THE PROPOSED FREEPORT MCMORAN SETTLEMENT:

Ineffective by Design

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The Freeport McMoRan Settlement

Coastal parishes in Louisiana are currently pursuing numerous lawsuits against oil and gas companies, alleging damages to the coast resulting from historic drilling. Freeport McMoRan, a global mining company and relatively small contributor to the overall alleged damages, is the first to reach an alternative agreement to settle with the parishes—if Louisiana changes its coastal laws.

The proposed settlement is heralded by some as a major victory, supposedly securing $100 million for the state to use for coastal restoration. In reality, the proposed settlement, if adopted, would yield nowhere near $100 million and divert much of the money it did raise to unrelated government spending. Two key flaws undermine the settlement's purported goals.

First, the settlement lacks the clear rules and careful oversight necessary for a successful restoration program. While securing a payout intended for environmental work brings favorable press, ensuring that money is well spent is comparatively thankless. For this reason, trust funds with broad spending rules and limited oversight—as in the proposed settlement—tend to be squandered.

Second, almost the entire settlement is based on a crediting scheme, whereby Freeport McMoRan will fund restoration that generates credits which can be sold to other companies to offset their own regulatory obligations. This makes the vast majority of the "$100 million" settlement a mirage—if the restoration merely displaces other restoration work that would have occurred anyway, there is no net gain.

Much of the political discussion surrounding the settlements makes them out to be a referendum on the petroleum industry writ large. But the ineffective proposed settlement should be concerning to all Louisianians, regardless of their position on the coastal lawsuits. To those who consider the lawsuits frivolous, an ineffectual settlement is salt in the wound. But to those in support, a settlement that forecloses the possibility of future action without guaranteeing any actual coastal restoration should be even less palatable.

As written, the settlement is designed to fail, providing an easy victory for those spearheading the litigation but ultimately doing little to nothing for coastal restoration. Before becoming effective, the settlement needs buy-in from 12 coastal parishes and the Louisiana legislature. So far, disagreements among parishes and failed bills in the legislature have prevented the settlement from taking hold. This is for the best, and there is no reason Louisiana legislators should consider accepting such a shoddy settlement in the future.

Preventing Waste in Environmental Trust Funds

The nature of democratic electoral politics is that spending on constituents generally earns votes while new taxes lose them, a trade-off that, in normal circumstances, places some limit on government largesse.[2] This makes trust funds with loose spending rules—enabling new spending programs without concurrent tax hikes—an irresistible temptation for politicians with an eye on the next election cycle. Without ample safeguards, trust funds are often dissipated on political pet projects.

Safeguards that enable trust funds to accomplish their intended goals are possible, and the ingredients for a successful program are clear: They require tightly defined earmarks and independent oversight. Earmarks bind the hands of future government officials by creating a clear commitment to what constitutes allowable spending.[3] Independent oversight helps to ensure that enforcement of those rules does not give way to political expediency, an otherwise common occurrence for state-managed earmarked funds.[4]

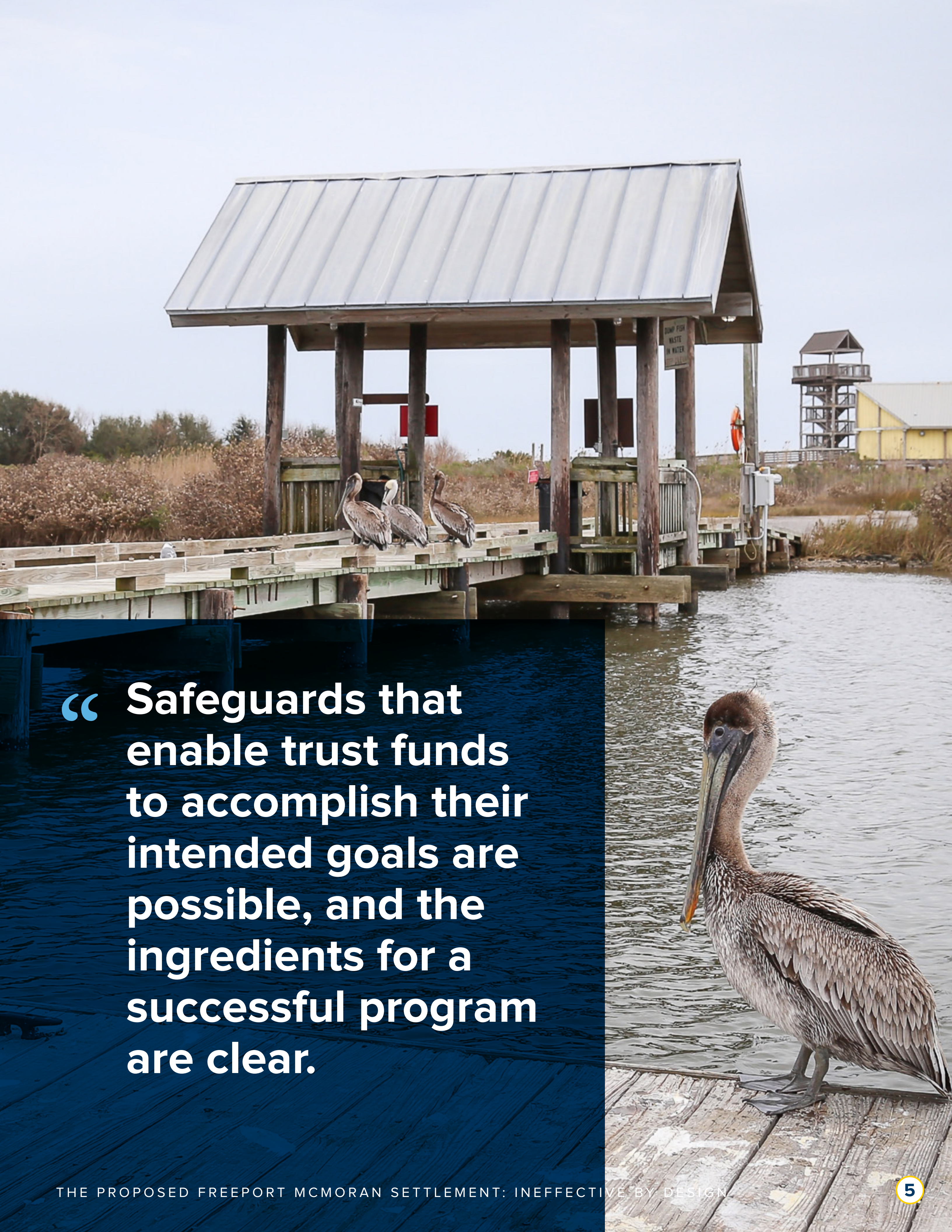
An excellent example of a well-designed trust fund is the Abandoned Mine Land (AML) trust fund, established by the federal government in 1977 to reclaim abandoned coal mines and funded by a coal production tax. The AML trust fund is a particularly good case for comparison, given its similar goals of funding the environmental cleanup of previous decades' extractive industries. The AML trust fund is not without flaws, but for the most part functions well and yields real progress in cleaning up after historic coal mining activities. As of 2015, the program had spent $5.7 billion cleaning 800,000 acres.[5] The critical design features that make the AML trust fund work are not present in the proposed Freeport McMoRan settlement.

2 This is discussed widely throughout the public choice economics literature on democratic fiscal policy, see e.g. Randall G. Holcombe and Jeffrey A. Mills, "Politics and Deficit Finance," Public Finance Quarterly 23, no. 4 (1995).

3 Though written in the context of environmental taxes, the insights of this paper apply equally well to environmental trust funds: Craig Brett and Michael Keen, "Political Uncertainty and the Earmarking of Environmental Taxes," Journal of Public Economics 75, no. 3 (2000).

4 William F. Shughart II and Josh T. Smith, "The Broken Bridge of Public Finance: Majority Rule, Earmarked Taxes and Social Engineering," Public Choice 183 (2020).

5 Eric L. Dixon and Kendall Bilbrey, Abandoned Mine Land Program: A Policy Analysis for Central Appalachia and the Nation, Appalachian Citizens' Law Center and The Alliance for Appalachia (2015).



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A major source of the AML trust fund's success has been its clear criteria for allowable reclamation projects. With some limited exceptions, funds are to be spent only on the reclamation of coal mine sites abandoned before 1977. Projects are approved either directly through the Office of Surface Mining, Reclamation and Enforcement (OSMRE), or through state reclamation plans approved by the OSMRE. The narrowly focused mission and strong oversight of the AML program has prevented the trust fund from turning into a slush fund and enabled consistent progress in dealing with the mine land reclamation backlog.[6]

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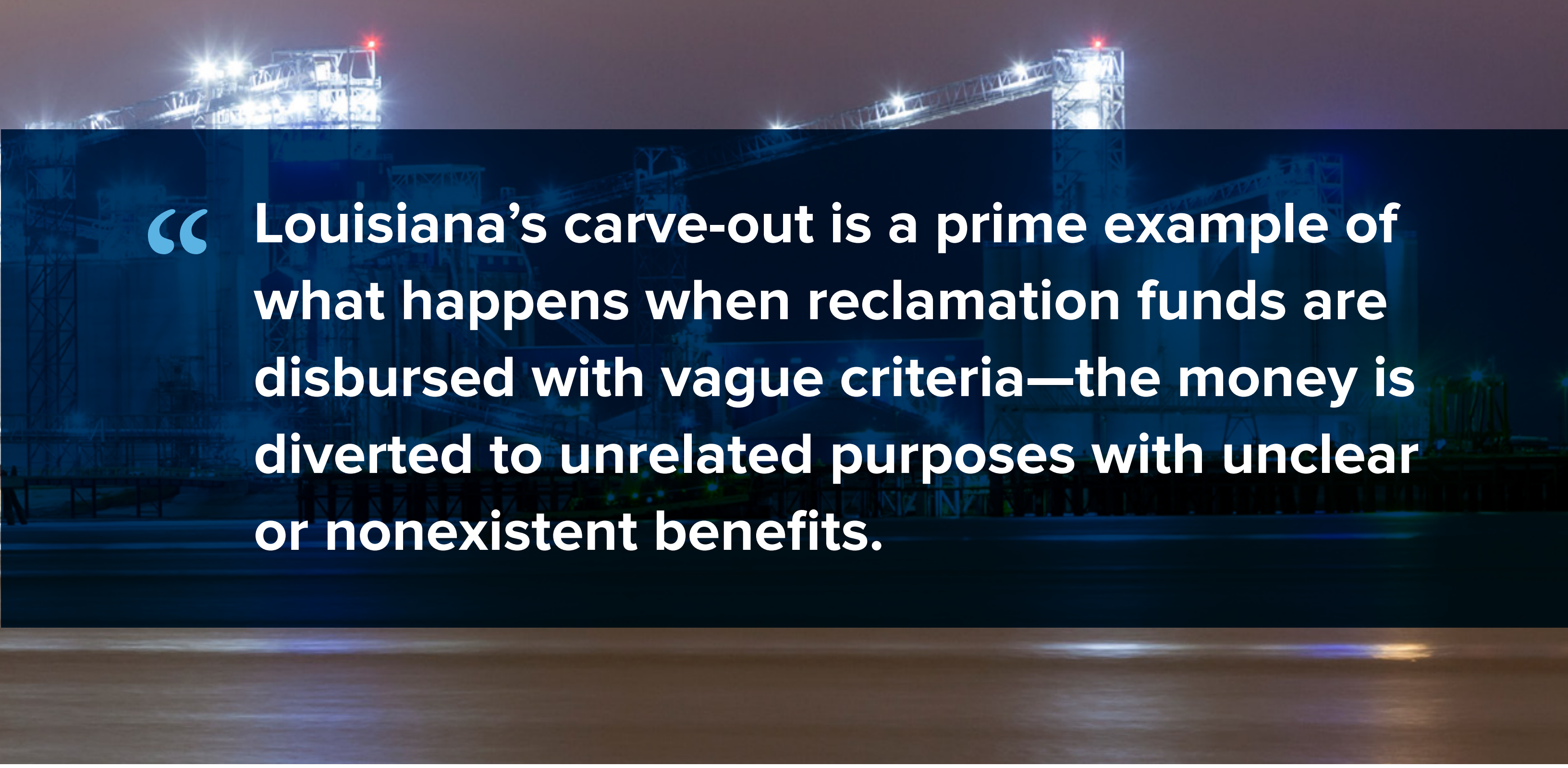
There are, however, exceptions that prove the rule. Acknowledging that some states may clear their abandoned coal mine problems entirely, the law allows states to petition the OSMRE for eligibility to spend AML funds on non-coal mine reclamation. Louisiana was one of three states to falsely claim completion at a time when the OSMRE did little to verify these claims and were grandfathered when Congress fixed the verification problem. As a result, Louisiana lacks much of the oversight that other states experience. What does Louisiana do with this relative flexibility? From 2008 to 2011, the state spent 100 percent of its AML funding on administrative costs.[7] From 2008 to 2017, the state did not complete a single mine reclamation project, coal or otherwise.[8] Louisiana's carve-out is a prime example of what happens when reclamation funds are disbursed with vague criteria—the money is diverted to unrelated purposes with unclear or nonexistent benefits.

The proposed coastal settlement offers none of the AML's safeguards to ensure reclamation

6 Ryan M. Yonk, Josh T. Smith, and Arthur R. Wardle, "Exploring the Policy Implications of the Surface Mining Control and Reclamation Act," Resources 8, no. 1 (2019).

7 Office of Surface Mining Reclamation and Enforcement's Oversight of the Abandoned Mine Lands Program, U.S. Department of the Interior Office of the Inspector General (2017).

8 Id.



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funding results in any actual coastal restoration. The proposed settlement splits the payout into five subaccounts—one for administrative costs, one to pay out private landowner lawsuits against Freeport McMoRan, and three for assorted government projects. Only 70 percent of one subaccount (which itself will receive a "TBD" share of the payout) is earmarked for the Coastal Master Plan.[9] Another subaccount is dedicated to very broadly defined "resiliency" projects (including new pipelines!), with the condition that Freeport McMoRan gets to pick recipients for up to 50 percent of the funds.[10] Most of the funds are to be disbursed with criteria so vague that essentially any local government project could seemingly qualify.

It is especially concerning that the proposed settlement does not even attempt to provide clear guardrails for program spending. Examples from across the country illustrate that it is difficult enough to keep earmarked funds targeted to their intended purpose without independent oversight. When the big three tobacco companies settled with 46 states in the 1998 Tobacco Master Settlement Agreement (MSA), the resulting funds were intended to help cover the costs of public health remedies for smoking. It took only a few years for many states to defund their tobacco control programs and use the windfall to cover budget deficits.[11] Four years after the settlement, only three states were spending at least 20 percent of their MSA funding on tobacco control.[12]

Trust funds that receive money from ongoing special taxes are often diverted too. Ubiquitous state highway trust funds are often raided for uses outside road construction and maintenance.[13] Last year, environmental advocates in Georgia succeeded in an intense legislative push to stop severe ongoing diversions from ten separate trust funds, made politically possible only by the stipulation that the funds could again be raided in the event of a sales tax revenue slump.[14]

9 Proposed Settlement Exhibit C, "Conceptual Framework."
10 Proposed Settlement Exhibit C, "Resiliency Subaccount."
11 Frank A. Sloan, Jennifer S. Allbrook, Leanne K. Madre, Leah E. Masselink, and Carrie A. Mathews, "States' Allocations of Funds from the Tobacco Master Settlement Agreement," Health Affairs 41, no. 1 (2005).
12 K. M. Clegg Smith, M. A. Wakefield, and M. Nichter, "Press Coverage of Public Expenditure of Master Settlement Agreement Funds: How are Non-Tobacco Control Related Expenditures Represented?" Tobacco Control 12, no. 3 (2003).
13 Shughart and Smith, supra.
14 Jill Nolan, "Georgia environmentalists score scrappy Capitol win on trust funds," Georgia Recorder, April 14, 2021.

Even the AML fund, which has done a commendable job preventing its resources from being diverted, faces a constant stream of interest groups seeking to officially expand the fund's purposes well beyond mine reclamation. So far, only the United Mine Workers of America (UMWA) have succeeded, and now interest income from the trust fund is diverted to UMWA retirement benefits.[15]

The lesson here is that, for any hope of success, clear rules must be established from the outset. Government trust funds have a natural tendency to get slushier over time. Those with control over fund spending tend to gain friends by opening existing funds to new interest groups; rarely can they do the same by shutting off the tap. The proposed settlement starts from an incredibly weak position, and ironing out implementation details later is not a workable option.

While plenty of coastal restoration work requires one-time investments that are well-suited to windfall financing, most government programs require ongoing revenue streams. This means diversions from the settlement funds could be worse than mere waste; they could encourage additional spending profligacy that would further burden Louisiana taxpayers once the proposed settlement fund runs dry.

As proposed, much of the settlement money could be diverted to political pet projects rather than being carefully guarded for coastal restoration. Louisiana's own track record in skirting trust fund rules is an ample red flag. Either through its drafters' disinterest in learning from effective trust funds or intentionally leaving the door open for fund diversion, the proposed settlement's absence of oversight mechanisms and lack of straightforward earmarks discredits its ability to prevent waste and promote actual restoration.

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15 Yonk, Smith, and Wardle, supra.

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No Net Restoration:

ADDITIONALITY IN THE PROPOSED CREDIT SCHEME

Even with better rules and oversight, though, the proposed settlement includes a credit scheme provision that could, in the worst case, allow Freeport McMoRan to avoid making *any* net investments in coastal restoration in Louisiana. To understand how, it is first necessary to understand the role of environmental credit programs in the proposed settlement.

There are numerous environmental credit programs at both the federal and state level. These programs allow companies facing some sort of regulatory environmental obligation to comply by “buying” the overcompliance of another firm. As an example, imagine a developer hoping to build a new neighborhood on a site legally designated as a protected wetland. An environmental crediting scheme would allow the developer to proceed in exchange for restoring wetlands elsewhere (or paying some other firm to do so). The upside of such a crediting program is that it allows firms to coordinate in protecting wetlands broadly while ensuring development is still possible. In other words, the credit program minimizes the cost of the wetland protection law—the inability to develop otherwise worthwhile projects on wetland sites—while preserving the same amount of wetland habitat.

This same basic set-up is possible for all kinds of environmental damages and is in broad use for everything from air pollution to species conservation. When this works, it can yield environmental improvements while helping to rein in the costs of regulatory compliance. Working, however, requires that the credits come from activities that would have not otherwise happened. If neighboring landowners start selling wetland credits for land that never needed restoration to begin with, the credit scheme can undermine the entire policy. Ensuring that credits go only to projects that wouldn’t have otherwise happened is called ensuring additionality, and it is absolutely critical for an environmental credit program to work properly.

Ensuring additionality is a difficult task even for experienced and dedicated regulators. Consider California’s cap and trade market for greenhouse gas emissions, which allows people outside the state to generate credits by agreeing not to log forestland—a perfectly fine way of mitigating greenhouse gasses, if the forest would otherwise be logged without the offset sale. California cap and trade regulators try their best to police this, but researchers find that huge portions of the total credit market are linked to non-additional projects.[16] In one particularly brazen example, the Massachusetts Audubon Society (not exactly known for its forays into the logging industry) managed to generate $6 million in revenue by promising not to log their property.[17] Phantom offsets generated by decisions that would have been made anyway do not mitigate any carbon emissions themselves and allow for more emissions (through an effectively higher cap) in California.

What does this mean for Freeport McMoRan's proposed settlement? The settlement dictates that the state-managed fund that Freeport McMoRan would contribute to should attempt to generate and sell credits into existing environmental credit programs to pay down Freeport McMoRan's outstanding balance. There are two consequences of this.

The first is that under the settlement, Freeport McMoRan would not pay anywhere near $100 million into the fund, because most of that money would come from the sale of credits. The second is that the restoration achieved by the fund will be largely illusory; any activity it engages in will displace the obligation of some other party. When Freeport McMoRan's contributions are used to restore the coast, the credits generated will be sold to other parties, who are then released from their

16 Grayson Badgley, Jeremy Freeman, Joseph J. Hamman, Barbara Haya, Anna T. Trugman, William R. L. Anderegg, and Danny Cullenward, "Systematic over-crediting in California's forest carbon offsets program," Global Change Biology, forthcoming (2021).

17 Lisa Song and James Temple, "A nonprofit promised to preserve wildlife. Then it made millions claiming it could cut down trees," MIT Technology Review (2021).

own environmental obligations. In other words, the settlement changes who does work protecting the environment, not the amount of work being done. In the extreme case, this would allow Freeport McMoRan to fully comply with the settlement without contributing to any net coastal restoration at all.

Perhaps it is unlikely that Freeport McMoRan will be able to comply with the entirety of the settlement with credit-generating activities, which will entail some remaining net benefits for the coast. But in any case, the net amount of investment in coastal restoration will be nowhere near the advertised $100 million. This is actually guaranteed in the text of the settlement, which assures Freeport McMoRan that their net contribution (i.e., money invested minus value of credits sold) will not exceed $23.5 million, less than a quarter of the $100 million figure touted by settlement lawyers.[18] The remainder of the supposed $100 million settlement relies on the fund's success in finding buyers for credits. It is worth emphasizing that $23.5 million is the best case scenario for net remediation—if the fund succeeds at identifying credit-generating projects and selling the credits, the net investment could be far lower.

California regulators have tried hard to ensure their offset program is additional, but still struggle to prevent non-additional projects from generating offset credits. In contrast, the proposed Freeport McMoRan settlement seems to intentionally violate the principle of additionality. The double-counting embedded within the proposed settlement ensures no more than a quarter of the supposed $100 million will produce any environmental net benefit and quite possibly far less.

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18 Proposed Settlement Exhibit E, 3(b).

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Conclusion

Coastal litigants' proposed settlement does a great job inflating its payout for press attention but shows no signs of seriously attempting to make sure the funds translate into real coastal restoration. Qualifying remediation projects are vaguely defined, all but ensuring that settlement funds will be squandered. Funds that are allocated to restoration will generate credits to be sold to other entities with environmental obligations, potentially canceling out the net benefit of the restoration work.

Settlements release defendants from all future claims of liability, meaning this is a one-and-done deal. All evidence, however, seems to point to a sloppily constructed settlement with a dramatically inflated dollar figure relative to the actual benefit it secures for Louisiana's coast. An effective settlement could easily incorporate design features present in other successful restoration programs: specific criteria for allowable projects, real oversight, and additionality requirements. The proposed settlement lacks all three. The likely result of the settlement, if approved, would be to encourage wasteful government spending that exacerbates Louisiana's budget problems for minimal coastal benefit.

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About the Author

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