the harsh noncoal impacts of section 3 penalties while still preserving the basic policy that coal leases are to be held for timely production.

2. Nonproducing coal lessees continue under the section 3 penalty, but other mineral operations are exempted. This provides full relief for some, but not all of the noncomplying lessees.

3. The nonproduction penalty is tied more directly tied to the activity that is being punished by the limitation to coal leases.

Disadvantages:

1. The limitation would effectively remove the force of section 3 as a tool for promoting development or divestiture of old nonproducing leases by many large leaseholders.

2. Option would not provide relief for a coal lessee that has not yet produced commercial quantities of 1 percent of reserves from a mine that is under development, if the lessee needs additional reserves for other mines during disqualification.

---

[2] A variation of this option would be to limit section 3 to the issuance of competitive coal leases. This alternate option would have all the same advantages and disadvantages of the coal only option, however it would allow the issuance of pending preference right lease applications if the required showings were made entitling the lessee to a noncompetitive coal lease.

3. A larger group of lessees would be unaffected by section 3 than under option 1. Nonproducing lessees with large amounts of reserves might remain unaffected for years, if at all, because they would not need to acquire any additional coal reserves in order to compete for new contracts.

4. Companies that prepared to comply with section 3 by divestiture of nonproducing leases would complain of unfairness and competitive disadvantage. The companies would argue that noncomplying leaseholders had been "rewarded" by waiting.

Option 4:

Extend the Time to Comply with Section 3.

There are two ways to extend the section 3 production deadlines. One approach would be to modify section 3 to lengthen the 10-year section 3 holding period, for example by two or five years, giving the lessees more time to bring leases into production. As reported from committee section 3 originally provided 15 years for a lease to go into production but this was shortened by a floor amendment. In the alternative, a noncomplying lessee might be given an extension if some progress toward development were demonstrated, such as, for example, a substantial investment in mine construction and development, or execution of a contract for delivery of coal from the mine. An extension would delay disqualification and would allow lessees even more time to find buyers, develop mines, produce enough to satisfy the commercial quantities test, or to stockpile coal reserves and other leases against eventual application of section 3. An extension might delay and diminish the effects of eventual section 3 enforcement. The conditional extension would be similar to option 5 which expands exceptions to the producing in commercial quantities requirement, but lease would still have to be producing at end of any extended period.

Advantages:

1. Extension delays imposition of the penalty while giving Congress and the Department more time to consider changes to section 3 and diligence provisions of coal leasing laws.

2. Extension would provide relief from the immediate impacts of section 3 enforcement in 1986 while maintaining the principle that Federal leases are to be held for development.

3. An extension would shift the section 3 penalty impacts forward in time to begin to coincide with the end of diligent development periods under the Department's 1982 diligence policy for readjusted leases.

4. A conditional extension could provide some additional flexibility in compliance for a mine close to commercial operations or that had not yet produced coal in commercial quantities. Such extensions would be discretionary with the Secretary and based on a finding that the lessee has demonstrated reasonable efforts at developing the lease. The lessee would still be faced with a production deadline.

Disadvantages:

1. Delay merely prolongs the eventual penalty for many leaseholders if a short extension is used. Current market conditions in some areas show little prospect of substantially increased demand for coal.

2. Extension would be similar to repeal in that it would effectively remove perhaps the last remaining mechanism adopted in the mid-1970s to force development or divestiture of old leases that had been held without production. Extensions of five years or more would defer the impacts into the 1990s on leases that already have been held idle for 10 to 20 years or more.

3. Pressure for legislative relief from section 3 would continue, although it might abate somewhat during initial period of extension.

4. Public and industry confidence in the Department's administration of any provision for discretionary extensions may be low. Unless the coal management program and its image are dramatically altered, any conditional extensions would be subject to criticism that they were the results of political pressure, or favoritism. The Fair Market Value Commission (2 members) recommended against discretionary extensions of the 10-year diligence period for this reason.

5. Review of requests for discretionary extensions would place additional administrative burdens on the Department given the large number of leases involved.

Option 5:

Modify the Producing in Commercial Quantities Requirement to Allow Additional Exceptions.

This option would preserve section 3, but address the concerns of producing lessees or lessees who have made significant investments and progress in bringing leases into production. This option would allow an exception to section 3 for a lessee who demonstrated that it achieved one or more milestones in mine development. These milestones might include a minimum investment in equipment and facilities, mine plan development and permitting, or a contract for sale of coal from the mine. Milestones can be a range of actions that provide demonstrable evidence of lessee commitments and investment in development of the lease. However, mine plans have been submitted and construction commenced on mines that do not operate at capacity or that were later closed because of poor market conditions. The key in setting effective milestone is when the decision to commit resources for compliance must be made. The later in a lease term that a milestone must be achieved, the more costly the provision reasonably should be. These types of diligence and production requirements do not guarantee the success of the venture, but only that lessee has made efforts to generate revenues for lessor thus fulfilling the supposed intent of parties.

This option could also legislatively "correct" the Department's restrictive definition of producing in commercial quantities and its conclusions concerning the availability of exceptions. In making such an amendment, commercial quantities might be defined as 1 percent of lease reserves. Some lessees would like to see this regulatory definition locked into law because they view it as the most favorable interpretation they would be likely to get. Other lessees, although agreeing that such a definition of commercial quantities is lenient, oppose any definition that sets an inflexible production goal without some allowance for the normal uncertainties in mine construction and operation. A large operation in its early years may find it difficult to satisfy a one percent production level and would look for alternative ways to demonstrate its commercial operation.

Advantages:

1. Option 4 provides additional flexibility in meeting the producing in commercial quantities requirement and thus could relieve lessees who are producing or are almost producing from a potential penalty for noncompliance.

2. The distinction is preserved between operators that are producing or actively developing a mine and those that are not. The section 3 penalty is maintained for the "undiligent" lessees.

3. Additional exceptions for nonproducing leases could obviate the need for LMU approvals for section 3 compliance for many mines.

Disadvantages:

1. Expanding exceptions to section 3 could be viewed by as weakening section 3 (and section 7 diligence provisions) if what is required to qualify is so minimal as to be viewed as frivolous. Because of the reduced public confidence in the coal leasing program, vesting extensive discretion in the Department to grant exceptions could continue the suspicion and controversy over coal lease management decisions.

2. The option provides little relief for lessees with many undeveloped leases, even though they may have one or more producing mines, or for leases with some leases are in later stages of development.

3. The substantial investment and supply contract exceptions would involve the Department in reviewing financial arrangements and contractual terms of lessees. The Department may not have enough competent professionals to perform these tasks adequately.

4. Granting too many exceptions would nullify section 3's effectiveness.

5. Early opportunities for applying 1982 diligence regulations and FCLAA requirements for existing leases on LMU approval would be reduced.

Option 6:

Make the Section 3 Producing in Commercial Quantities Requirement Applicable to All Pre-FCLAA Leases in 1986.

Under this option section 3 would be amended to remove the 10-year holding period before the producing in commercial quantities requirement applied. The section 3 penalty would attach to leases and not to leaseholders. Congress would amend section 3 to remove the "holds and has held a lease.. for ten years" language making the restriction applicable to any lessee who holds a lease that is not producing after, for example, August 4, 1986. An example of such a provision would be:

> After August 4, 1986, the Secretary shall not issue a lease under the provisions of this act to any lessee which holds a noncompliance lease. As used in this section, lessee means any person, association, corporation or other entity that holds actual or beneficial title to a Federal coal lease and any association, subsidiary, affiliate, or other entity that controls or is controlled by or is under common control with

such lessee. Noncompliance lease means a Federal coal lease that has been in effect for ten or more years and which is not, except as provided for in section 7(b) of this act, producing coal in commercial quantities."

Such an amendment would indisputably expand the section 3 sanction to all nonproducing pre-FCLAA leases. (It is assumed that Congress would not use language that would apply this requirement to post -FCLAA leases or to exchange leases that have pre-FCLAA effective dates during the first 10 years of their terms,)

The action avoids any constitutional or contractual issues since it restricts the authority of the Secretary of the Interior and limits the entities that can acquire new leases which are property rights that have not yet been created.

Advantages:

1. This option provides an additional penalty for all old nonproducing leases that, unlike the diligent development requirements, is independent of any lease terms, regulations, or discretionary enforcement decisions.

2. No section 3 relief is provided. This Congressional action would be seen as reaffirming and strengthening penalties for nonproduction independent of diligence enforcement by DOI.

3. The obligation to bring a lease into production could not be avoided by assignment. The section 3 production obligation would more closely track lease diligence obligation; the development clock would not be restarted with a change in owner.

4. This option would relieve some of administrative burden on the Department in tracking ownership changes since the producing status of a lease can be readily determined.

5. This provision limits in part the effect of the Department's 1982 rules changes for some classes of leaseholders without affecting the terms of old or readjusted leases.

6. Lessees could still retain old leases under the same terms as previously, but could not get new leases.

Disadvantages:

1. This option magnifies the impacts of section 3 enforcement, all nonproducing old leases would be affected.

2. Pressure for legislative relief would continue.

3. This change would disrupt the expectations of assignees who acquired old leases after 1976 assuming that they would have 10 years before disqualification was imposed. The unfairness issue would be raised,

4. The compliance status of all lease applicants would still have to be determined before issuing coal or other mineral leases and a larger number of leases would be initially affected.

5. This option would make nonproducing leases less marketable and more likely to be relinquished and would make it less likely that leases would move into the hands of those who would mine them more quickly than their current owners.

6. Major coal producers and oil and gas companies and their affiliates would be pressured to produce or give up their coal leases.

7. Lack of flexibility in defining producing in commercial quantities could have same harsh consequences for some lessees as section 3 as it is now.

8. No additional relief is provided from section 3 penalties.

9. Administrative burdens on the Department to approve LMU formations, lease assignments, suspensions, and relinquishments would be increased because all lessees seeking such relief to avoid a section 3 penalty would be applying and expecting necessary action before the same deadline.

10. Lessees that have no immediate need for additional coal leases and that are not active in other mineral leasing areas would be relatively unaffected and could continue to hold old nonproducing lease until diligence provisions might be enforced.

Options, 7, 8, 9 and 10:

Adopt New Exceptions to Section 3

Options 7, 8, 9, and 10 would keep and enforce section 3 but allow nonproducing leaseholders the opportunity to qualify for additional leases. These approaches would add some flexibility to the administration of section 3. These options include:

Option 7: Addition of a qualifying payment requirement for noncomplying lessees through voluntary modification of lease terms.

Option 8: Requiring noncomplying lessees to pay a surcharge on any new coal leases.

Option 9: Requiring noncomplying lessees to relinquish equivalent amounts of noncomplying leased acres or reserves to qualify for new leases, also known as the “lease turnback” approach.

Option 10: Allowing noncomplying lessees to relinquish old nonproducing leases in exchange for a preferential option to purchase a new lease on the same lands if it survives the new lease screening process. This is also known as the “Lease Rollover” option.

For various reasons, many of these changes could most easily be implemented as legislative exceptions to section 3. Because of the uncertainty and controversy over the extent to which Congress can alter the financial obligations of Federal leases before the current lease term expires, it is probably more practicable to implement the Option 7 payment provisions as a voluntary election by the lessee thus avoiding the legal issues.[3] The Department took a similar approach in requiring the amendment of pre-FCLAA leases to include the 1982 regulatory diligence system as a precondition for LMU approval. The other options do not involve similar contractual issues because the existing leases are unaffected and the lessee would need to negotiate with the Department only for a new lease that the Department is under no obligation to grant. The noncomplying lessee would not be forced to relinquish any leases. Any lessee who wishes to endure disqualification and forego additional leases is under no obligation *to* use any of the available exceptions.

OTA has assumed here that these provisions would be in addition to any diligence requirements or production incentives imposed in section 7. OTA has also assumed that they would apply to post-FCLAA leases that were not terminated for nonproduction after 10 years. For some of these options we have added an additional condition requiring that the option must be elected within a specified election period (e.g., by August 4, 1986) whether or not a new lease is sought at that time. Lessees who did not elect the exception would not be able to take future advantage of the relief provision. (This approach is particularly important for the holding fee option so that revenues would accrue from the date of noncompliance.)

These exceptions would allow noncomplying lessees with many nonproducing leases to take maintain their reserves position, but at a cost. Because a few major lessees hold a large portion of the noncomplying leases, Congress may wish to consider adding further qualifications for these exceptions. For example S. 382 limits the availability of an option to lessees with no more than two noncomplying leases. There is some inherent regional inequity in conditioning an exception on the number of leases held. A viable mining property might consist of one lease or eight (or more) depending on the peculiar history of the leases and the State or region in which they are located. Consider, for example, two hypothetical coal mines under development but which are not yet under contract or being mined. Lessee A in the Powder River basin has one lease, which like many leases in the Powder River basin of Wyoming issued in the late 1960s and early 1970s is very large (over 2000 acres) and contains several hundred million tons of reserves -- enough to sustain a large surface mine for many years. Lessee B has a mine under development in Central Utah that consists of five leases, the smallest 80 acres and the largest 2200 acres, and reserves that would sustain a large underground mine for 40 years. For geological and engineering reasons, the Utah leases would be mined in sequence over

---

[3] By noting the existence of such objections to direct modification of lease obligations, we are not suggesting that Congress cannot lawfully alter existing leases, including payment obligations, before expiration of the current lease terms without impermissible abrogating contract rights or incurring an obligation to compensate the lessee. We have not researched the precedent for such legislation. However it is arguable such action might be sustained by the courts if Congress was asserting its constitutional authority over disposition of the public lands and correcting what it perceived as errors or abuses of discretion on the part of the Secretary in the administration of his responsibilities which resulted in detriment to the public interest and unjust enrichment of lessees. Lessees have an obligation to develop leases diligently and to pay for use of public resources, the Secretary cannot relieve them of that responsibility either directly or through inaction or inadvertence. The past history of disregard of the MLA's statutory diligence requirements by the Department and lessees may be one circumstance where, direct Congressional action would be sustained. Congress might be more successful and on firmer legal ground in enacting legislation that terminates nonproducing leases by operation of law for failure to satisfy the diligence obligation within a reasonable period of time. The Supreme Court recently sustained a provision of the Federal Land Policy and Management Act of 1976 creating a presumptive abandonment and forfeiture of mining claims for failure to file annual assessment reports on time. See U.S. v. Locke, U.S.—, No.83-1394, Apr. 1, 1986. See also these legal memoranda by the American Law Division of the Congressional Research Service, Library of Congress: "Constitutional Issues Raised by Proposal to Impose New Obligations upon Leaseholders on the Outer Continental Shelf", Jan. 23, 1980: "Legal Analysis of Legislative Cancellation of Existing Oil and Gas Leases", Mar. 20, 1980; and "The Federal Coal Leasing Amendments Act of 1976 and 'Diligent Development' Requirements", Mar. 1,1982.

many years. The Powder River nonproducing lessee would not be much affected by a qualification that limited availability of an option to those lessees with two or fewer leases, while the Utah lessee B would be faced with the prospect of disqualification or, perhaps irreversibly, dismantling a minable property through assignment or relinquishment. The Utah lessee B might try to have the leases consolidated into two leases to qualify for the exception, but it is not certain that the Department would approve such a request. The two lessees are arguably in similar positions with respect to compliance with section 3, but they would not be equally helped by relief conditioned on the number of nonproducing leases that they hold. Limiting an exception to any lessee with no more than two noncomplying leases *or* one noncomplying logical mining unit including any number of qualifying leases would treat both lessees more equitably.

OPTION 7:

Payment of Holding Fees on Nonproducing Leases as a Qualification for Additional New Leases.

Under this option a lessee would make annual payments on all noncomplying leases in order to qualify for new leases. The lease terms would be modified to include an annual payment for nonproducing leases. This obligation would run with the lease and would transfer to the new owner if the lease were assigned. The payments would begin on August 4, 1986 for most nonproducing pre-FCLAA leases and would cease when the lease was brought into compliance with section 3 (or relinquished). The payments would begin 10 years after lease issuance for all other coal leases. The lessee would have a limited period in which to elect to have the lease modified to qualify for new leases. Lessees who did not make an election by the end of the period would not be allowed to use this mechanism to avoid section 3. Leases that were not modified to contain the section 3 nonproduction payment could be made subject to a similar nonproduction payment on the next readjustment date. To create an incentive to make an early election, these nonproduction payments incurred on readjustment could not be used by the current lessee to avoid section 3 disqualification. The payment scheme could allow a partial credit for any production that occurs in that year to assist lessees who are producing but have not yet reached the commercial quantities threshold.

One way of implementing such an approach would be to amend section 3 so that the Secretary may (or shall) accept annual payments in lieu of producing in commercial quantities if the lessee agrees to modify the lease to include such a provision by August 4, 1986 or 10 years after lease issuance, whichever is later.[3] By conditioning the availability of this relief on the lessee's election to be governed by its terms, the legislation does not amend existing leases without the consent of the lessee. Any lessee who chooses to be subject to the section 3 disqualification in the future is free to do so. Setting an immediate time limit on the

---

[3] An example of this formulation might provide:

> The disqualification provisions of section 3 shall not apply if qualifying payments in the amount of (insert basis for payment) are made in lieu of production in commercial quantities. A lessee may elect to amend the lease terms to include a qualifying payments provision by notifying the Secretary in writing by August 4, 1986 (or alternatively before the end of his ten year holding period). All such elections shall be approved by the Secretary but the effective date of the election shall be **the** date on which it was filed. Within 60 days of the date of enactment of this act, the **Secretary shall propose regulations specifying the information required to be filed for an election. and one might also partially address problem of old leases that were not readjusted to conform to FCLAA by making such readjustment a further condition of section 3 relief.**

availability of the election forces an early decision by the lessee about a commitment to develop and provides some certainty that a section 3 disqualification can be avoided. One might also partially address problem of old leases that were not readjusted to conform the FCLAA by making such readjustment a further condition of section 3 relief. The payment election also assures an early stream of revenues to government.

For purposes of this discussion, OTA assumes that the annual payment requirement is similar to a delay rental and is initially paid for the privilege of maintaining one's qualification for new leases. A relatively simple payment formula should be used since it is expected that many lessees would seek to comply. A flat cents per ton or dollars per acre payment would probably provide the most predictability for lessees and be the easiest to administer, despite some of the inherent inequities in any such uniform approach. The payments should be substantial enough to affect the economics of holding the property without production. OTA's review of various holding fees suggests that an annual payment of 1 cent or more per ton of recoverable reserves under lease would begin to have a measurable impact in almost all regions. (See Chapter 4.) The fee is still less than would be paid in royalties if the lease were producing even at the pre-FCLAA royalty rate of 20 cents per ton and is significantly less than what a lessee would probably have to pay for a new lease with marketable coal.

This payment option is similar in effect to the proposals for advance royalties or delay rental in lieu of production after 10 years under section 7. However here it is primarily viewed as supplementary to the production-forcing provisions of section 7. (If additional payments were relied upon to spur production or relinquishment of existing lease or to provide a stream of royalty income in lieu of production in the absence of any section 3 requirements, one would expect that the such payments would have to be higher than those extracted as a qualification for new leases under section 3, although there is no economic requirement that it be so.)

One might also use the option to correct some of the problems with tardy or ineffective lease readjustments by limiting the availability of the payment option to leases that have been readjusted or modified to contain the post- FCLAA terms on royalties, diligence, and other require merits.* This will also help to overcome the advantage gained by some lessees as the result of the Department's failure to conform the leases to the new terms by timely and effective readjustments. These unadjusted leases will be required to be made subject to higher royalties and the 1982 diligence requirements as a further condition for avoiding section 3.

Advantages:

1. A qualifying payment would provide some relief from section 3 by allowing all noncomplying lessees to pay to keep a nonproducing lease to avoid the section 3 disqualification.

2. The payment option makes the decision of whether to keep a lease or acquire a new one an economic choice for lessee. Such an approach would be more in keeping with private sector practices than the current section 3.

3. Some view the payment option as essentially neutral with respect to different classes of lessees by making it an economic decision.

---

[4] Such a condition might provide, for example, that such election shall not be granted for to any lessee or parent or affiliate, etc., that holds any lease issued (or with an effective date) before August 4, 1976 which waa subject to readjustment after August 4, 1986 and haa not been so adjusted to conform to the requirements of post -FCLAA diligence and continued operations provisions, unless the lessee consents to amend the lease to include all terma and conditions required by FCLAA, and the lease form and regulations that were or are in force at the firat 20-year anniversary date of the lease after August 4, 1986.

4. This option allows section 3 to apply to issuance of all onshore mineral leases, thus keeping the pressure on nonproducing coal lessees with noncoal leasing operations, particularly oil and gas companies. The penalties for nonproducing coal leases are incurred by coal lessee and not by the noncoal resource divisions or affiliates. (That is assuming that the coal division will pay (or be forced to pay) for the ability of the other divisions or affiliates to obtain noncoal leases.

5. The payment option offers relief primarily to coal lessees who are actively involved in coal and other leasing activities. Individuals, and other passive lease-holding companies would be probably be unlikely to elect payments unless they were seeking more leases.

6. The payment would generate some revenues for the States and the Federal Government in the absence of production royalties. (OTA assumes that the payments would be subject to the MLA's revenue distribution scheme.)

7. Additional payments would increase the lessee's financial stake in the lease, thus making later relinquishment, termination, cancellation through eventual enforcement of diligence requirements a greater economic penalty. This might tend to provide an additional incentive to make an earlier decision about developing the lease than under the 1982 diligence system.

8. Substantial payments may make some old leases uneconomic to mine. (It is arguable that many such leases probably are noncompetitive even without such payments. In such cases the lessee would (if he has any sense) relinquish the lease. If the lease has not yet been reclaimed, it might force the lessee to take the necessary actions to restore the surface so that the lease may be relinquished.)

9. Substantial payments should force lessees to reevaluate their reserves holdings and get rid of those leases not likely to be mined. This weeding out of leases with poor development potential might generally improve the quality of the reserves under lease, while reducing the amount of such inventory. The reduction in the lease reserves "overhang" might make it easier politically to justify additional new leasing.

10. A continuing payment obligation that ran with the nonproducing lease might diminish the resale value of old leases because of the future payments that the purchaser must make to the Federal government. The government, rather than the nonproducing leaseholder would, however, at least receive a share of any resale value of the reserves.

Disadvantages:

1. The payment option continues to tie noncoal operations to the actions of coal lessee affiliates as a mechanism to force production, but unlike the current section 3, it does allow escape, assuming the coal lessee will pay to avoid corporate disqualification.

2. This option may impose administrative problems on the Department in determining the payments for each lease if it is not a flat dollar per acre or cents per ton rate, but rather an ad valorem calculation tied to the lease reserves, production rate and regional selling price of coal. Lessees also would have an increased burden in providing the necessary information for calculating the payment, but presumably they would be willing to incur it to avoid disqualification.

3. The economic impacts of this option are greatest on lessees with large acreages and reserves and little production. They could face substantial payments if the nonproduction fee were set high and they wished to keep all or most of their nonproducing leases.

4. High payments might make some tracts less economic to mine. Payments increase the lessee's stake in lease and may make later relinquishment or diligence enforcement more costly and lead to renewed efforts for changes in lease diligence provisions.

5. Payments might increase the compensable value of leases that might later be exchanged for environmental or other reasons. (Although DOI has not tended to base such transactions on how much the lessee paid the Government for the lease rights but on the value of the coal in place.)

6. Large corporate lessees could continue to hold reserves and maintain their dominant reserves position through payments. Modest qualifications payments are unlikely to alter the concentration of holdings by these lessees. A high payment would be a disincentive for them to continue to hold nonproducing reserves.

7. Lessees that have already turned back or traded potentially noncomplying leases might argue that the option is unfair because they did not have opportunity to pay to keep their lease qualification status and their inventory of leased reserves.

8. Not all nonproducing lessees would elect to make qualifications payments, but similar annual nonproduction payments requirements could be imposed at the next lease readjustment.

Option 8:

Surcharge on New Leases

Under this option, a lessee would make an additional payment on any new MLA leases obtained while under disqualification. The provisions of the noncomplying leases would be unchanged. This qualification surcharge would be in addition to payment of a fair market value bonus, rentals, and royalties on the new lease. This option could theoretically work while continuing the section 3 applicability to all MLA leases, however, structuring of an appropriate surcharge for oil, gas and other minerals on anything other than an acreage basis would appear to be a complicated process. Because the payment is applicable to the new lease, a payment obligation would not arise until and unless a new lease is sought. The payment obligation would end when the lessee is no longer in noncompliance because the old leases are producing, transferred or relinquished. One consequence that must be considered is the possibility that the lessee may initially agree to the surcharge and win the competitive bidding for a new coal lease and then later petition for a royalty reduction on the grounds that the surcharge make the operation of the new lease uneconomic under its terms. If a later royalty reduction were granted, the surcharge effect might be reduced to only a nominal level.

Advantages:

1. The section 3 penalty is maintained, but the noncomplying lessee can escape disqualification by paying more for new leases.

2. The surcharge is conditioned on and applicable to acquisition of new leases, no economic penalty is applied to the old nonproducing lease.

57-883 O - 86 - 4 : QL 3

3. The payment obligation extends to any new lease. Depending on how the surcharge is structured, this approach may be less costly than Option 7 holding fees for a noncomplying lessee with many noncomplying leases if only a few additional coal leases are needed.

4. The additional payment requirement could place a noncomplying lessee at a disadvantage with complying lessees in competitive lease bidding, since the surcharge would be added to other lease payments.

5. The surcharge option could require qualifying payments for the issuance of new preference right coal leases that might otherwise be issued without any initial payment obligation.

6. This option assists all lessees interested in acquiring new leases while under section 3 disqualification.

Disadvantages:

1. This option is easiest to administer if section 3 is limited to new coal leases only, however, much of incentive to produce on old leases is lost.

2. If the noncomplying lessee has little need for additional coal, this option is unlikely to generate much revenue and will have little impact on nonproducing leases.

3. The royalty reduction authority for coal leases might allow the lessee to escape full impact of the payment requirement for lease, if the Secretary later lowers production royalties to offset the economic impacts of the surcharge.

Option 9:

Lease Turnback

Under this option and its variations, a lessee would agree to relinquish an equivalent amount of noncomplying coal acreage or reserves as a precondition for acquiring a new lease. The turnback might be on an acre-for-acre or ton-for-ton basis or based on some formula adjusted for regional differences in the quality and value of the coal. The relinquishment requirement would be in addition to payment of fair market value for the new leases.

A turnback is not an exchange, but could have many of the administrative problems and controversies that have plagued lease exchanges in determining the equivalence of reserves between different tracts. Because of this aspect, many have advocated that a straight ton-for-ton formula or some variation be used, and that it not be based on the coal quality or fair market value of the coal in place. Acreage-based tradeins also would be straightforward but regional equity issues would be raised. For example, there is generally more coal per acre in the Powder River basin than in the Fort Union or Uinta Regions. A relinquished Fort Union Tract might be considerably less valuable than one of similar size in the Powder River basin.

Among the problems that can be anticipated in establishing equivalence for turnbacks include:

o Setting a monetary value or other equivalency basis for coal from different regions (This could be dealt with administratively or legislatively by establishing a schedule of values for different regions.);

0 Determining the adequacy of geologic information to be used to determine the amount of reserves for tradein equivalence (This problem exists for all reserves based options.); and

o The administrative time and resources required to conduct the necessary analyses of tracts to be relinquished.

A lease turnback approach might provide create a secondary market in nonproducing leases with poor development potential that might otherwise be relinquished early. The low development potential tracts could be used to qualify for new leases through turnbacks while protecting other tracts with high development potential. The Department policy limiting assignments to noncomplying lessees could limit this potential somewhat.

Companies with a few high development potential leases within development delays would not be helped by the turnback option. They and their affiliates would be disqualified and would be faced with giving up all or part of mines that were very near or in production. If the turnback were paired with a qualification payment option, companies with many noncomplying leases could avoid payments while companies with only a few noncomplying leases might actually have to pay more for new leases. This would tend to reward noncompliance.

Lessees who had already turned in nonproducing leases and still had minor problems with compliance would complain of the unfairness of allowing competitors to preserve their dominant reserves position, even with payment or additional conditions.

This option only works well if section 3 is limited to coal leases only and thus also carries the advantages and disadvantages of Option 3. Attempts to apply this option to qualifications for other mineral leases are not likely to be very successful since they would require establishing a monetary value as a basis for equivalence. The initial amounts paid for most onshore oil and gas leases are relatively low, so not much coal would be turned in as equivalent value. Moreover, the Department has experienced difficulties in assessing the value of both coal and oil and gas tracts for competitive bidding purposes. The additional burdens in determining an equivalent monetary value for turnback purposes would only add to the difficulty and controversy attendant on these determinations.

Turnback provides some relief from section 3 disqualification. The lessee could continue to hold any nonproducing leases in excess of those needed to qualify for new leases.

Advantages:

1. The turnback option provides some relief from section 3 for companies desiring new coal leases that have large amounts of noncomplying leases or reserves.

2. A nonproducing lessee can acquire more leases but cannot enhance its reserve position except, perhaps, to improve the quality of coal in its inventory with more marketable coal.

3. Turnback creates a more orderly, phased mechanism for the relinquishment of leases with little development potential than under the current approach because lessees would keep noncomplying leases until new leases were needed instead of relinquishing them all before August 4, 1986 or the applicable section 3 date.

4. Turnback creates an additional incentive to relinquish old leases rather than assign them to any available purchaser if the lessee wants more Federal coal.

5. Leases most likely to be turned back first are those with poor development potential or where mine development is likely to be controversial or difficult for environmental reasons.

6. As under existing law, lessees would not have to give up any leases unless they wished to acquire new leases.

Disadvantages:

1. The turnback option would only be workable if section 3 were limited to coal leases only. Lifting of its applicability to other minerals would remove the most effective incentive for most of the major noncomplying leaseholders to turn back their old leases.

2. Leases most likely to be turned back under this option are the least marketable coal properties under lease, i.e. those with poor development potential and or serious environmental conflicts, and also are the leases most likely to be relinquished under other options

3. Turnback creates an incentive to keep or trade leases that might otherwise be relinquished.

4. The turnback option is most favorable to lessees with either large numbers of leases or large reserves that are not in compliance with section 3.

5. Turnback imposes additional administrative burdens on the Department in reviewing tracts for equivalence in addition to determining the appropriateness of tract for relinquishment. Difficulties and controversies can be expected to be similar to those encountered in exchanges.

Option 10:

Relinquishment and Reissuance of Noncomplying Leases or Lease Rollover

Under this option, a noncomplying lessee could avoid section 3 by entering into a special relinquishment agreement with the Secretary. The lessee would agree to relinquish all of its noncomplying old leases in exchange for section 3 relief and a noncompetitive preferential right to purchase a new post-FCLAA lease for the same lands when and if the relinquished lands pass the new lease screening process.

The lessee would have to comply with all relinquishment conditions under current law and regulations. The relinquishment must be unconditional. The section 3 disqualification would be lifted on approval of the special relinquishment agreement. The relinquished lease areas would then be subject to the complete land use planning, environmental screening, surface owner consent, and tract evaluation process for new leases. Any new leases would contain the post-FCLAA royalty and diligence provisions. If the tracts are reoffered, the lessee would have a noncompetitive or preferential right to acquire the tracts on payment of a fair market value bonus. Some credit might be allowed for any prior bonus payment.

This option could improve the quality of the inventory of leased reserves. It is likely that the better quality tracts would survive this process and still be economically attractive prospects. The lessees would be assured of reobtaining the leases that survived the screening, and any investments in surface rights, environmental baseline studies, reserves assessment, and engineering and mine design studies might be preserved. Areas that were environmentally unsuitable could be eliminated, areas that were environmentally sensitive would be identified so that protective lease stipulations could be developed to address such concerns during mining. The review period would not be chargeable against the new lease's primary term or initial diligence period.

This option surfaced in informal discussions among DOI, congressional staff, conservation groups, and oil and gas company lessees. It would require legislative authorization because it involves granting future preferential lease rights or options to section 3 leaseholders in exchange for lease relinquishments. Such transactions are not now possible because of the requirement that all new coal leases be offered by competitive bidding. Legislation would have to allow the government to grant the lessee the option of reacquiring the old leases. Legislation would also give the lessee the security that the Department could honor its agreement. It would be important for the success of this option to avoid creating any right to compensation or exchanges for leased areas that did not survive the screening process. However, since submittal of leases to this process would be voluntary, there need be no legal requirement to compensate for lands that may legally be prevented from mining anyway or for terms that could be imposed on readjustment. The major benefit to the lessee would be eligibility for additional coal and noncoal leasing and an option to purchase new lease on the relinquished lands should the Department reoffer them. The agreement could specify that a decision on lease review and reissuance must be accomplished within a certain period of time. Legislation might require the lessee to pay any administrative costs associated with the requalification process to defray the cost impacts on the Department. Such purely administrative fees would not be credited against payment of fair market value, and would not be revenues that must be shared with the States.

Advantages:

1. The rollover option provides relief from section 3 and addresses many environmental and other concerns about letting old nonproducing leases continue in effect beyond 1986.

2. Old leases are converted into post-FCLAA leases with post-FCLAA environmental, financial, surface owner consent, and production requirements.

3. Rollover would have the same effect as an early lease readjustment for imposition of discretionary environmental protection and socioeconomic impact stipulations. Areas that would be unsuitable or environmentally difficult to mine and reclaim would be identified and unsuitability designations or protective stipulations applied.

4. Valuable tracts would likely survive the review process. A lessee who acquired the tract initially at a low price would probably still have an incentive to hold on to it longer, assuming that payment of fair market value did not wipe out all of the tract's profitability. The government would receive a fair return on the tract.

5. For multi-lease tracts with different diligence deadlines, relinquishment and conversion into new leases would allow the tract to be maintained intact and perhaps receive an extended diligence period.

6. Leases with little near term chance of development would probably not be reissued if costs of maintaining or of reprocessing were high enough and the current 10-year post- FCLAA diligent production requirements were kept.

57-883 O - 86 - 5 : QL 3

Disadvantages:

1. Only lessees with valuable tracts they wish to keep and no other options would elect this exception. Many lessees with old leases would do nothing, or relinquish or sell their leases.

2. Converting old leases into post-FCLAA leases without significantly favorable trade offs in addition to section 3 relief, such as a longer diligence period, might be too disadvantageous for some lessees.

3. Rollover would not help a lessee with only a few nonproducing leases that were close to commercial production if there were no other section 3 relief available. The time necessary to review and reoffer relinquished leases could delay opening of the mine for several years possibly resulting in loss of market opportunities.

4. A preferential right to reacquire relinquished lease areas as new leases might bring less bonus revenue than resale of the leases by competitive bidding if other companies are interested in acquiring the reserves.

5. The Department might reissue leases with environmental conflicts identified during the lease review in an effort to avoid litigation and defer a decision over minability of tract to mine plan permitting. Later, the Department might needlessly be faced with the pressure to seek an exchange of the unminable new leases for valuable Federal coal leases elsewhere.

Section 3 Options and Modification of Section 7 Diligence Requirements

The options discussed above were primarily designed as alternatives for the section 3 producing in commercial quantities requirement under existing law. OTA notes that several section 3 options also are similar to suggested reforms for the section 7 diligent development and continued operations requirements and most specifically the 10-year diligence period for new leases imposed by statute, and by regulation for readjusted leases. These options are: extensions (Option 4); use of alternative lease development milestones (Option 5); and payment of holding fees in lieu of production (Option 7). Under certain unusual circumstances the lease rollover option might also be an alternative for extending the 10-year diligence period.

Many of the advantages and disadvantages of these approaches as modifications to the diligence provisions are similar, but the underlying policy question is different. Section 3 was originally an adjunct to the basic diligence requirements. As a result of administrative policy changes, section 3 is now the major production requirement for most old leases. Modifications to section 7 involve direct alteration of a fundamental policy of Federal coal leasing. Without some form of diligence requirement, private interests could tie up Federal coal reserves indefinitely without production while remaining eligible to compete for even more Federal coal. A dynamic Federal leasing system that strove to offer Federal coal leases to create opportunities to the private sector to compete for coal supply contracts and thus keep fuel costs low for consumers is highly dependent on a diligence mechanism. Without some means of returning undeveloped tracts to the system, the government might soon exhaust its supply of marketable tracts and lose its ability to affect the price or supply of coal to consumers.