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GETTING THE COAL LEASING PROGRAM BACK ON TRACK: THE LINOWES COMMISSION AND BEYOND

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PUBLIC LANDS AND MINERAL LEASING: ISSUES AND DIRECTIONS

Sponsored by the Natural Resources Law Center,
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STATUTES


I. INTRODUCTION

A. The Commission on Fair Market Value Policy for Federal Coal Leasing — "The Linowes Commission"

1. In July, 1983 Congress directed the Secretary of the Interior to appoint a commission "to review the Department's coal leasing procedures to ensure receipt of fair market values". 1983 Supplemental Appropriations Act, Pub. L. No. 98-63 (1983).

2. Congress directed the Commission to address the following issues:

   a. The methodology for estimating fair market value, including economic valuation methods, pre-sale versus post-sale analysis, and the value of independent and review appraisals.

   b. The impact on competition and achieving fair market value of leasing large amounts of coal, particularly under depressed market conditions, versus a more moderated leasing schedule.
c. Whether the leaseholder should share more in the risk of holding the lease by increasing rental rates, on a regionally adjusted basis.

d. Whether the public should share in the appreciation of the value of its resources by imposing a tax on transfers of surface or lease rights.

e. The methodology for assigning value to maintenance tracts, based on the value of the coal in the ground to the adjoining mine owner rather than as a "competitive" lease tract, when no competitive interest can be expected.

f. Possible methods of increasing competition, such as changing tract delineation methods, requiring meaningful fees to accompany expressions of interest, adopting intertract bidding procedures, or requiring a minimum number of bids in order to have a competitive sale.

g. Methods of evaluating tracts to reflect regional differences in
coal, and establishing cents-per-ton minimums on a regional basis.

h. Whether pre-sale planning procedures are adequate, particularly with regard to land-use planning, public participation, and the role of the Regional Coal Teams in determining the timing and amount of leasing.

i. Methods of carrying out authorized exchanges so as to minimize adverse effects on sales competition.

3. The Commission was created largely in response to the controversy surrounding the 1982 Powder River Basin coal lease sale, in which lands containing an estimated 1.6 billion tons of coal were leased for a total bonus bid value of $67 million.

a. A report by the House Appropriations Committee Staff in April 1983 concluded that the Powder River Basin coal leases were sold for $60 million less than fair market value, due in part to poor economic conditions, a "soft" coal market, and lack of bidding
b. A report by the General Accounting Office (GAO) in May, 1983 concluded that leases were sold for roughly $100 million less than fair market value, due in part to lack of competitive bidding, and recommended that Congress authorize the Department to negotiate lease sales.

4. In its February 1984 report, the Commission made some 36 recommendations to enhance the management of federal coal leasing program and improve the prospects for recovery of fair market value. These recommendations were divided into six major categories:
   a. Coal Leasing Levels
   b. Tract Selection Process
   c. Coal Lease Sales Procedures
   d. Appraisal Methods
   e. Key Statutory and Related Factors
   f. Organization and Management

5. On March 19, 1984 Secretary Clark released Interior's response to the Commission report, in which he accepted and agreed to implement 28 of the 30 recommendations that did not require
action by Congress.

a. Interior rejected Recommendation VI-6, that bidders for federal coal leases should provide confidential data on prices and other terms of private coal transactions to Interior for use in comparability analysis, preferring to rely on voluntary data submittal.

b. Interior rejected Recommendation VII-5, that the base for calculating federal royalty payments should be F.O.B. price minus all state and local severance and similar taxes, as inconsistent with Departmental treatment of other leasable minerals and other costs included in the "value" basis for royalty purposes, and recommended that the issue be studied and addressed by Congress.

c. Proposed guidelines and regulations implementing the recommendations were published for comment in the Federal Register on October 31, and November 1, 1984.

B. Environmental Protection in the Coal Leasing Program - The OTA Report
1. Shortly after creating the Linowes Commission, Congress directed the Office of Technology Assessment (OTA) to assess the federal coal leasing program's "ability to ensure the development of coal leases in an environmentally compatible manner." (H. Rep. No. 98-399, 98th Cong. 1st Sess. p. 22).

2. The OTA report identified 10 policy options that would "help to insure environmental protection and compliance with existing statutory mandates, reduce the environmental risk of leasing decisions, maintain a predictable and stable leasing process, and restore public confidence in the environmental soundness of the leasing program." (OTA Report, p. x).

3. On July 9, 1984, Secretary Clark proposed procedures to respond to OTA's recommendations, primarily by improving data adequacy and decentralizing the decisionmaking process.

C. In February 1985, Interior published a supplemental DEIS on the Federal Coal Management Program. The proposed action would continue the program while incorporating decisions made or proposed in
response to the recommendations of OTA, the Linowes Commission, and Interior’s program review.

II. MAJOR PROGRAM ISSUES AFFECTING THE FUTURE OF FEDERAL COAL LEASING

A. Fair Market Value (FMV) - Definitional problems with fair market value have created confusion and undermined public confidence in the program.

1. FCLAA requirement: "No bid shall be accepted which is less than the fair market value, as determined by the Secretary, of the coal subject to the lease." (30 U.S.C. § 201(a)(1).)
   a. FMV is not defined in FCLAA or legislative history.
   b. Legislative history indicates strong congressional concern with FMV and a belief that FCLAA changes (competitive bidding requirement, rental and royalty rate charges, elimination of preference right leasing) would help ensure a fair return to the public. (S. Rep. No. 94-296, 94th Cong., 1st Sess. (1975); H. Rep. No. 94-681, 94th Cong., 1st Sess. (1975).)

2. The legal standard for fair market value
is found in the relatively well-developed body of case law dealing with taxation and eminent domain, i.e., the amount a hypothetical buyer, willing but not obligated to buy, would pay to a hypothetical seller, willing but not obligated to sell. See, e.g., Olson v. United States, 292 U.S. 246 (1934); United States v. Branch Coal Corp. 285 F. Supp. 514 (E.D. Pa. 1968), aff'd 411 F.2d 601 (3rd Cir. 1964)

a. Administrative agencies routinely determine fair market value in condemnation proceedings:

Under established law the criterion for just compensation is the fair market value of the property at the time of the taking. "Fair market value" is defined as the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would be sold by a knowledgeable owner willing but not obligated to sell to a knowledgeable purchaser who is desired but is not obligated to buy. In ascertaining that figure, consideration should be given to all matters that might be brought forward and reasonably be given substantial weight in bargaining by persons of ordinary prudence, but no consideration whatever should be given to matters not affecting fair market value. (Interagency Land Acquisition Conference, Uniform Appraisal Conference, Uniform Appraisal)
b. "Fair" is generally understood to refer to the market (i.e., lack of compulsion or "fair market conditions"), as well as the method for determining market value and the factors or circumstances to be "fairly" considered (i.e., "market value fairly determined"). (United States v. Miller, 317 U.S. 369 (1943); Olson v. United States, 292 U.S. 246 (1934); Heiner v. Crosby, 24 F.2d 191 (3rd Cir. 1928).)

c. Where there is "no market", assumptions must be made concerning the hypothetical market and factors that would be considered by knowledgeable and willing buyers or sellers.

d. The fair market value standard does not require that the government exploit its near monopoly position in western coal to maximize federal revenues. (California v. Watt, 712 Fed. 2d 584, 606 (D.C. Cir. 1983) (rejecting challenge to OCS oil and gas leasing program based on
assertion that large lease offerings and accelerated rate of leasing reduced lease bids below fair market value, where Secretary relied on competitive bidding and limited post-sale evaluation to assure receipt of fair market value).

e. Interiors failure to receive fair market value in the 1982 Powder River Basin lease sale is being asserted in pending litigation. (National Wildlife Federation v. Burford, Civil No. 82-117 (D. Mont.).)

3. As an economic concept, fair market value is inherently imprecise and changes from time to time to reflect bidders expectations about future coal prices, mining revenues and costs, and developmental risks associated with government regulation or lease terms.

a. Although coal supply markets are generally considered competitive, there are unique problems in applying the concept of market value as determined by a competitive market to federal coal
leasing, (e.g., the extent of federal control of western coal, the 10-year moratorium on coal leasing, the dramatic increase in federal coal royalties, surface owner consent requirements, the 10-year diligence requirement, lack of comparable sales in certain coal regions, lack of competitive bidding for leases - particularly maintenance tracts).

b. From an economic viewpoint, lease rentals and production royalties should be included in determining fair return to the public for coal leases.

4. Recognizing the inherent difficulties in determining fair market value for federal coal leases, the Linowes Commission recommendations focused on improved appraisal methods and program changes needed to increase competition.

B. Leasing Levels - Leasing levels have become the focus of debate regarding both fair market value and environmental protection.

1. While the Linowes commission did not attempt to determine the precise weight the Secretary should give to the impact
of leasing levels on the determination on fair market value, it concluded that this impact could not be disregarded, and recommended:

a. Interior should not seek to raise coal prices above competitive market levels by limiting federal coal leasing, nor should it flood a depressed market. (Recommendation III-3)

b. The quantity of coal leased should be determined so as to achieve a fair return consistent with other policy objectives, such as efficient land use, environmental planning, and conserving coal for the future. (Recommendation III-5)

c. Pending preference right lease applications contribute to uncertainty regarding appropriate leasing levels and processing of PRLA's should be rapidly completed. (Recommendation III-6).

2. OTA concluded that high leasing rates overtaxed the ability of BLM to adequately assess the environmental acceptability of proposed lease tracts, and recommended lower leasing rates to
reduce the probability that environmentally sensitive tracts would be leased.


4. The debate over "leasing for production demand" versus "leasing for reserves" has been revived by the 1985 supplemental DEIS.

C. Data Adequacy and Land Use Plans – Lack of adequate data for coal leasing decisions is perceived to be a major obstacle to an economically and environmentally sound leasing program.

1. The Linowes Commission identified the lack of adequate coal resource data as a problem affecting: a) accuracy of tract delineation, b) Interior's appraisal of fair market value, and c) potential competitive bidding on lease tracts. (Linowes Report, 178).

a. The commission concluded that federally-funded exploration encourages industry interest and
bidding competition for new production lease tracts, and is virtually mandated by FCLAA.

b. The Commission recommended that Interior sponsor more drilling for use in tract delineation and encourage cooperative drilling by industry. (Recommendation IV-2).

2. OTA concluded that the data and analysis supporting land use planning and leasing decisions should be improved to reduce environmental risk and restore public confidence.

a. OTA recommended incorporation of regulatory guidelines and standards for adequacy of presale data and analysis at all stages in the leasing process.

b. OTA also recommended incorporation of a "threshold" concept for estimating cumulative impacts during land use planning, tract ranking, and EIS preparation.

3. The adequacy of land use plans to support federal coal leasing decisions is being challenged in litigation over the 1982 Power River Basin lease sale. (National Wildlife Federation v.
D. Checkerboard Ownership Patterns and Railroad Leasing - The statement over railroad leasing of federal coal and fee coal exchanges by railroads impedes development and affects fair market value for federal coal resources.


2. The Linowes Commission took no position on repeal of Section 2(c), but concluded that steps should be taken to facilitate development of federal coal in railroad checkerboard areas, specifically:
   a. Cooperative leasing procedures should be implemented to enhance competition for fragmented federal coal holdings (Recommendation IV-3);
   b. The exchange of federal and non-federal coal tracts should be pursued in a vigorous but prudent manner to consolidate coal holdings into logical mining units. (Recommendation IV-4).

3. Interior's authority to make fee
exchanges with railroads is being challenged in pending litigation.  
(Northern Plains Resources Council v. Clark, ____)

E. Statutory Problems

1. Diligence - The rigid 10-year diligent development requirement of FCLAA reduces the market value of federal coal leases and may encourage lessees to develop coal leases prematurely.

   a. The Linowes Commission recommended that Congress amend FCLAA § 7 to:

      1) allow a 10-year extension for post-1976 leases by payment of escalating advance royalties,  
         (Recommendation VII-7) and

      2) require payment of advance royalties to maintain pre-1976 leases for 10 years beyond lease readjustment.  
         (Recommendation VII-2)

   b. Requiring advance royalties or escalating "incentive" rentals on pre-1976 leases would eliminate the
need for FCLAA's § 3 diligence provision (which disqualifies holders of nonproducing federal coal leases from acquiring new mineral leases under the 1920 Mineral Leasing Act after 1986.)

c. Congress is currently considering a number of bills that would change the diligence provisions of FCLAA § 3 and § 7.

2. Royalty Rates - FCLAA's mandated minimum royalty of 12½ percent on all surface mined coal may not be appropriate for all coal regions.

a. The Linowes Commission recommended that Congress consider giving the Secretary administrative discretion to reduce federal royalty rates prior to a lease sale, where current royalty rates would have adverse effects on resource production. (Recommendation VII-4).

b. In some regions, federal royalty rates exceed competitive royalties on private and state coal leases, resulting in reduced competition and lower bids for federal coal leases.
c. Variable royalty rates can cause economic inefficiencies in coal production patterns.

d. The Secretary has authority to reduce royalty rates on existing leases "for the purpose of encouraging the greatest ultimate recovery of coal" and "in the interest of conservation of natural resources" under certain circumstances. (30 U.S.C. 209)

3. Surface Owner Consent - Legislative changes are needed to reduce uncertainty and assure fair market value for federal coal leases.

a. The Surface Mining Control and Reclamation Act of 1977 (SMCRA) requires written surface owner consent by qualified surface owners prior to lease of federal reserved coal. 30 U.S.C. § 1304(c).

b. The Linowes Commission concluded that substantial payments for surface owner consent have the effect of depressing bids for federal coal. (Linowes Report, 312)
c. The Commission recommended that Congress reexamine the need for limitations on payments to surface owners. (Recommendation VII-3)

4. Negotiated Sales - Due to lack of competition and comparable sales for "captive" maintenance and bypass lease tracts, Interior should have authority to negotiate lease sales in limited circumstances.

a. FCLAA requires that federal coal leases be awarded by competitive bidding. (30 U.S.C. § 201(a)(1).)


c. The Linowes Commission recommended that where reasonable efforts to obtain competitive bids fail, Interior should have authority to negotiate a fair price. (Recommendation V-6).
III. RELATED POLICY ISSUES AFFECTING THE FUTURE OF COAL LEASING

A. Energy Policy and Demand Forecasts - The uncertainty of demand forecasts for coal, particularly western coal, complicates any attempt to establish federal leasing levels.

1. Factors affecting the uncertainty of coal projections include economic growth rates, conservation trends, world oil prices, coal transportation rates, acid rain legislation, and synthetic fuels development. (See, e.g., Energy Outlook)

a. The demand for coal is largely a function of electricity demand, since 85% of domestic coal use is for electricity generation, amounting to 53% of total electrical generation.

b. While coal is our most abundant fossil fuel, representing 85% of total U.S. fossil fuel reserves, it provided only 23% of U.S. energy consumption in 1984.

c. Coal is the least expensive fossil fuel on a BTU-equivalent basis.

d. Assumptions regarding world oil prices and economic growth rates
affect coal demand forecasts.

1. Low oil prices stimulate economic growth and demand for electricity.

2. The importance of oil prices to electricity demand outweighs the effect of substituting coal for oil when prices are high.

3. EIA expects oil prices to increase gradually from $28 per barrel to $40 per barrel ($1984) in 1995, which is below the 1980 price in real terms.

4. By 1995, net oil imports are expected to be double the 1983 level, or about the same as 1978 levels.

2. Total coal production is expected to grow at an annual rate of 3.6% over the next 10 years, from 900 million tons in 1985 to 1.2 billion tons in 1995. (See attached Table 1).

   a. The 322 ton-per-year increase is nearly evenly divided between east and west, although the percentage increase is higher for the west.

   -25-
b. DOI forecasts show no significant differences in total or regional coal production between its proposed action (i.e., continued federal coal leasing) and the no action alternative (no new federal leasing) at medium production levels. (DEIS, 90)

3. Foreign coal imports may pose a threat to expanded domestic coal production. (U.S. Dept. of Commerce, Potential for U.S. Steam Coal Imports (April 1985).)

a. Coal from Columbia, Canada, Australia, Poland and South Africa can be delivered to U.S. utilities at lower prices than many U.S. coals.

b. The potential for displacement of domestic coal production by 1990 ranges from 6.4 million tons to 40 million tons, with a most likely limit of 17.7 million tons.

c. The impact of imports could be greatest for Wyoming and Montana (9.8 of the 17.7 million tons), where subbituminous coals can be displaced by Columbian coal with equally low sulfur but a higher
heat content.

d. The number of jobs displaced by coal imports ranges from 1120 to 2780.

B. "Acid Rain" Legislation - Proposed legislation for control of sulfur dioxide \((SO_2)\) emissions from power plants could result in shifts in regional coal production.


a. A trust fund generated by a fee of 1 mill per kilowatt hour on non-nuclear generated electricity would be used to reimburse 90 percent of capital expenditures for scrubber retrofit of 50 largest emitters.

b. By mandating retrofit scrubbers, this approach minimizes regional shifts in coal production and employment.

c. Analysis by DOE indicates the bill would increase western coal production by 23 million tons and reduce eastern coal production by 2 million tons in 1995. Increased

2. Under a "cost effective equivalent" strategy, decreases in high-sulfur coal production in Northern Appalachia and the Midwest of 74 million tons per year would be offset by increases in low sulfur coal from Central Appalachia for a net gain of 43 million tons; while western coal production increases by 427 million tons. (ICF Inc., Analysis of the Waxman-Sikorski Sulfur Dioxide Emission Reduction Bill (H.R. 3400) (April 1984).)

3. Fuel switching to low-sulfur coal under a least-cost approach is very sensitive to rail transportation rates. (EIA, Imports of Proposed Clean Air Act Amendments of 1982 on the Coal and Electric Utility Industries (June 1983).)
C. Transportation Issues - Increased rail rates under deregulation and defeat of eminent domain legislation for coal slurry pipelines have reduced the competitiveness of western coal.

1. Delivered coal prices (in real terms) to utilities increased by about 17 percent over the past 10 years, primarily due to transportation rates, as real mine mouth prices decreased. (Energy Outlook)

2. The Linowes Commission recommended that Congress consider instituting a review to assess whether shippers of federal coal are adequately protected from anti-competitive or discriminatory practices. (Recommendation VII-6).

3. A recent analysis indicates that coal users could save between $200 million and $1 billion in 1995 if four slurry pipelines were built. EIA, Coal Slurry Pipelines: Impact on Coal Markets (April 1985).

a. Only minor shifts in regional coal production would occur.

b. Although railroad revenues would be reduced by 8%, railroad revenues
from coal hauling would still be
one half to two-thirds greater than
those of 1984.

4. ICC recently suffered a setback to its
railroad deregulation efforts when
decisions deregulating coal exports and
joint boxcar rates were overturned.
(ICC v. Coal Exporters Ass'n, 745 F.2d
76 (1984), cert. denied, ___ S. Ct.
___ April 29, 1985); ICC v. Brae Corp.,
740 F.2d 1023 (1984), cert. denied, ___
S. Ct. ___ (April 29, 1985).)

5. The current view of market dominance
gives little protection to shippers.
(E.g., Western Coal Traffic League v.
United States, 719 F.2d 772 (5th Cir.
1983), cert. denied, 104 S. Ct. 2160
(1984).)

6. Two different legislative approaches are
being pursued by shippers in Congress:

a. Reregulation by I.C.C. of rail
rates under certain circumstances
(e.g., "CURE" proposal).

b. Trackage rights and antitrust
amendments (Railroad Antimonopoly
Act of 1985, S. 447 & H.R. 1140)

D. Research & Development Policies and
Commercialization of Clean Coal Technologies
1. "Clean Coal Initiatives" - In 1984 Congress directed the Secretary of Energy to solicit proposals for projects employing emerging clean coal technologies, and report to Congress on DOE's assessment of each technology and "the extent to which federal incentives, including financial assistance, will accelerate the commercial availability of these technologies." (Pub. L. No. 98-476, 98 Stat. 1874).

   a. While no funds were appropriated to DOE, Congress indicated an intent to base FY 1986 funding decisions on the report.

   b. DOE evaluated 175 responses from 28 states involving flue gas cleanup, fluidized bed combustion, gasification, liquefaction, combined cycle turbines, etc.

   c. DOE concluded that federal incentives are unnecessary and could adversely affect free market forces, which "are operating to select and commercialize the most efficient and environmentally effective technologies." (U.S. Dept. of Energy, Report to Congress
2. Industry and other groups have supported government cost-sharing amounting to $750 million over the next five years to close the "technology gap" in commercialization efforts.

3. Synthetic Fuels Corporation (SFC) remains moribund, and SFC funded projects are facing financial and technical difficulties (See, e.g., GAO, Financial Status of the Great Plains Coal Gasification Project (February 21, 1985).

E. National Coal Council

1. Then-Secretary of Energy Don Hodel established the National Coal Council in October 1984 to provide recommendations to the executive branch on government-industry cooperation in coal-related matters.

2. The Coal Council is patterned after the National Petroleum Council established in 1946.

3. A total of 113 charter members have been appointed, with former Virginia Governor John N. Dalton serving as Chairman Pro Tempore.
V. CONCLUSION

A. Legislative changes recommended by the Linowes Commission are needed to increase competition, assure receipt of fair market value, and improve the efficiency of the coal leasing program.

B. Recent and proposed program change should satisfy most program critics, although ideological differences and east/west politics will remain.

C. The future of federal coal leasing will be influenced by related federal policy issues such as transportation regulation, coal imports, acid rain legislation, and R&D policy.
## Table 1. Coal Production Forecasts

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1. Medium Forecast DOI, DEIS (February 1985).
3. Data Resources Inc.