**CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE**

September 14, 2000

S. 1950
Powder River Basin Resource Development Act of 2000

As ordered reported by the Senate Committee on Energy and Natural Resources on June 7, 2000

SUMMARY

S. 1950 would establish a process for resolving disputes over the development of coal and coalbed methane in cases where the rights to develop those resources underlying the same piece of land are owned by different parties. The bill would apply only to certain disputes within the Powder River Basin, located in Wyoming and Montana and depicted on a map identified in the bill. CBO estimates that enacting this legislation would reduce offsetting receipts from royalties on federal resources by at least $13 million over the 2001-2010 period. Because the bill would affect direct spending (including offsetting receipts), pay-as-you-go procedures would apply.

S. 1950 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). The bill could benefit the states of Wyoming and Montana and some tribal governments within those states if the process for resolving disputes allows for the timely development of coal, oil, and gas resources, thereby protecting, and possibly increasing, revenues collected by those governments. Enactment of this legislation would have no impact on the budgets of other state, local, and tribal governments.

S. 1950 would impose a private-sector mandate as defined by UMRA on certain developers of mineral resources involved in disputes over the sequence of coal and oil or gas development in the Powder River Basin. CBO estimates that the cost of complying with the mandate would be well below the threshold established by UMRA ($109 million in 2000, adjusted annually for inflation) for any of the first five years that the mandate is in effect.

BACKGROUND

In the Powder River Basin, as in many parts of the west, ownership of the subsurface estate is split: the coal estate, oil and gas estate, and hardrock mineral estate may all be separately owned. Thus, conflicts may arise when overlapping rights to develop those resources are owned by different parties. Historically, lessees of coal rights and lessees of oil and gas rights have been able to develop both resources without significant loss of either resource because traditional oil and gas deposits lie far below the coal resources.

In the past several years conflicts have developed, however, between those who own the right to develop coal resources and those who own the right to develop oil and gas resources, including coalbed methane, underlying the same piece of land. These conflicts mostly concern a recent increase in oil and gas producers' interest in developing coalbed methane, a type of natural gas that is found within coal reserves. Coal and coalbed methane cannot be produced simultaneously, and initial development of one resource can make recovery of the other more expensive, or even impossible.

In response to these types of conflicts between federal lessees, the Bureau of Land Management (BLM) developed a policy, in February 2000, aimed at optimizing the development of both resources. Historically, conflicts between federal lessees tended to be resolved by allowing the lessee with the older lease to proceed with production ahead of the junior lease. In the Powder River Basin, such a policy would tend to favor oil and gas, and hence, coalbed methane producers, whose leases were issued before many federal coal leases. Under BLM's new policy, however, the agency uses its authority under existing law and lease terms to require the optimal sequential recovery of coalbed methane and coal.

MAJOR PROVISIONS

S. 1950 would establish a process for resolving disputes over the development of coal and coalbed methane in cases where the rights to develop those resources underlying the same land are owned by different parties. The bill would apply only to disputes that occur in "common areas" within the Powder River Basin as defined by the bill.

Under S. 1950, coal and oil and gas developers within common areas would be required, at least 240 days prior to the date when their operations are expected to intersect, to notify each other and the Secretary of the Interior of the anticipated conflict. If the parties cannot negotiate a voluntary agreement to settle the conflict, either party could file a petition asking the U.S. District Court to resolve it. The Secretary of the Interior would have 90 days to recommend to the court whether either lease should be suspended to allow production under the other lease to proceed. Within 90 days of receiving the Secretary's recommendations, the District Court would review any objections to those recommendations and, if necessary, issue an order to suspend any federal or nonfederal lease. S. 1950 would require the Secretary and the District Court to make such decisions on the basis of maximizing the net present value of the federal and state income from royalties and severance taxes that would be generated from the production of both resources.

Once the District Court orders or confirms an initial suspension of a lease, S. 1950 would require the court, within 210 days, to determine the amount of compensation to be awarded to the lessee (and all other owners of any interest in the resource) whose lease is suspended or terminated. A panel of experts would advise the court on that amount, which would be based on the amount of net income that would be forgone by owners of any interest in the resource whose production would be delayed as well as the amount of any unavoidable fixed costs incurred by those parties. Decisions regarding compensation awards would be subject to appeal. Under the bill, compensation costs must be paid by the lessee who is permitted to proceed to develop a resource within 62 months of the court order to pay such costs.

S. 1950 would allow certain federal lessees who are ordered by the court to pay compensation to credit such compensation costs against federal royalty payments that would otherwise be due under current law. That provision of the bill also would apply to federal lessees who must pay compensation costs pursuant to certain voluntarily negotiated settlement agreements ratified by BLM on or after September 1, 1999. The royalty credit provision would apply only to conflicts involving federally owned resources that occur within areas identified in the bill.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

For this estimate, CBO assumes that S. 1950 will be enacted near the start of fiscal year 2001. The estimated budgetary impact of S. 1950 on direct spending is shown in the following table. The legislation also would affect spending subject to appropriation, but CBO estimates that any such changes would be less than $500,000 a year. The costs of this legislation fall within budget function 300 (natural resources and environment).

	By Fiscal Year, in Millions of Dollars				
	2001	2002	2003	2004	2005
CHANGES IN DIRECT SPENDING [a]					
Estimated Budget Authority	3	4	1	2	2
Estimated Outlays	3	4	1	2	2

a. Implementing S. 1950 also would increase discretionary spending by less than $500,000 a year to conduct the new dispute resolution process.

BASIS OF ESTIMATE

CBO estimates that allowing certain federal lessees to credit their compensation costs against federal royalty payments would reduce federal receipts from those payments. The provisions allowing for royalty credits to pay compensation costs in S. 1950 would apply to a major settlement agreement between a coal operator and an oil and gas operator that has already been resolved. Based on information from BLM and parties to that agreement, CBO estimates that enactment of the bill would allow the operator to claim royalty credits amounting to about $13 million over the 2001-2006 period.

Forgone royalty payments under S. 1950 could be higher over the next 10 years if additional disputes arise between different resource developers, and more compensation costs must be paid. However, the cost of any future compensation paid through royalty credits could be at least partially offset, on a net present value basis, by an increase in receipts from bonus bids paid by companies to secure new leases for federal resources. According to BLM and industry experts, there is considerable uncertainty regarding the number of disputes that may occur in the future. Hence, CBO has no basis for predicting the amount of compensation that may be ordered to be paid in the future, or the effect this might have on bonus bids for land that has not yet been leased.

Royalty Payments and Compensation Credits

Under current law, when federally owned resources are produced, the federal government collects royalty payments from those who lease the right to develop those resources. States generally receive about 50 percent of those receipts. S. 1950 would allow certain federal lessees to take as a credit against royalties due to the federal government the costs of compensation pursuant to a court order issued under S. 1950 or a settlement agreement approved by BLM on or after September 1, 1999. That provision would apply only to conflicts between federal lessees operating within lands referenced in the bill. S. 1950 provides that subsequent payments to states would not be reduced as a result of that provision.

Under S. 1950, certain producers that already have paid bonus bids to secure leases for federal resources within the Powder River Basin could qualify for credits against federal royalty payments. CBO estimates that allowing those lessees to credit their compensation costs against federal royalties would result in forgone offsetting receipts totaling at least $13 million over the 2001-2010 period. That amount is based on information provided by parties to one major recently negotiated settlement agreement that would be included under the royalty credit provisions in S. 1950. Under that agreement, we estimate that the amount of compensation costs that could be credited against royalty payments would be about $3 million in 2001, and $10 million over the 2002-2006 period.

The total amount of forgone receipts from S. 1950's royalty credit provision could be greater depending on whether other eligible settlement agreements or court orders involving existing or future federal leases occur. Because any such effects depend on the outcome of court proceedings or negotiations involving nonfederal parties, CBO cannot estimate the timing or magnitude of any additional forgone receipts under S. 1950. Although the number of conflicts that might occur is uncertain, we expect that, on average, there would be a couple such conflicts each year. Based on information from BLM and industry representatives, we expect that few, if any, of those conflicts would result in compensation costs as large as those that resulted from the settlement agreement referenced above. Other recent settlement agreements in the region have involved compensation payments of less than $1 million.

Bonus Bids

CBO estimates that allowing some federal lessees to take royalty credits could affect bonus bids paid by producers to secure new leases for federal resources, particularly for coal. A bonus bid reflects a company’s willingness to pay for the right to develop a federal resource, based on the estimated net present value of that lease to that company. Under current law, coal companies typically take the estimated cost of resolving conflicts with oil and gas producers that may arise into consideration when preparing bonus bids. We expect that allowing certain producers to credit those costs against royalty payments under some future leases would increase the value of those leases to the companies that would bid on them.

Enacting S. 1950 could result in an increase in offsetting receipts from higher bonus bids for coal leases within the areas of the Powder River Basin where the bill’s royalty credit provisions would apply. Any higher bonus bids would partially offset, on a present value basis, the cost to the government of forgone royalty payments from those provisions. CBO cannot estimate the timing or magnitude of any increases in bonus bids because such a change would depend on the judgments of resource developers about the likelihood of any future disputes in the Powder River Basin and the outcomes of such disputes. As mentioned above, and based on information from BLM and industry experts, we expect that any increases to bonus bids under S. 1950 would involve leases where compensation costs are likely to range from less than $1 million to no more than $13 million per conflict.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Because S. 1950 would affect federal offsetting receipts from royalties and bonus bids, pay-as-you-go procedures would apply. The net changes in outlays that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in outlays	0	3	4	1	2	2	1	0	0	0	0
Changes in receipts	Not applicable										

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

S. 1950 contains no intergovernmental mandates as defined in UMRA. Coal, oil, and gas development generates revenues for state and tribal governments from bonus bids, rents, royalties, and taxes. States receive revenues from the development of state-owned resources and share in bonus bids, rentals, and royalties paid to the federal government for federally owned resources. CBO expects that enactment of this legislation could benefit the states of Wyoming, Montana, and some tribal governments within those states insofar as it promotes the timely development of coal, oil, and gas resources in the Powder River Basin.

In a few specific cases, S. 1950 could result in a decrease in revenues to state or tribal governments. Such a decrease could occur if mining of resources owned by states or tribes were delayed or forgone in order to allow mining under a federal lease to proceed, and if the compensation the states or tribal governments received failed to cover their litigation costs.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

S. 1950 would impose a private-sector mandate as defined by UMRA on certain developers of mineral resources involved in disputes over the sequence of coal and oil or gas development in the Powder River Basin. CBO estimates that the cost of complying with the mandate would be well below the threshold established by UMRA ($109 million in 2000, adjusted annually for inflation) for any of the first five years that the mandate is in effect.

The bill would require certain resource developers to participate in a new dispute resolution process when a resource developer with interests that conflict with another developer files a written notice of conflict with the Secretary of the Interior. Typically, conflicts that arise in the Powder River Basin occur when different parties own overlapping rights to develop coal and oil or gas and the two resources cannot be developed simultaneously. Currently, such conflicts between resource developers are settled (with a negotiated settlement or by a court judgment) with one developer compensating the other for lost production or delays in production. The bill's dispute resolution process would require the parties involved in such a dispute to adhere to time lines, procedures, and compensation mechanisms that differ from practices under current law. Moreover, under the new resolution process, developers would not be able to appeal a court order to suspend or terminate their right to develop a resource. According to most industry experts, the amount of compensation under the bill's dispute resolution process would tend to be less than it would be in the absence of the bill. The cost of the mandate would be the difference between the settlements or judgments (net compensation) that certain developers of mineral resources would be able to obtain under current law and under S. 1950.

Based on information from various industry representatives and state and private geologists, CBO estimates that the current net income of developers of mineral resources who would most likely be subject to compensation under the bill is less than $20 million annually. Further, CBO estimates that net income of those developers would be less than the private-sector threshold even if production and prices of those minerals were to increase significantly over the next five years as some industry observers predict. CBO expects that only a subset of those developers would be affected by the mandate and thus, the cost of the mandate would be some fraction of the net income of the group as a whole. Consequently, CBO estimates that the direct costs of the mandate would be well below the private-sector threshold for at least the first five years that the mandate is in effect. Over time, the potential area of conflict under the bill would expand as mineral producers continue to develop in more areas of the Powder River Basin. Thus, to the extent that conflicts among developers arise in those expanded areas, more developers in those areas would be subject the bill's dispute resolution process.

ESTIMATE PREPARED BY:

Federal Costs: Megan Carroll

Impact on State, Local, and Tribal Governments: Susan Van Deventer and Marjorie Miller

Impact on the Private Sector: Gail Cohen

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis