

CS-188  
7  
1970  
deep

098296

UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

For Release on Delivery  
Expected at 10:00 a.m. EDT  
Monday, February 16, 1976



C1 ENO1964

STATEMENT OF  
PHILLIP S. HUGHES  
ASSISTANT COMPTROLLER GENERAL OF THE UNITED STATES  
BEFORE HEARINGS CONDUCTED  
BY SUBCOMMITTEE ON MINERALS, MATERIALS AND FUELS  
COMMITTEE ON INTERIOR AND INSULAR AFFAIRS  
UNITED STATES SENATE

33 We welcome the opportunity to appear before this Subcommittee to discuss some of the issues related to the development of Federal Coal resources and the ability of the Department of the Interior to effectively administer a development program. The GAO has been deeply involved in reviews of issues affecting Federal leasing policies and practices for oil, gas, and coal. All three resources must play a part in any overall strategy for balancing U.S. energy supply and demand. The large holdings of such resources by the Federal Government--primarily the Department of the Interior--place it in a key position to shape future development patterns.

Most recently, we have completed a study of Federal coal leasing. The conclusions and recommendations we have reached should help identify problems and opportunities associated with Federal coal leasing and with

~~702871~~ 098296

implementation of the leasing policy announced by the Secretary of the Interior on January 26, 1976. Our report should be issued shortly and we will make it available to the Committee as quickly as possible.

To focus this testimony on Federal coal leasing, I would like to raise two broad questions and answer each on the basis of facts developed during our recent study.

(1) Has a need for new Federal coal leasing been clearly established?

(2) If a need exists, can the Department of the Interior effectively administer a coal leasing program?

We believe the simple answer to both questions is "No" for reasons I hope to make obvious this morning.

#### The Relationship of Federal Lands to Coal Production Goals

The Administration's national coal production goal is to double our yearly production by 1985. This would result in annual production of about 1.2 billion tons by that date. The Federal role in meeting this goal is significant because the Federal Government owns 60 percent of the coal lands west of the Mississippi and can influence coal development on another 20 percent bordering on Federal land.

It seems to us axiomatic that Interior should have as clear a conception as possible of the potential contribution of Federal lands toward meeting the national coal production goal. We do not believe it sound policy to launch a new leasing program without having reasonable

goals of how much to lease and when to lease, based on the best possible estimates of how much coal to expect from development of the leases.

The Department of the Interior has decided to lift the moratorium on new coal leasing without adequately addressing these issues. Interior intends to rely on the leasing process itself to indicate the need for new leasing. Under that process, as Interior officials explained it to us, the level of lease offerings would be determined by industry nominations and by bidding results in competitive lease sales. Lease sales, if environmentally acceptable, would be offered as long as bids were sufficiently high. Reliance on such a process places Interior in the position of reacting, rather than providing the leadership needed to develop sound National energy strategy.

Experience with coal lands now under lease also should be evaluated in deciding when new leasing is necessary. Production experience on Federal leases has been poor. Interior statistics show that most of the leases have yet to produce a single ton of coal. Interior has projected that over 50 percent of the leases will not produce before 1990, although this projection was based on inadequate information. Interior's widely quoted estimate of 16 billion tons of recoverable coal under lease is at best a rough and conservative approximation of actual resources because of inadequate data and because most of the information used in computing the estimate is based on 1973 conditions, a time at which coal prices were much lower than they are today. Since the amount of coal deemed recoverable is largely a function of price, it stands to reason that, at present and anticipated prices, there is likely to be much more recoverable coal under lease than the 16-billion-ton estimate implies.

In addition, there is an estimated 9.3 billion tons of recoverable coal covered by some 190 "preference right" lease applications. Under the Minerals Leasing Act of 1920 a preference right lease may be issued to a permittee after he files an application showing that coal was discovered in commercial quantities while operating under a valid prospecting permit. Interior has recently published a proposed definition of the terms "commercial quantities", to be applied in disposing of the pending applications. If the Department decides to issue leases on these applications it will increase by more than half again the amount of coal already under lease. The 9.3 billion ton estimate, of course, is subject to the same conservative bias as is the 16 billion.

In any case, some fundamental attempts should be made (1) to better identify the amount of coal under lease and prospecting permit and (2) to relate the amount of Federal coal required to meet national goals to any program of renewed leasing. At this stage, we literally do not know how much is expected from the Federal lands, how much is already under lease that can meet such an expectation or how much more if any, coal should be leased. And Interior's present practices and plans do not contemplate providing the Nation with that data.

In summary, Mr. Chairman, we believe that the Secretary of the Interior should more precisely identify what role should be played by Federal coal resources in meeting national coal production goals. Also we believe that Interior should require existing and potential lessees and permittees holding preference rights to furnish information on (1) reserve holdings, (2) production plans, (3) reasons and justifications for nonproduction, and the need, if any, for additional Federal coal reserves.

Now I would like to turn to the question of Interior's readiness to implement the new coal leasing program.

## COAL LEASING PROGRAM ADMINISTRATION

The leasing process which Interior adopted as of January 1976 is conceptually much improved over the previous system. However, we believe much remains to be done before it can be applied effectively on a large scale.

To prepare for eventual selection of tracts for leasing, Interior had underway several data-gathering projects which are designed to provide maps and other information for use in the proposed coal leasing program. The effectiveness of Interior's leasing system depends on the integration of this information--for example, on the potential for reclamation and revegetation of the mined areas, on coal reserve estimates, and on conflicting land uses.

We found weaknesses in the components of the planning system which would seriously undermine the effectiveness of the leasing process. Weaknesses exist in Interior's coal resource mapping program, in drilling programs to obtain data for mineral classification and environmental protection, and in the land management planning system.

The accuracy of the coal resources mapping program is jeopardized by the incompleteness of the data base being used. Survey geologists recognize that gaps exist in the reserve data on hand but are uncertain how much is missing because a complete inventory has never been taken. Data gaps can only be judged on a site by site basis as the ongoing mapping program progresses. Field officials estimated this could take as long as 15 to 20 years, even if the program is limited only to the

"priority" areas where Survey is now directing their attention. The priority areas are those identified by Interior's Bureau of Land Management as having the best potential for future leasing. The areas are in 67 townships and seven counties in seven States (Colorado, New Mexico, North Dakota, Montana, Wyoming, Utah, and Oklahoma) and cover about 55,000 square miles. Within the priority areas the U.S. Geological Survey plans to map about 1000 areas.

et 3. Both the Bureau of Land Management and the Geological Survey have 8 of 215 drilling programs, but the funding levels have been relatively low-- about \$5.6 million in 1975 and 1976. The Survey's share for the 2 years totaled only about \$1.0 million. Survey field officials believe that more drill hole data is needed to up-grade the quality of reserve estimates.

The Bureau's drilling efforts are important in assessing land reclamation potential in areas being considered for mining. Limited data on soil, surface and groundwater, and mining problems are being obtained. However, while Interior officials estimated that drilling results at 17 to 20 sites each year would be needed for new leasing, in addition to a comparable effort on existing coal leases, drilling was conducted at only four sites in fiscal year 1975 and seven sites in 1976.

With respect to the land management plans the Bureau acknowledges that many of the completed plans are poor. Interior's auditors in August 1975 reported that many plans have been completed and approved which did not contain sufficient data, particularly on resource

inventories. The planning decision for coal leasing through the land management framework program is expected to have considered all of the resource management programs and resolved the resource use conflicts or found them to be of minimum impact.

BLM's June 1975 policy statement announcing new planning system changes deals with these problems, but when and how the action called for will be taken is not clear, nor is the actual effect of the changes on the quality of plans.

We have made a number of proposals to the Secretary of the Interior which we believe are necessary to make a leasing process workable and which we believe should be implemented before issuing new leases.

The Secretary should:

- Provide Departmental guidance as to work priorities and data reliability requirements.
- Develop a systematic coal drilling program which would provide data for appraising coal resources and insure planned and coordinated drilling. Data not obtained from private drilling should be obtained through federally financed activities.
- Issue special use permits for coal exploration under which exploratory work could be done and financed by the private sector with Government approval.
- Direct the Bureau of Land Management to give priority to completing the land management framework plans in the coal priority areas and assess the usefulness of those plans already completed for those areas.

### TRACT VALUATION DATA

In the past, Interior gave little attention to adequately valuing coal lands, and leased coal under conditions of great uncertainty about the quantity and quality of the resources. Interior is now attempting to change this, but finds that it lacks the information to make reasonably sound valuations. We believe a stepped-up coal exploration program using both private and Government resources would help fill a serious gap in coal reserve data. Also, Interior should more aggressively seek the economic and cost data it needs for valuing tracts. Some of the information is available only from lessees, and Interior has not enforced Department regulations or lease provisions which require lessees to submit the data.

### DILIGENT DEVELOPMENT AND CONTINUOUS OPERATIONS

I indicated earlier that the production experience on Federal leases has been poor. Recognizing this fact, Interior has published proposed regulations on diligent development and continuous operations by lessees. We believe the proposals do not go far enough.

First the regulations proposed would allow lessees to tie-up public coal resources for a full 10-year period without having to show any evidence of progress toward development. Interior believes that this is not likely to happen especially for leases issued since April 1973, which require the payment of advance cumulative royalties beginning in the sixth lease year on the basis of a predetermined rate of coal extraction regardless of actual production. However, since the advance royalties

can be offset against royalties due when production occurs, the profit from speculative delay may be greater than the cost in interest on advance royalties.

Further, the lessees are not required to report on the work and expenditures incurred toward development of the lease. We believe that a lessee should be required to furnish detailed exploration and developmental plans within a specified time after the lease award, and to report periodically on development. A similar requirement is already part of Interior's oil shale leasing program.

#### LOGICAL MINING UNITS

Under Interior proposals, compliance with diligent development and continuous operation requirements would be judged on a logical mining unit (LMU) rather than an individual lease basis. The provision would permit almost any combination of Federal and non-Federal land to be combined into an LMU. The LMU concept is a potentially good one, and could, if implemented properly, expedite the development of Federal leases. However, more specific definitions and criteria are necessary to insure that the concept does not merely become a vehicle for retaining Federal leases without good reason. For example, the proposed regulations offer no guidance for a determination that the LMU can be developed and mined in an "efficient, economical and orderly manner with due regard to the conservation of coal reserves and other resources." In the absence of more specific criteria mining units could be established without adequate justification of need, without demonstration of

reasonable ess, and without a determination of the appropriateness of the size of the unit being established.

Accordingly, we believe the Department should establish explicit criteria for establishing and administering logical mining units.

Finally, I would like to comment briefly on three other issues which will be discussed in our forthcoming report.

#### ADJUSTMENT OF LEASE TERMS

Existing coal leases are for an indefinite term with provisions for adjustment every 20 years. A 20-year period does not provide Interior with much flexibility in program administration--a need of special importance in rapidly changing situations such as those now facing national energy goals and programs.

We have previously recommended to the Secretary of the Interior that he seek a change in the law that would, for future leases, permit adjusting lease terms more frequently. Interior, on the other hand, believes that a 20-year lease period provides the lessee needed security of investment and a basis for obtaining venture capital.

A degree of certainty or stability in lease terms clearly is needed by lessees to permit them to properly plan their operations, but Interior has not been able to present any evidence in support of a 20-year period. We have observed that the terms of coal leases on non-Federal lands often do contain shorter adjustment periods. For example, regulations issued by the Bureau of Indian Affairs, Department of the Interior, governing coal leases on Indian lands stipulate that lease terms may be made for specified terms not to exceed 10 years unless coal is produced in paying

quantities. Likewise, coal leases on State lands in Wyoming provide for an initial term of 10 years and a preference right to renew the lease for successive periods of 10 years each. Survey personnel also informed us that coal leases on private lands are for 10-year terms and generally contain clauses to provide for readjustment of royalty rates at frequent intervals during the 10-year term. Accordingly, we believe the Congress should give the Secretary of the Interior the authority to adjust future lease terms more frequently than after a 20-year period.

#### ASSIGNMENT OF LEASES

Interior regulations permit leaseholders to assign, transfer, or sublease their leases to other individuals or corporations either with royalty compensations or other financial settlements. Applications for approval of assignment are made to the Bureau and are generally automatic. The Bureau does not examine the assignees' ability to develop the lands nor impose any development or production requirements. Lease terms are not amended at the time of assignment or transfer.

The ability to assign coal leases combined with the indeterminate lease term for which Federal coal leases are issued has permitted leaseholders to speculate on the right to mine public lands and, generally, to act as if the lands were private property. For example, in our sample of coal leases, we noted one lease which was assigned as payment of a gambling debt. Of the 32 leases we sampled, 25 had been assigned in whole or in part. Some had been assigned as often as three times since lease issuance. Only two of the 25 assigned leases were in production at the time of our review.

Survey personnel told us that the ability to assign leases provides a process which enables legitimate developers to acquire leaseholds to consolidate areas to form mining units for efficient and economical coal extraction. We agree that there may be instances where the ability to assign or transfer leases can encourage or even stimulate development, but such actions should be restricted to bonafide developers. Rather than granting automatic approval of lease assignments, the Bureau should question the assignees' ability to develop and produce coal.

To help discourage speculation on coal leases, the Secretary should issue regulations providing for full disclosure by the assignor of financial dealings regarding the assignment, the submission by the assignee of a development plan, and readjustment of lease terms and conditions where warranted by conditions existing at the time of assignment.

#### PREFERENCE RIGHT LEASES

We believe Interior should first decide whether or not a preference right lease must be issued. We understand that Interior's Solicitor is considering this question. Until then no preference right leases should be issued. If it is determined that a preference right lease must be issued, certain conditions should be met. Specifically preference right leases should be issued only after

--Interior has defined "commercial quantities," and the permittee has furnished evidence to the satisfaction of the Survey that coal exists in commercial quantities on each of the applications.

--The permittee has furnished evidence that production is planned to begin within a reasonable time from the date of the lease.

Finally, we believe that the Secretary for the future should discontinue the practice of issuing prospecting permits and preference right leases, and award leases only on a competitive basis. The Secretary of the Interior has indicated that he also favors competitive bidding.

- - - - -

That concludes my prepared statement. We would be pleased to answer any questions.