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Gail L. Wurtzler

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DILIGENCE REQUIREMENTS
UNDER THE FEDERAL
COAL LEASING AMENDMENTS ACT
OF 1975

Gail L. Wurtzler
Davis, Graham & Stubbs
Denver, Colorado

PUBLIC LANDS MINERAL LEASING:
ISSUES AND DIRECTIONS

A Short Course Sponsored by the
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I. Background - Developments Before Enactment of the FCLAA

A. Prior to August 4, 1976, the date of enactment of the FCLAA, the Mineral Leasing Act of 1920, as then amended, delegated broad discretion to the Secretary of the Interior with respect to federal coal leasing but provided few standards for exercise of that discretion.

1. The Secretary of the Interior was authorized to issue coal prospecting permits for a term of two years. If, within that two-year period, the permittee showed that the land contained coal in commercial quantities, the permittee could apply for a preference right lease for all or part of the land included in his permit. (30 U.S.C. § 201(b)).

a. As construed by the agency for nearly 60 years, a prospecting permittee who established the presence of commercial quantities of coal in the area covered by the permit was automatically entitled to

b. For a definition of commercial quantities Interior relied upon U.S.G.S. determinations of whether the coal deposit existed and whether it was workable, i.e., could be mined by existing technology. *(Natural Resources Defense Council, 609 F.2d at 556, n.7; Utah International, 488 F. Supp. at 964-965).*

c. Many pre-FCLAA leases were issued in this manner. *(H.R. Rep. No. 94-681, 94th Cong., 1st Sess. 15, 17 (1975)).

2. The Secretary was also authorized to award leases by competitive bidding or by such other methods as he might by regulation adopt. *(30 U.S.C. § 201(a)). Few pre-FCLAA leases, however, were issued following competitive bidding where multiple bids were received. *(H.R. Rep. No. 94-681 at 17).*
3. The leases awarded required the lessees to pay a royalty of at least five cents per ton and an annual rental beginning at a minimum of 25 cents per acre and escalating to a minimum of fifty cents per acre in the second year and to a minimum of one dollar per acre in the sixth year. (30 U.S.C. § 207).

4. The leases were for indeterminate periods upon condition of diligent development and continued operation of the mine or mines, except when such operation was interrupted by strikes, the elements, or casualties not attributable to the lessee. (30 U.S.C. § 207).

a. Diligent development and continued operation were not defined by regulation before December, 1974. (H.R. Rep. No. 94-681 at 12-15). Lease terms did little more than recite the statutory language of diligent development and continued operation. Neither the regulations nor the lease terms provided any standards or mechanism for enforcement of those conditions.
b. Administration of the diligence requirements was lax. No proceeding to cancel a lease for lack of compliance with diligence requirements was ever initiated. (H.R. Rep. No. 94-681 at 14-15). Perceptions of the value and marketability of the federal coal reserves (primarily western deposits of low-sulphur coal located at great distances from many potential markets) may have contributed to the lack of interest in enforcing the diligence requirements.

5. The Secretary had discretion to accept payment of an annual advance royalty upon a minimum amount of coal in lieu of the provision requiring continuous operation of the mine, provided that he determined this was in the public interest and that the amount of the advance royalty was at least equal to the amount of rentals. (30 U.S.C. § 207).

a. In practice this provision was construed to permit payment of an annual advance royalty upon a minimum amount of coal in lieu of development as well as operation after production had begun.
b. Payment of these nominal advance royalties in lieu of development and extraction of coal reserves was a common practice. According to testimony before the House Subcommittee on Mines and Mining in 1975, 474 of 533 federal coal leases were held under a waiver of the condition of continued operation issued by the Secretary and payment of advance royalties. (H.R. Rep. No. 94-681 at 14-15).

6. The Secretary could also permit suspension of operations under a coal lease for a period up to six months at any one time when market conditions were such that the lease could not be operated except at a loss. (30 U.S.C. § 207).

7. The leases issued also included the further condition that at the end of each twenty-year period following the date of the lease, the Secretary of the Interior could make such readjustment of terms and conditions as he might determine, unless otherwise provided by law at the time of expiration of such twenty year period. (30 U.S.C. § 207).

8. The pre-FCLAA statute also limited the right of common-carrier railroads to obtain federal
coal leases in excess of their own needs (30 U.S.C. § 202), authorized consolidation or collective prospecting, development and operation of coal fields (30 U.S.C. §§ 201-1(a), 205), authorized the lease of additional tracts upon the same conditions as the original leasehold upon a showing by the lessee that all workable coal deposits would be exhausted within 3 years thereafter (30 U.S.C. § 204), and authorized the issuance of limited licenses to take coal for local domestic needs without an obligation to make royalty payments (30 U.S.C. § 208).

B. By the 1970's, federal coal leasing was widely regarded by the administration, Congress and public interest groups as undesirable for a variety of reasons.

1. It was perceived that the public received an inadequate and unfair return on its coal lands.

   a. The amounts of production royalty, rental and advance royalty payments required by federal coal leases were far below fair market value as measured by the terms fee leases then received. The average federal
production royalty over 54 years of leasing was only 12.5¢ per ton. Although royalty rates had increased seventy five percent since 1920, the price of a ton of coal had more than doubled, so the actual production royalty paid was a smaller percentage of the value of the coal than it had been in 1920. (H.R. Rep. No. 94-681 at 18).

b. Few coal leases issued were the result of competitive sales. Many were preference right leases, and of those leases issued by competitive bidding, seventy two percent were bid upon by less than two bidders. Since the amount of the bid is related to the number of bidders, leases for which only one bid was received were less likely to result in a fair return to the public. (H.R. Rep. No. 94-681 at 17).

2. The public also received an inadequate return because most federal coal leases were undeveloped and did not produce coal.

a. Prior to an informal Interior decision to impose a coal leasing moratorium in 1971, acreage under lease had increased while
production had declined. Acreage under lease had increased from about 80,000 acres in 1945 to 778,000 acres in 1970, or 1/1000 of 1 percent of the public lands. Production in that period, however, had declined from 10 million tons in 1945 to 7.2 million tons in 1970. (Sen. Rep. No. 94-296, 94th Cong., 1st Sess. 9 (1975)).

b. Most federal coal leases were nonproducing. Of 533 leases outstanding in 1975, only 59 were in production. (H.R. Rep. No. 94-681 at 14-15). Ninety-one and one-half percent of the land under federal coal leases was held under nonproducing leases. (H.R. Rep. No. 94-681 at 11).

c. Many such leases had been held for years by the payment of nominal advance royalties permitted by the Secretary in lieu of development. (H.R. Rep. No. 94-681 at 14-15).

d. There was an absence of any meaningful diligence criteria to assure production under existing leases. The Department of the Interior had never defined the terms "diligent development" and "continued
operation" before December, 1974 and had never cancelled a lease for failure to comply with those conditions. (H.R. Rep. No. 94-681 at 14-15).

3. There was also a widespread belief that only speculators benefitted from the federal coal leasing program as it existed in 1975. Coal lease brokers, rather than companies which were coal producers, held significant amounts of coal lands. As of 1970, 761,000 acres of public and acquired lands included within outstanding coal prospecting permits were held principally by speculators. (Sen. Rep. No. 94-296 at 9. See also H.R. Rep. No. 94-681 at 14-16). Speculators who had obtained coal leases and prospecting permits at prices below fair market value received, or had the potential to receive, substantial profits when the demand for coal increased in the early 1970's.

4. The oil shortage in the early 1970's created new and increased demand for coal by utilities and industry. Production was slow to increase, and critics pointed to the number of nonproducing federal leases as a factor contributing to the shortage.
a. The ownership of leases by speculators, rather than coal producers, was seen as one reason for lack of production.

b. Concentrations of holdings as evidenced by the fact that fifteen leaseholders held leases on two-thirds of the leased federal coal acreage was regarded as a further restraint on production. (H.R. Rep. No. 94-681 at 15-17).

c. The fact that some of the companies with the largest number of federal coal leases or acres were owned by major oil or mining companies also raised concerns about possible disincentives to produce coal. 122 Cong. Rec. 484 (1976) (comments of Rep. Young).

5. Growing concern with land use planning and the environmental impact of coal leasing and mining led to questions about the wisdom of Interior's reactive leasing in answer to stated needs of industry and its inability to deny preference right leases to prospecting permittees who were otherwise entitled to them regardless of the impact on the environment. (H.R. Rep. No. 94-681 at 18-19); Natural
C. The administrative response to these concerns was to stop leasing until new regulations to provide the Secretary with greater administrative control over the leasing system could be adopted.


2. The Secretary undertook to develop a new leasing system so that the size, timing and location of coal leases would more effectively meet the U.S.'s energy needs. In February, 1973, the Secretary of the Interior suspended further issuance of coal prospecting permits and halted all federal coal leasing (except under short term relief criteria). (H.R. Rep. No. 94-681 at 11).

3. In December, 1974, Interior published proposed regulations to address the problem of speculative holding of leases and that of lease size. Those regulations established locigal mining units and defined diligent development and continuous operation. Diligent development was defined in terms of work directed
toward production of coal, rather than in terms of a certain amount of production. It included environmental studies, geological studies, mapping, surveying, engineering, and other work done in preparation to mine. Continuous operation meant production of commercial quantities of coal without interruptions greater than 6 months. (H.R. Rep. No. 94-681 at 12-14).

D. In the meantime, Congress took over the problem of federal coal leasing and focused on the royalty and diligence issues.

1. In the royalty area, Congress drew a comparison between the coal industry and the oil and gas industry and imposed a typical oil and gas lessor's royalty of a minimum of 12-1/2 percent on federal coal leases, except that a lesser royalty of 8 percent could be applied to underground coal mines. (Fair Market Value Policy for Federal Coal Leasing, Linowes Commission Report (1984), p. 287).

a. This was a substantial increase from the prior royalty rate of a minimum of five cents per ton.
b. The increase was not tied to the realities of coal development which, unlike oil and gas, typically requires a large initial investment and significant continuing investment over the life of the mine.

2. In the diligence area, Congress set detailed standards of diligence and provided for harsh and absolute penalties for failure to meet those standards.

a. Diligence was defined in terms of achieving a certain amount of production within a set period and maintaining a particular amount of production thereafter, rather than in terms of investment or good faith. The definition apparently was selected without regard for the long lead times needed to bring a coal mine into production or the need to arrange for special transportation arrangements and long-term purchaser contracts before development and marketing can begin. The definition also ignored the effect of market conditions, events of force majeure, and other limitations on the development and operation of coal mines.
II. Diligence Criteria Under the FCLAA.

A. Section 6(b) of the FCLAA (30 U.S.C. § 207(b)) provides that:

Each lease shall be subject to the conditions of diligent development and continued operation of the mine or mines, except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. The Secretary of the Interior, upon determining that the public interest will be served thereby, may suspend the
condition of continued operation upon the payment of advance royalties ... [f]or an aggregate number of years during the period of any lease ... [which shall] not exceed ten.... Nothing in this subsection shall be construed to affect the requirement contained in the second sentence of subsection (a) of this section relating to commencement of production at the end of ten years.

(See also 43 C.F.R. § 3475.5 (1984)).

1. Diligent development is defined as production of recoverable coal reserves in commercial quantities (one percent of recoverable coal reserves) within a ten year period. (43 C.F.R. § 3480.0-5(a)(6), (12), (13) (1984)).

2. Continued operation means production of not less than commercial quantities (one percent) of recoverable coal reserves in each of the first two years following achievement of diligent development and an average amount of not less than one percent of recoverable coal reserves per year thereafter, computed on a three-year basis consisting of the year in question and the two preceding years. (43 C.F.R. § 3480.0-5(a)(6), (8), (9) (1984)).

3. Each lease issued after enactment of the FCLAA is required to achieve diligent development within ten years after its effective date and
is thereafter subject to the requirement of continued operation. (43 C.F.R. § 3483.1(a)(1), (2) (1984)).

4. Each lease issued prior to enactment of the FCLAA is required to achieve diligent development within ten years after the first lease readjustment after August 4, 1976, or the operator's prior election to be subject to the FCLAA, and is thereafter subject to the requirement of continued operation. (43 C.F.R. § 3483.1(b)(1)(2) (1984)).

5. The diligent development requirement cannot be suspended or extended. (30 U.S.C. § 207(b); 43 C.F.R. § 3483.3(b)(1) (1984)).

6. The condition of continued operation may be suspended upon application if the Secretary determines that suspension is in the public interest. (30 U.S.C. § 207(b); 43 C.F.R. § 3483.3(a) (1984)).

a. That condition may be suspended by the period of time during which the authorized officer finds operations are interrupted by strikes, the elements, or casualties not attributable to the operator/lessee. (30 U.S.C. § 209; 43 C.F.R. § 3483.3(a)(1) (1984)).
b. It also may be suspended upon the payment of advance royalty in an amount equal to the production royalty (8 percent if the coal would be recovered only by underground mining operations; 12-1/2 percent if it would be recovered by surface mining operations) due on the production of one percent of the recoverable coal reserves. (30 U.S.C. § 207(b); 43 C.F.R. §§ 3483.3(a)(2), 3483.4(a), (c) (1984)). Advance royalty may not be accepted in lieu of the requirement of continued operation on any lease for more than ten years. (43 C.F.R. § 3483.4(d) (1984)). It may be credited against production royalties due during the initial twenty year term of the lease. (43 C.F.R. § 3483.4(e), (f) (1984)).

7. Operations and production also may be suspended upon application if determined to be in the interest of conservation by the Secretary. (30 U.S.C. § 209; 43 C.F.R. § 3483.3(b) (1984)).

a. Such suspensions do not apply to the diligent development period, but do
suspend all other lease terms including rental and royalty payments. Minimum annual production requirements are proportionately reduced for that portion of a federal lease year for which operations are so suspended. (43 C.F.R. § 3483.3(b)(1), (2) (1984)).

b. The term of the lease will be extended by adding any period of suspension to it. (43 C.F.R. § 3483.3(b)(3) (1984)).

8. Not all production must be credited toward achievement of diligent development.

a. All production on post-FCLAA leases after the lease effective date must be credited toward diligent development. (43 C.F.R. § 3483.5(a)(1984)).

b. Production on pre-FCLAA leases after the effective date of the first lease readjustment after August 4, 1976 must be credited toward diligent development. (43 C.F.R. § 3483.5(b) (1984)).

c. For pre-FCLAA leases which have not been readjusted and which the operator/lessee elected to subject to the FCLAA diligence requirements prior to August 30, 1983, all
production between August 4, 1976 and the effective date of the election may be credited toward diligent development. All production after the effective date of the election, however, must be so credited. (43 C.F.R. §§ 3483.1(b)(1), 3483.5(c), (d) (1984)).

d. For pre-FCLAA leases which have been readjusted after August 4, 1976, all production between August 4, 1976 and the effective date of the first lease readjustment may be applied toward diligent development if the operator/lessee so requests. Such a request must comply with the election requirements under 43 C.F.R. § 3483.1(b)(1), and presumably the operator must have made this request prior to August 30, 1983 as well. (43 C.F.R. § 3483.5(e) (1984)).

B. Section 6(c) requires submission for the Secretary's approval of:

an operation and reclamation plan prior to taking any action on a leasehold which might cause a significant disturbance of the environment, and not later than three years after a lease is issued.

(30 U.S.C. § 207(c)).
1. The regulations permit extension of the three-year period for filing a resource recovery and protection plan upon application and after a determination by the Secretary that it is in the public interest. Interruption of operations by strikes, the elements, or casualties not attributable to the operator/lessee permit an extension, but payment of advance royalty does not. (43 C.F.R. § 3483.3(a) (1984)).

C. Similar diligence requirements apply to logical mining units (LMUs) under Section 5 of the FCLAA. (30 U.S.C. § 202a(2); 43 C.F.R. § 3487.1(h)(2) (1984)). An operator/lessee may initiate, or the authorized officer may direct, consolidation of coal leases into LMUs upon a determination that maximum economic recovery of coal would be served thereby. 30 U.S.C. § 202(a)(1); 43 C.F.R. § 3487.1(b) (1984)). An LMU is a consolidation of one or more federal leases and may include intervening or adjacent private or state-owned coal deposits in a single unit of no more than 25,000 contiguous acres under the control of a single operator and worked as a single operation. (30 U.S.C. § 202a(1), (7); 43 C.F.R. § 3487.1(f)(1), (5) (1984)).
1. An LMU, like an individual lease, must achieve diligent development within a ten year period. (43 C.F.R. § 3483.1(a)(1) (1984)). For LMUs containing a pre-FCLAA lease which has not been readjusted after August 4, 1976, prior to LMU approval, the diligent development period begins on the effective approval date of the LMU. (43 C.F.R. § 3480.0-5(13)(ii)(A) (1984)). For LMUs without such a lease, the diligent development period begins on the effective date of the most recent federal lease issuance or readjustment prior to LMU approval. (43 C.F.R. § 3480.0-5(13)(ii)(B) (1984)).

2. After achieving diligent development an LMU must maintain continued operation for every continued operation year thereafter. (43 C.F.R. § 3483.1(a)(2) (1984)). The condition of continued operation may be suspended upon application if it is determined to be in the public interest. (43 C.F.R. § 3483.3(a) (1984)).

a. That condition may be suspended when operations are interrupted by strikes, the elements, or casualties not attributable
to the operator. (43 C.F.R. § 3483.3(a)(1) (1984)).

b. It may be suspended upon payment of advance royalty. (43 C.F.R. § 3483.3(a)(2) (1984)). The amount of advance royalty must be equal to the production royalty (8 percent if the coal is mined by underground operations; 12-1/2 percent if it is mined by other means) due on production of one percent of the federal LMU recoverable coal reserves. (43 C.F.R. § 3483.4(c) (1984)). This option may be exercised for no more than ten years. Periods of payment of advance royalty on individual leases in the LMU prior to their inclusion in the LMU are not considered in calculating the ten-year period. (43 C.F.R. § 3483.4(d) (1984)). Advance royalties may be credited against production royalties during the initial twenty year term of the LMU, and advance royalties paid on leases in their initial term prior to inclusion in the LMU may also be credited against LMU production royalties to the extent they were not
previously credited against lease production royalties. (43 C.F.R. § 3483.4(f) (1984)).

3. The authorized officer may also suspend the requirement of continued operation in the interest of conservation. (30 U.S.C. § 209; 43 C.F.R. § 3483.3(b) (1984)). In that instance all terms and conditions of the LMU, including rental and royalty payments and excepting the diligent development period, are also suspended. (43 C.F.R. § 3483.3(b)(1) (1984)).

4. Production anywhere within the LMU of either federal or nonfederal coal reserves applies toward satisfaction of the conditions of diligent development and continued operation. (43 C.F.R. § 3483.6(a) (1984)). Any production credited to a federal lease prior to its inclusion in an LMU also applies toward diligent development for the LMU. (43 C.F.R. § 3483.5(g) (1984)).

5. Operators of LMUs also are required to file plans for resource recovery and protection within three years of approval of the LMU. (43 C.F.R. § 3487.1(e)(1) (1984)).
a. That period may be extended if the Secretary determines it is in the public interest. Interruptions of operations by strikes, the elements, or casualties not attributable to the operator are events authorizing extension. (43 C.F.R. § 3483.3(a)(1) (1984)).

6. Any federal lease included in an LMU is subject to the diligence requirements imposed on the LMU in lieu of those that would apply to the lease individually. (43 C.F.R. §§ 3475.6(b), 3483.1(c), 3487.1(b), (e)(4) (1984)).

7. An additional diligence requirement applies to LMUs. The reserves of an LMU must be mined within a period established by the Secretary which is not more than 40 years. (30 U.S.C. § 202(a)(3); 43 C.F.R. § 3487.1(e)(6) (1984)).

D. In order to qualify for new leases under Section 3 of the FCLAA, a prospective lessee which already has federal coal leases, or which has an affiliate or a subsidiary, is controlled by, or is under common control with an entity holding federal coal leases, must meet a separate diligence requirement. Those federal coal leases which the prospec-
tive lessee or its related entity holds and has held for ten years must be producing coal in commercial quantities. (30 U.S.C. § 201(a)(2)(A); 43 C.F.R. § 3472.1-2(e) (1984)).

1. "Producing coal in commercial quantities" is not yet defined by regulation.

2. The Bureau of Land Management proposes to use the definition of commercial quantities used for the Section 6 diligence standards, namely one percent of recoverable coal reserves, in this situation as well. (50 Fed. Reg. 6398, 6399 (1985)).

3. The proposed definition of producing, however, is considerably more complicated. The Bureau proposes to use a moving 10-year bracket, which begins on various dates depending upon the type of lease, to determine whether the lease is producing as required. These dates are:
   a. the date of lease issuance for leases issued after August 4, 1976;
   b. the date of first lease readjustment for pre-FCLAA leases which were first readjusted after August 4, 1976;
c. the date production began for pre-FCLAA leases which have not been readjusted after August 4, 1976 and which began production after August 4, 1976;
d. the date ten years prior to the date on which a new lease is sought for pre-FCLAA leases which have not been readjusted after August 4, 1976 and which began production prior to August 4, 1976.

(50 Fed. Reg. 6398, 6402-04 (1985)).

4. A nonproducing lease included in a producing LMU does not prohibit the lessee, or any affiliate, from qualifying for another federal lease after August 4, 1986. (50 Fed. Reg. 6398, 6404 (1985)).

5. Nonproducing leases, or leases in nonproducing LMUs, which are under suspension because of force majeure strikes, the elements, or casualties not attributable to the operator/lessee), payment of advance royalty in lieu of continued operation, or a suspension under 30 U.S.C. § 209 do not prohibit the lessee, or any affiliate, from qualifying for another federal lease after August 4, 1986. (50 Fed. Reg. 6398, 6404-05 (1985)).
III. Penalties for Lack of Diligence

A. Section 6(a) of the FCLAA requires termination of leases which fail to meet the diligence requirements of that Section.

A coal lease shall be for a term of twenty years and for so long thereafter as coal is produced annually in commercial quantities from that lease. Any lease which is not producing in commercial quantities at the end of ten years shall be terminated.

(30 U.S.C. § 207(a)).

1. There is no question that any federal coal lease issued after enactment of the FCLAA on August 4, 1976 which is not producing in commercial quantities ten years after the lease effective date will be terminated.

(43 C.F.R. §§ 3483.1(a), 3483.2(a) (1984)).

2. Termination of leases for failure to achieve diligent development also applies to pre-FCLAA leases ten years after election by the operator/lessee to be subject to the FCLAA, or the first lease readjustment after August 4, 1976. (43 C.F.R. §§ 3483.1(b)(1), (2), 3483.2(a) (1984)). Upon readjustment the lease will be made subject to the conditions of diligent development and continued operation in Section 6 of the FCLAA. (43 C.F.R. § 3483.1(c) (1984)).
3. Leases which do not maintain continued operation or fail to submit a resource recovery and operation plan are subject to cancellation. (43 C.F.R. § 3483.2(c), (d) (1984)).

4. Similar penalties apply to LMUs which do not meet diligence requirements. (43 C.F.R. §§ 3483.1(a)(1), (2), 3483.2(a), (d) (1984)). If an LMU is terminated for failure to achieve diligent development, the federal leases in it are subject to the diligence requirements that would have applied if they had not been in the LMU. (43 C.F.R. § 3483.2(b) (1984)). Production from the LMU cannot be prorated among the individual leases once the LMU terminates, so each lease must meet the diligence requirements on its own. (47 Fed. Reg. 33114, 33170 (1982)).

B. Section 3 of the FCLAA disqualifies those with certain nonproducing leases from applying for new leases. It provides that:

The Secretary shall not issue a lease or leases under the terms of this Act to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or
leases issued by the United States to coal deposits and has held such lease or leases for a period of ten years when such entity is not, except as provided for in section 207(b) of this Act, producing coal from the lease deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to the date of enactment of the Federal Coal Leasing Amendments Act of 1975 [August 4, 1976,] shall not be counted.


1. Neither the statute nor the regulation makes any distinction between pre-FCLAA leases and post-FCLAA leases for purposes of application of the Section 3 disqualification to lease. Based upon the legislative history, this lack of distinction was intentional and designed to provide an incentive to lessees with pre-FCLAA leases to bring their holdings into production.

The problems of speculation are addressed directly by H.R. 6721, which requires termination of any lease which is not producing in commercial quantities at the end of [10] years. Old leases (those existing on the date of enactment of the 1975 Act) would be exempt from this provision, except to the extent it might be made applicable upon
readjustment of lease terms, but the lessees would be prohibited from acquiring any new Federal leases should they continue to hold old leases ten years after enactment without producing therefrom.


2. The ten-year period in Section 3 is separate and independent of the ten-year diligent development period required by Section 6. The Section 3 period began on August 4, 1976, the date of enactment of the FCLAA, and that Section's penalty will apply on August 4, 1986, ten years after enactment of the FCLAA. (43 C.F.R. § 3472.1-2(e) (1984). See also H.R. Rep. No. 94-681 at 22).

3. Section 3 provides for exceptions to the August 4, 1986 deadline, but under current Interior regulations, none applies when the company seeking additional leases, or its affiliate, subsidiary or other entity under common control, has held a coal lease for ten years which is not producing coal in commercial quantities and still holds that lease on August 4, 1986. The exceptions are limited
to leases which have achieved diligent
development and are subject only to the con-
dition of continued operation.

a. Prior Interior regulations had adopted a
construction that the exception for
"strikes, the elements, or casualties not
attributable to the operator/lessee" in
30 U.S.C. § 207(b) tolled the ten-year
period under Section 3 for all pre-FCLAA
leases, even for those which had not
achieved diligent development by August 4,
1986. (43 C.F.R. §§ 3472.1-2(e),
3475.4(b) (1980)).

b. Current regulations, however, preclude
such a construction and limit the excep-
tion to those leases which have achieved
diligent development and are then subject
only to the condition of continued opera-
tion. (43 C.F.R. §§ 3472.1-2(e), 3483.4
(1984)).

c. The recent publication of the draft
proposed guidelines for administration of
Section 3 contains language which may
indicate the Bureau of Land Management is
considering force majeure suspensions for
leases subject to the FCLAA requirement of diligent development but which are not yet subject to the condition of continued operation.

After a lease or LMU is subject to either diligent development or continued operation, Section 2(a)(2)(A) may be satisfied by a force majeure suspension (strikes, the elements, or casualties not attributable to the lessee) if approved by the Secretary.

(50 Fed. Reg. 6398, 6404 (1985)).

4. The Bureau is also considering regulations to further determine what is an affiliate under the Section 3 lease disqualification provision. (50 Fed. Reg. 6398, 6400 (1985)).

5. The Section 3 prohibition does not apply to modifications of leases to add acreage or reserves to a lease because application of this Section in that situation could result in the bypass of coal. (50 Fed. Reg. 6398, 6405 (1985)).

IV. Interim Solutions for Compliance with Diligence Requirements

A. Inclusion of a nonproducing lease in a logical mining unit (LMU) may have the effect of extending
the period in which a particular lease must be
developed under Section 6 of the FCLAA.

1. If a pre-FCLAA lease which was readjusted after
August 4, 1976 and/or a post-FCLAA lease are
included in an LMU that does not contain a pre-
FCLAA lease which has not been readjusted after
August 4, 1976, the ten-year diligent development
period begins on the effective date of the most
recent lease readjustment or issuance. (43 C.F.R.
§ 3480.0-5(a)(13)(ii)(B)(1984)). For example, if
a lease issued on March 1, 1960 and readjusted on
March 1, 1980 is combined in an LMU with a lease
readjusted on June 1, 1982 or a lease issued on
June 1, 1982, the ten-year diligent development
period for the LMU begins on June 1, 1982. That
adds more than two years to the time in which the
lease originally issued in 1960 must be
developed. (43 C.F.R. § 3480.05(a)(13)(ii)(B)
(1984); 47 Fed. Reg. 33114, 33157-58 (1982)).

2. Inclusion in an LMU does not benefit pre-FCLAA
leases which have not been readjusted.

a. To include such a lease in an LMU, a
lessee necessarily elects to subject it to
the FCLAA diligence requirements which
otherwise would not be imposed until
readjustment. (43 C.F.R. § 3487.1(b),
(e)(4) (1984)).

b. Inclusion in an LMU effectively shortens the period of time in which these leases must achieve diligent development. For example, a May 15, 1968 lease and an April 1, 1974 lease are included in an LMU approved June 10, 1985. The LMU diligent development period begins on the LMU approval date, June 10, 1985, and ends on June 10, 1995. If the leases were not included in such an LMU they would be readjusted on May 15, 1988 and on April 1, 1994, respectively, at which times their ten year diligent development periods would begin. (43 C.F.R. § 3480.0-5(a)(13)(ii)(A) (1984); 47 Fed. Reg. 33114, 33157-58 (1982)).

3. There are disadvantages to formation of an LMU.

a. After coal has been produced from the LMU, the 40-year period in which the LMU's recoverable coal reserves must be exhausted begins. (43 C.F.R. § 3487.1(e)(6) (1984)).
b. If the LMU fails to achieve diligent development and is terminated, the leases in that LMU are individually subject to the diligent development and continued operation requirements which would have applied if the leases had never been included in an LMU. (43 C.F.R. § 3483.2(a), (b) (1984)).

c. Production from an LMU cannot be prorated among the individual leases after the LMU terminates, so then each lease must meet the diligent development and continued operation requirements on its own or be terminated. (47 Fed. Reg. 33114, 33170 (1982)).

B. Sale or exchange of the entire interest in a pre-FCLAA lease which is not producing in commercial quantities to an unrelated entity in an arms-length transaction will relieve the holder of that lease of the Section 3 disqualification from acquisition of new leases. Relinquishment of the entire interest in such a lease will also avoid application of the Section 3 disqualification.

1. The company assigning, exchanging, or relinquishing a nonproducing pre-FCLAA lease
which it holds and will have held for ten years on August 4, 1986 becomes eligible to acquire future leases. (Letter to Sen. John Warner, Chairman, Subcommittee on Energy and Mineral Resources, from Legislative Council, Interior Department, dated December 2, 1983).

2. The company acquiring the nonproducing pre-FCLAA lease does not thereby become subject to the Section 3 disqualification because it will not have held the nonproducing lease for ten years on August 4, 1986. It, however, does not necessarily have a full ten-year period to achieve diligent development of the assigned lease. If that lease has been readjusted, the assignee has the number of years remaining of the ten-year period beginning on the readjustment date to achieve diligent development. If that lease has not been readjusted, the assignee will have ten years from the readjustment date to achieve diligent development. Lease assignment does not affect the diligent development requirement of Section 6 of the FCLAA. (Letter to Sen. John Warner, Chairman, Subcommittee on Energy and Mineral Resources, from Legislative Council, Interior
Department, dated December 2, 1983. See also 50 Fed. Reg. 6398, 6405 (1985)).

3. Such a transfer can be made to any company meeting the requirements for coal lease applicants. Prior to August 4, 1986, there is no limitation on assignments to companies holding nonproducing leases which they have held for ten years. After that date, the Section 3 disqualification applies to assignments of old leases as well as to issuance of new leases. (43 C.F.R. §§ 3453.1(a), 3472.1-2(e) (1984)).

4. The Bureau of Land Management is considering the policy implications of approving assignments to avoid the prohibition of Section 3 and has solicited public comment on that issue. (50 Fed. Reg. 6398, 6399 (1985)).

V. Problems Created by the Diligence Provisions of the FCLAA

A. The definition of diligent development is unrealistic because it ignores the logistics of mine development which typically requires nine years or more. It also makes no provision for unexpected fluctuations in coal markets or other

B. The ten year period for diligent development may also encourage lease holders to initiate coal development prematurely rather than relinquish the lease. This may artificially stimulate excessive coal production by overriding market incentives to delay production. Conservation of federal coal reserves may be impaired as a result. In the long run, this also may raise costs to coal users. (Linowes Commission Report, pp. 294-95).

C. The penalty of lease termination for failure to achieve diligent development in conjunction with the unrealistic definition of that condition may deter bidder competition and reduce the prices bid for federal coal leases. (Linowes Commission Report, pp. 169, 295).

D. Diligence requirements make it difficult to rely on competitive market mechanisms. Competition requires that more reserves be leased than need to be produced within ten years. This permits a more efficient selection of sites to be mined than if the government selects them. That efficiency should reduce the price of coal to users. More
leasing, however, conflicts with the goal of diligence requirements to produce all coal within a short specified period. (Linowes Commission Report, p. 296).

E. The selection of a ten year period to achieve a certain amount of production will lead to arbitrary and capricious lease termination in that a lease achieving diligent development in nine years continues, but one that would not achieve it until after eleven years would be cancelled. (Linowes Commission Report, pp. 296-97).

F. There has been considerable discussion whether the Section 3 disqualification is limited to applications for coal leases or extends to applications for any mineral lease issued under the authority of the Mineral Leasing Act of 1920.

1. Research memoranda prepared by the Department of the Interior Solicitor's Office and the American Petroleum Institute in 1980 concluded that the Section 3 disqualification could be interpreted to prohibit issuance of mineral leases under the Mineral Leasing Act of 1920 to any person, association, or corporation which either holds and has held for ten years a nonproducing coal lease in its own right or
is a subsidiary, affiliate, or person controlled by or under common control of such a person, association, or corporation. This construction depends upon a conclusion that "this Act" as used in the FCLAA refers to the Mineral Leasing Act. Others construe Section 3 in this manner as well. (See Linowes Commission Report, p. 302; 131 Cong. Rec. 2500 (March 5, 1985) (comments of Sen. Wallop); 131 Cong. Rec. 941 (Jan. 31, 1985) (comments of Sen. Johnston)).

2. The Section 3 disqualification more likely only applies to coal leases.

a. Examination of the context in which the Section 3 disqualification appears indicates that it is limited to coal leases. It is one of several provisions in 30 U.S.C. § 201(a) that create conditions precedent to the issuance of coal leases. These include, preparation of a comprehensive land use plan, consideration of the effects of issuing such a lease on local communities, notification of the proposed offering in the county in which the land is situated, and consultation with public entities.

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b. A broad interpretation of the Section 3 disqualification is also inconsistent with the structure of the Mineral Leasing Act. That Act is divided into "general provisions" which apply to all leases issued under that Act (30 U.S.C. §§ 181-193(2)) and "specific provisions" which apply to leases of particular minerals. (30 U.S.C §§ 201-209 (coal)). Section 3 of the FCLAA expressly amends Section 2(a) of the Mineral Leasing Act, which pertains only to coal leasing requirements, and only appears as part of 30 U.S.C. § 201(a). In the case of those sections of the FCLAA intended to apply to all mineral leases (Sections 9 and 11, for example), Congress amended the general leasing provisions rather than those provisions applicable to specific minerals.

c. The legislative history supports a construction of the Section 3 disqualification as limited to coal leases. All references to the restriction on "new leases" are predicated on the prior use of language referring to coal leases.
d. Construction of the Section 3 disqualification as limited to new coal leases is also supported by contemporaneous interpretation of the Department of Interior. On January 25, 1977, the Department promulgated regulations implementing the FCLAA in part and amending existing rules including those relating to mineral leases other than coal leases. The Department included the Section 3 restriction on new lease acquisition only in the new coal leasing regulations. (42 Fed. Reg. 441 et seq. (1977); 43 C.F.R. § 3525.1(f) (1977)).

e. Present regulations also support this interpretation. The Section 3 restriction appears only in regulations setting out qualifications for applicants or bidders on coal leases. (43 C.F.R. § 3472.1-2(e) (1984) (coal); 43 C.F.R. §§ 3102.1 et seq. (1984) (oil and gas); 43 C.F.R. §§ 3502.1 et seq. (1984) (minerals other than coal)
or oil and gas). See also 47 Fed. Reg. 33114, 33131 (1982) (comments on rule-making for 43 C.F.R. § 3472-1-2(e)).

3. However, uncertainty regarding the scope of the Section 3 disqualification remains, and until a Supreme Court decision or a change in the statute by Congress, coal lessees meeting the criteria of 30 U.S.C. § 201 (a)(2)(A) have some exposure to disqualification from making application for new mineral leases issued under the Mineral Leasing Act.

a. Regulations limiting the Section 3 disqualification to coal leases can be changed.

b. In addition, any oil and gas lease issued by lottery or competitive bidding may be challenged by a disgruntled applicant on the basis that the lessee was unqualified by reason of the Section 3 restriction.

G. The term "producing in commercial quantities" in Section 3 is not clearly defined. That is the standard that leases which a lessee, or its affiliate, holds on August 4, 1986 and which it has held for the prior ten years must meet if the lessee is to be eligible to apply for new leases.
under 30 U.S.C. § 201(a)(2)(A). Obviously, a lessee with such a lease that has never produced coal is disqualified from acquiring future leases under 30 U.S.C. § 201(a)(2)(A). The uncertainty arises where the amount of production is small or production is sporadic.

1. Currently, regulations define commercial quantities only in the context of diligent development and continued operation. (43 C.F.R. § 3480.0-5(a)(6), (8), (12) (1984); 50 Fed. Reg. 6399 (1985)).

2. The Bureau of Land Management has proposed draft guidelines for the proposed administration of the Section 3 disqualification provision and solicited comments on the amount of production and the time over which it must be produced to constitute "producing in commercial quantities." (50 Fed. Reg. 6398 (1985)). These draft guidelines are discussed in more detail at II.D. above.

VI. The perceived purpose of the diligence requirements can be achieved in a less disruptive manner.

A. The purpose of the diligence requirements is to discourage speculative holding of nonproducing
federal coal leases and to encourage good faith
development of those leases by the lessees.

B. Development incentives can be created by provision
for payment of substantial annual advance royalties
for the right to defer development.

C. Such incentives will not be undermined by per­
mitting the Secretary to suspend development
requirements in cases involving loss of market or
events of force majeure. The current ten-year
period in which a lessee must begin mining coal or
lose the lease is arbitrary and unfair in this
respect.

D. The Section 3 disqualification provision is
unnecessary if a provision for payment of sub­
stantial annual advance royalties to defer
development is adopted. Section 3 is likely to
have an uneven effect because it would create
unequal development incentives for different
companies unlike annual advance royalties.

VII. Program for Corrective Action

A. Congressional relief.

   1. In the past, bills to modify the FCLAA,
especially Section 3, have been introduced in
both houses. None of them have met with
success.
2. There are currently two Senate bills to amend the FCLAA, S. 372, introduced by Senator Johnson, and S. 570, introduced by Senator Wallop, pending in the 99th Congress, 1st Session. Both were referred to the Committee on Energy and Natural Resources. Representative Udall is also expected to introduce a bill in the House for this purpose.

3. Both Senate bills address the Section 3 disqualification to lease provision.
   a. S. 372 would expressly limit the application of that Section to coal leases. It also permits lessees subject to that Section's restriction to relinquish non-producing leases for new leases with equivalent estimated reserves, or if the lessee holds no more than two nonproducing pre-FCLAA leases, to pay an additional rental on new leases in lieu of disqualification. In addition, the bill requires the Secretary to accept relinquishment of pre-FCLAA leases where there has not been significant surface disturbance pursuant to a permit issued under Section 506 of the Surface Mining Control and Reclamation Act of 1977.
b. S. 570 would repeal the Section 3 lease disqualification provision.

4. S. 570 proposes to change Section 5 on LMUs.
   a. It deletes the requirement that the leases in the LMU be contiguous.
   b. It deletes the requirement that the reserves of the entire LMU be mined within 40 years.

5. Both Senate bills address the diligence criteria of Section 6 and the provision for lease cancellation for failure to meet them.
   a. Both delete the requirement that production in commercial quantities at the end of the twenty-year primary term is required to hold the lease. S. 372 proposes that the lease continue as long as the condition of continued operation is met. S. 570 proposes that the lease continue as long as the conditions of diligent development and continued operation are met.
   b. Both delete the absolute requirement that a lease attain diligent development, i.e., production in commercial quantities, at the end of ten years or be terminated. In
the alternative, they propose a provision permitting the lessee to elect to relinquish the nonproducing lease or extend it beyond the tenth lease year through payment of annual advance royalties based upon escalating amounts of assumed production through the twentieth lease year.

c. Payment of advance royalties in this manner would satisfy the diligence condition under S. 372's revised Section 3 for issuance of new leases.

d. Only S. 372 addresses the definitions of the diligence requirements. It incorporates the definitions of commercial quantities and diligent development contained in the current Interior regulations. It redefines the diligent development period as ten years beginning on the effective date of lease issuance for all leases, whether issued before or after August 4, 1986. Finally, it reformulates the definition of continued operation, which appears at 43 C.F.R. § 3480.0-5(a)(8), to require production of commer-
cial quantities of recoverable coal reserves in each year following the achievement of diligent development rather than only in each of the first 2 years thereafter.

6. Both Senate bills propose deletion of the three-year deadline for preparation of an operation and reclamation plan.

B. Administrative relief.

1. Interior has already engaged in interpretative rulemaking regarding the Section 3 lease disqualification by including that restriction in only the regulations governing the qualification of applicants for new coal leases. (43 C.F.R. § 3472.1-2(e) (1984)). That alone, however, is insufficient to provide much certainty for a coal lessee as the statute is susceptible to a broader reading.

2. Interior has also proposed guidelines for the administration of the Section 3 lease disqualification provision. (50 Fed. Reg. 6398 (1985)).

3. Affected parties could request Interior to promulgate a specific regulation on the applicability of the Section 3 disqualification and
to support it with a Solicitor's Opinion. That regulation then could be challenged under the process provided by the Administrative Procedure Act. A ruling of the Court of Appeals for the D.C. Circuit on the regulation would be strong authority either that the Section 3 disqualification applied to all new mineral leases or only to coal leases.

C. Judicial Relief

1. An action for a declaratory judgment on the scope of the Section 3 disqualification provision may present standing problems. Until a statute or regulation is construed against a plaintiff, a court may be unwilling to act. That problem is avoided by the rule-making and appeal under the Administrative Procedure Act as described above.

2. In regard to the Section 6 diligence criteria, judicial actions challenging the imposition of those criteria on pre-FCLAA leases at readjustment, apart from those cases where there was a procedural defect in the readjustment, have proceeded on primarily constitutional grounds.