CORRECTED-Asia coal export boom brings no bonus for US taxpayers

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(In fourth paragraph from the bottom, please read company name as Marathon Oil, not Marathon Petroleum, Corp)

* Taxpayers stand to miss out as Asian coal exports boom

* Changing royalty base could net billions more in future

* Former officials, taxpayer watchdog say program flawed

By Patrick Rucker

WASHINGTON, Dec 4 (Reuters) - U.S. miners who are booking big profits on coal sales to Asia are enjoying an accounting windfall to boot.

By valuing coal at low domestic prices rather than the much higher price fetched overseas, coal producers can dodge the larger royalty payout when mining federal land.

The practice stands to pad the bottom line for the mining sector if Asian exports surge in coming years as the industry hopes, a Reuters investigation has found.

Current and former regulators say their supervisory work has lagged the mining industry as it eyed markets across the Pacific. They say they will now give the royalty question a close look.

"We are committed to collecting every dollar due," said Patrick Etchart, spokesman for the Office of Natural Resources Revenue, which collects federal royalties.

At issue is the black rock pulled from the coal-rich Powder River Basin in Wyoming and Montana. Miners there say they abide by the letter of royalty rules that call for the government to get a 12.5 percent cut on coal sold under federal lease.

The question is: At what point is that coal valued?

Most Powder River Basin coal is sold domestically, where prices have been depressed by a glut of natural gas and regulations meant to curb pollution.

But Asian economies rely on coal to sustain growth, so the ton worth about $13 near the Powder River Basin mines last year fetched roughly 10 times that in China.

After deducting costs like shipping by sea and rail, that ton of Powder River Basin coal sold in China last year would have returned about $30 to the miners, several industry analysts estimate.

Luther Lu, director at China-based Fenwei Energy Consulting, said the figure was closer to half that, with miners up against other costs that would have cut into their margin.

Whatever the take-home for miners, several royalty experts said, the taxpayer is due a share of the final sale price overseas.

Powder River Basin mining companies disagree and say that they are right to pay out royalties at the low domestic prices.

"If you look at the regulations, we are not required to do a net-back," said Karla Kimrey, a spokeswoman for Cloud Peak Energy, referring to the return on Asian sales. The taxpayers' bite would be based on that number.

The rules that govern Powder River Basin sales to Asia deserve a more rigorous review, and short royalty payments will not be tolerated, Etchart said.

The royalties question will remain an important one as Asian coal exports look set to expand and the United States faces a fiscal crisis.

"How do you justify paying royalties at anything less than the true value, particularly in these times of tight budgets?" said Autumn Hanna of the nonpartisan Taxpayers for Common Sense.

$100 MILLION SHORT?

Mining companies declined to explain how they book Asian coal sales, and their securities filings give only a partial picture of how miners operate in volatile energy markets.

Industry and publicly available data, though, indicates that taxpayers stand to lose out.

Paying royalties calculated on the net-back formula for Asian exports from Wyoming and Montana rather than on the benchmark domestic price would have yielded around $40 million in additional revenue for the government last year alone, according to data from Goldman Sachs and other analysts, and figures from the U.S. Energy Information Administration.

Extended to the last few years of increased Asian demand, that total could exceed $100 million in forgone royalties. The sum could balloon into billions of dollars if mining giants are allowed to ship 150 million tons of coal a year or more through the Pacific Northwest, as the industry wants.

Of course, if the companies are more profitable because of lower royalty payments, they may well be paying more in corporate taxes, though some experts dispute the point.

"A certain $1 collected on royalties is worth more than the unsure tax take," said Tom Sanzillo, a former deputy comptroller for New York state who has studied the economics of coal exports with the Institute for Energy Economics and Financial Analysis.

For now, the debate over exports from the Powder River Basin is of limited scope: Less than 4 percent of the roughly 476 million tons of coal produced in Wyoming and Montana was exported last year, according to the EIA. Three-quarters of U.S. coal exports are bound for Europe or other non-Asian ports, much of that from private, not federal lands, in the Appalachian region.

But Asian economies such as India and China cannot grow without abundant electricity, and that demand has opened a window for a U.S. coal sector long focused on delivering domestic power.

'EXPORTS WERE NOT ON THE RADAR'

Several large coal companies mine the Powder River Basin - a high, grassy plain in eastern Montana and Wyoming. Cloud Peak exclusively works that terrain, which is chiefly on federal land. The company was in a position to save tens of millions of dollars in recent years by their reading of royalty rules.

Less than 5 percent of Cloud Peak coal was shipped to Asia last year, but that accounted for nearly 19 percent of total revenue, or about $290 million. A year earlier, Asian sales were only 3.4 percent of the total volume but 12 percent of revenue.

Cloud Peak, Peabody Energy and Arch Coal all declined to explain how they book their Asia business, but a large share of Powder River Basin sales passes through traders.

Sales to brokers and traders are allowed, but royalty rules assume that those buyers' economic interest is opposite to miners'. Sales to in-house or affiliated traders are due more scrutiny under the law.

"We are familiar with the rules around both arms-length and non-arms-length transaction and fully comply with both," said Vic Svec, a Peabody Energy spokesman, referring to the principle that is supposed to guide such sales.

Arch Coal declined to comment on their trading business, and Cloud Peak said it faces frequent audits from state and federal officials to make sure they follow the rules.

"In my neighborhood, I don't stop at every block. I could. But that's not where the stop signs are," said Cloud Peak spokeswoman Karla Kimrey. "You can say you don't like the regulations, but we play by the rules."

Former and current officials said the government has been slow to understand the power of foreign markets or protect the taxpayer's stake in those lucrative sales.

"Exports were simply not on the radar," said Bob Abbey, who in May stepped down as head of the Bureau of Land Management, the agency that grants federal coal leases.

A PRECEDENT IN GAS

While the industry says it is acting above-board, outside lawyers point to a natural gas precedent that they say further indicates the issue is far from settled.

In the late 1970s, Marathon Oil Corp used a similar accounting system to settle royalties on natural gas that was produced in Alaska but sold to Japan.

A federal court eventually told Marathon to pay out royalties based on the overseas value. Officials leveled a $10 million fine against Marathon.

Peter Appel, a former Justice Department attorney, said the case shows that officials expect taxpayers to get a taste of the true gains on exported fuel.

" This ruling should give officials confidence to give a hard look at coal sales," said Appel, who prosecuted cases for the DOJ's Environment and Natural Resources Division and teaches at the University of Georgia School of Law. (Reporting by Patrick Rucker; editing by Jonathan Leff and Prudence Crowther)

RPT-U.S. coal miner says sales practice being probed was permitted

Thu, Feb 14 2013

* Cloud Peak says Interior blessed coal export business

* Regulators aware miners book exports through sister firms

* Taxpayers stand to lose on existing sales practices

By Patrick Rucker

WASHINGTON, Feb 14 (Reuters) - A coal producer at the center of a U.S. Interior Department investigation into whether miners and traders skirted royalty payments on lucrative exports to Asia says the government agency gave the green light for such practices in 2009.

Cloud Peak Energy Inc CEO Colin Marshall said in a letter to Interior Secretary Ken Salazar that sales through affiliates that helped it and other companies avoid royalty payments had been cleared by Interior, adding that the miners have been open about their trading practices.

"Cloud Peak Energy clearly delineated ... our views on the appropriateness of continuing the existing royalty valuation system and structure," Marshall said in the letter, noting that it was in response to a recent Reuters article.

The clearance from the department was delivered through a PowerPoint presentation in 2009, Marshall wrote, when officials also cited a 2003 case involving natural gas sales as an example of how coal royalties should be treated.

Last week, Salazar announced the investigation, telling lawmakers in a letter that Interior would aim to determine whether miners on federal land wrongly cleared their sales through sister companies to dodge royalty payments.

The Interior Department had no comment on Marshall's letter, which was sent in January and seen by Reuters.

Using affiliates to handle coal exports stands to cost taxpayers hundreds of millions of dollars in forgone royalties in coming years if miners fulfill their plans to ship more of the fuel from the Powder River Basin of eastern Montana and Wyoming to coal-hungry Asian markets, the Reuters investigation found.

By moving their sales through affiliated brokers, coal companies can clear royalties at a low price and actually collect more than that value when prices in Asia climb.

Salazar said that one clue to a royalty shortfall would be if miners gain more from a coal sale than what they claim the fuel was worth.

U.S. taxpayers are due a 12.5 percent royalty on coal sales from federal land.

Interior officials will, Salazar wrote, "aggressively pursue any company found in violation of the laws and regulations related to the valuation of federal coal."

Arch Coal Inc and Peabody Energy Corp, two other dominant miners in the Powder River Basin, declined to comment on the investigation.

Cloud Peak's insistence that broker sales are permitted, and how that meshes with Interior's reading of its own royalty rules, could frame the dispute over how large the royalty payments to the government will be on Asian coal sales that the industry hopes will soar in coming years.

GUIDANCE FROM INTERIOR

Interior's Office of Natural Resources Revenue (ONRR), the steward of federal royalties, routinely instructs mining and drilling interests how to best interpret the rules.

One court ruling cited in a 116-page Interior presentation on regulations, which has been seen by Reuters, led Cloud Peak to value coal for royalties using a broad range of benchmarks such as prices in the domestic market, Marshall wrote.

Cloud Peak and the Interior Department did not reply to several requests for comment on royalty payments or the presentation, which is available via the ONRR website.

Coal exports from Montana increased more than sixfold to more than 13 million tons in the three years since that ONRR presentation, according to the Energy Information Administration.

And those sales have been profitable.

In 2011, less than 5 percent of Cloud Peak's coal production was shipped to Asia but that accounted for nearly 19 percent of total revenue or about $290 million.

In May 2011, Interior proposed new royalty rules that might have closed off the gains from affiliated sales and Cloud Peak defended the status quo in comments to regulators at that time, Marshall wrote.

The company made a similar defense of the existing royalty rules at a meeting with regulators in October 2011 that was led by ONRR Director Gregory Gould, according to a transcript.

The Interior Department has not finalized those rules.

Interior's message to the industry over royalties would be important to settling any dispute but the case cited in the Cloud Peak letter is not comparable, said Peter Appel, a former Justice Department attorney who has reviewed coal and gas rules.

In the letter, Cloud Peak says Interior guided it to a federal court decision (Fina Oil and Chemicals Co. v. Norton) that shielded a natural gas supplier from paying royalties on fuel it received from producers.

"But it appears that many of these transactions in the coal market are structured differently than the marketing agreements in the gas market," said Appel, who prosecuted cases for the Justice Department's Environment and Natural Resources Division and teaches at the University of Georgia School of Law.

Senator Ron Wyden, chairman of the Energy and Natural Resources Committee, said the coal industry's reading of the existing rules is troubling.

"This should have set off warning lights," Wyden said on Monday. "And it makes the case for a thorough investigation."

Wyden, a Democrat, and Senator Lisa Murkowski, the senior Republican on the committee, last month called for an investigation into coal royalties.

"We are going to monitor this very closely," said Wyden, who expressed satisfaction with the rigor of the investigation proposed by Salazar. "This is a taxpayer issue, first and foremost. It is critical that taxpayers get every penny due."