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RELEASED

JAN 29 1974

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The Honorable Henry M. Jackson, Chairman
Committee on Interior and Insular Affairs
United States Senate

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Dear Mr. Chairman:

During hearings before your Committee in 1971, pursuant to Senate Resolution 45 which authorized investigation into the national fuels and energy policy, Navajo and Hopi Indian tribal members and others questioned the equity of utility and coal companies' payments for mining coal on tribal lands. In a June 1972 report on problems of electrical power production in the Southwest, the Committee recommended that the Comptroller General be requested to review provisions of Navajo and Hopi coal leases and to report to the Congress on his analysis of the comparison of royalties and other payments to the tribes with payments received on public lands and elsewhere for similar types of contracts.

In your February 20, 1973, letter, you requested that we review these leases and compare the revenues and royalties being received by the Navajo and Hopi Tribes with the revenues and royalties being received by the Federal Government from similar coal leases issued during the same period and, to the extent feasible, with revenues being received from mining on State and private lands. You suggested that we consider such factors as coal quality, mining ease, transportation and mining costs, and required land reclamation work.

We reviewed and evaluated the provisions of 1 Hopi and 5 Navajo coal-mining leases on tribal lands in Arizona and New Mexico; 61 coal-mining leases on Federal lands in Colorado, New Mexico, and Utah; 25 coal-mining leases on State lands in Colorado, New Mexico, and Utah; and 14 coal-mining leases on private lands in Colorado, Montana, New Mexico, and Wyoming. We also interviewed appropriate Federal, State, tribal, and coal-mining-company officials. We made our review at the Navajo Tribal Headquarters and Bureau of Indian Affairs (BIA) Area Office, Window Rock, Arizona; the Hopi Tribal Headquarters and BIA Agency Office, Keams Canyon, Arizona; the BIA Area Office, Phoenix, Arizona; the U.S. Geological Survey (USGS) State offices and State land resources agency offices in Arizona, Colorado, New Mexico, and Utah; and the offices of two coal-mining companies.

We reviewed the provisions of the Navajo and Hopi coal-mining leases and compared the revenue provisions of these leases with the revenue provisions of similar Federal, State, and private leases issued during the same period. The revenue provisions of the Indian leases, except the first lease, are generally as good as, or better than, the revenue provisions of the non-Indian leases.

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The first Indian lease contained royalty rates about the same as Federal leases but not as favorable as those in two State leases issued about the same time. Also, the first Indian lease contained no provision similar to Federal and State leases whereby the revenue rates could be periodically adjusted to enable the Indians to share in the coal's increased value.

NAVAJO AND HOPI COAL LEASES

The Navajo and Hopi Tribes currently have six leases with utility and coal companies for coal mining on tribal lands.

<u>Lessor</u>	<u>Lease number</u>	<u>Date</u>	<u>Acres leased</u>
Navajo	2505	7-26-57	24,320
	^a 2505	1-19-62	549
	^a 2505	9-29-65	6,547
Navajo	8669	5-22-64	11,157
Navajo	8580	8-28-64	24,858
Navajo	9910	6- 6-66)	
Hopi	5743	6- 6-66)	40,000
Navajo	2190	12- 2-68	<u>40,286</u>
	Total		<u>147,717</u>

^aAmendment.

The 1966 Navajo and Hopi leases are for lands owned jointly by the two tribes and referred to as joint usage lands. The Navajo Tribe also entered into another coal lease on September 17, 1960. However, this lease was terminated in December 1966 without production because the lessee had not constructed a coal gasification plant, as required by the terms of the lease.

The six current leases involve an estimated 1.9 billion tons of bituminous coal which lies as much as 120 feet below the surface and is strip mined. As of May 1973, coal was being produced under all the leases except the 1968 lease. The coal is used primarily as fuel at electric-generating plants in southern Nevada and northwestern New Mexico. The Navajo and Hopi Tribes received approximately \$7.6 million and \$0.7 million, respectively, from the leases through April 30, 1973.

Tribal officials and officials of the utility and coal companies having preference rights to lease the lands for coal mining established the terms of five of the current leases through negotiations. These companies had received these rights under the terms of prospecting permits the tribes issued. The 1968 Indian lease was advertised for bids, rather than negotiated, because the preference right had expired.

The Navajo and Hopi Tribes received technical and scientific support from USGS and legal support from BIA during negotiation and advertising activities for leasing their lands. As Federal regulations required, BIA approved all leases prior to their execution.

LEASE PROVISIONS

The coal leases we reviewed contained revenue provisions, and most of them provided for periodically adjusting revenue rates. In addition, the Navajo and Hopi leases give priority rights of employment to members of the respective tribes. We compared the provisions of the Indian leases with those of leases issued during the same period for strip mining coal on Federal, State, and private lands.

Revenue provisions

The leases we reviewed contained two types of revenue provisions-- for production and nonproduction revenues. The lessor of the land receives production revenues (royalties) once mining operations begin. Royalties are usually expressed in cents per ton of coal mined or sold. The lessor receives nonproduction revenues (rents) yearly, in advance, regardless of whether mining operations are being conducted. Rents are usually expressed in dollars per acre of land leased.

Most leases also provide that all or a portion of the yearly rental be credited toward royalties. Thus the lessor receives royalties only after production has been sufficient to generate royalties which exceed the rent paid in advance. Some leases provide that current-year rents be credited only to current-year royalties, whereas other leases provide that rents paid in previous years be credited to current-year royalties only to the extent they have not been applied.

Because mining under three of the six leases generated yearly royalties that exceeded rents and because we believe this will occur for the other three leases when full-scale mining begins, the rental rates, in our opinion, are not significant factors to consider in comparing revenue provisions.

Factors considered in establishing royalty rates

According to USGS officials, royalty rates for coal leases on Federal lands before February 1971 were established on an individual-lease basis after considering such factors as coal quality, mining and transportation costs, and required reclamation work. Although we considered such factors, royalty rates were usually standard for a particular State or geographic area. USGS officials told us that coal deposits within a particular State or geographic area were usually similar in terms of quality and ease of mining and that therefore royalty rates tended to be equal. They also said that deviations from the standard rate resulted

when the coal quality varied significantly or when the coal was particularly difficult to mine.

For six leases the quality or accessibility of the coal affected the royalty rates. The rates for four Federal leases in New Mexico were \$0.025 a ton lower than the prevailing Federal rate and the rates for the two Navajo 1964 leases were at least \$0.025 a ton higher than the prevailing Federal rate. USGS officials told us that the rates for the Federal leases were lower because the quality of the coal was below average for New Mexico or because the coal was difficult to mine. They also said that the Navajo royalty rates were higher than the Federal rate because the coal was of high quality.

Royalty rates on State lands also are usually standard but are generally lower than the Federal royalty rate for that State.

Coal company officials told us that royalty rates on private lands were negotiated but that the coal companies' goal was the prevailing rate for Federal- or State-owned land. They also said that, once a higher rate was negotiated on a particular private lease, a precedent was set which became the guideline for subsequent private leases in the same geographical area.

In February 1971 USGS established a new method for computing royalties for Federal coal leases. The method provides that royalties for leases be computed on the basis of a percentage of the coal's selling price. A USGS official told us that the new method attempted to consider the cost of extracting coal by providing for low royalty rates for coal which was costly to mine and higher rates for coal which was less costly to mine. We believe that the new method is an improvement over the previous method.

Comparison of royalty rates

Enclosure I is a comparison of the royalty rates for the six Navajo and Hopi leases with the rates for 86 Federal and State leases in Colorado, New Mexico, and Utah. There are no coal-mining leases in Arizona other than the Indian leases. Although we reviewed the royalty rates for private leases, we did not include these rates in our comparison because the coal-mining companies considered these rates proprietary information.

The royalty rate for the 1957 Navajo lease was the same as the royalty rates for Federal leases but less than the royalty rates for leases on State lands at about the same time. The \$0.15-a-ton royalty rate for the 1957 lease was the same as the royalty rates for two 1958 Federal leases in Colorado; however, the royalty rates for the two 1958 leases of State land in Colorado were \$0.2316 a ton and \$0.25 a ton, respectively; both of which were higher than the royalty rates for the 1957 Navajo lease and the two 1958 Federal leases.

The royalty rate in the 1962 amendment to the 1957 Navajo lease, which added 549 acres to the lease, was \$0.15 a ton. Rates for Federal leases issued the same year were \$0.15 a ton and \$0.175 a ton, respectively. Leases issued by two States specified minimum rates of \$0.15 a ton and maximum rates of 5 percent of the coal's selling price or the prevailing Federal rate in the State, whichever was higher.

The royalty rate for the 1965 amendment to the 1957 Navajo lease, which added 6,547 acres to the lease, was \$0.20 a ton. The royalty rates for Federal leases issued the same year were \$0.175 a ton and increased to \$0.20 a ton after 10 years. State rates were the higher of \$0.15 a ton or 5 percent of the coal's selling price.

The royalty rates for the five Navajo and Hopi leases issued in 1964, 1966, and 1968 were higher than those of the non-Indian leases.

Adjustment provisions

The Mineral Lands Leasing Act (30 U.S.C. 181) requires that coal leases on Federal lands be issued for indeterminate terms, subject, at 20-year intervals, to such adjustment of terms and conditions as the Secretary of the Interior may determine. Indian leases, however, are not subject to the act's adjustment provisions.

All Federal leases and most State leases we reviewed contained adjustment provisions. Private leases, however, generally do not contain such provisions.

Two of the six Navajo and Hopi leases provide that the Secretary of the Interior may periodically adjust royalty rates. One of the two leases provides that the royalty rate be adjusted after the first 20 years and every 10 years thereafter. The second lease provides for adjusting the royalty rate every 10 years.

Three of the four Navajo and Hopi leases that do not provide for periodically adjusting the royalty rates do, however, provide for increasing royalties to the tribes as the selling price of coal rises. For example, one of the 1964 Navajo leases provides that, if the selling price of a ton of coal is below \$4, the royalty rate will be \$0.25 a ton; if the selling price of coal is between \$4 and \$4.99, the royalty rate will be \$0.30 a ton; and, if the selling price of coal is \$5 or over, the royalty rate will be \$0.375. Also, the two 1966 leases provide that the royalty rate will be \$0.25 a ton or 6.67 percent of the selling price of coal, whichever is higher. The royalty provisions of these leases thus mitigate, to some extent, the lack of adjustment provisions.

The 1957 Navajo lease and its two amendments do not provide for periodically adjusting the royalty rates or for increasing the royalties to the tribe as coal's selling price increases. Therefore the tribe may not be able to have the royalty rates adjusted for increases in coal's value.

In March 1957 BIA gave USGS a copy of the proposed 1957 Navajo coal lease and requested USGS's comments. The proposed lease represented the results of conferences among representatives of BIA, the Navajo Tribe, and the coal-mining company.

In a March 18, 1957, memorandum to the Commissioner of BIA, the Director of USGS recommended that BIA consider modifying the lease to (1) decrease the lease acres from 24,320 to a smaller number of acres to prevent the coal company from holding such large acreage without development or need, (2) require the coal company to pay a minimum of \$1 an acre as a bonus, and (3) provide for coal and by-product royalty-rate adjustments at reasonable intervals.

On April 10, 1957, the Commissioner of BIA forwarded the proposed lease to the Navajo Area Director for presentation to tribal and to coal company representatives. The Commissioner said that the terms of the proposed lease had been agreed upon by BIA, the attorney for the Navajo Tribe, and the attorney for the coal company. He further said that the USGS recommendations had been discussed and resolved at conferences with tribal and coal company representatives. The lease, signed on July 26, 1957, did not reflect any of the changes USGS recommended.

BIA lease files do not document whether BIA considered the USGS recommendations or the reasons for BIA's not accepting the recommendations. BIA officials could not give us documentation concerning this matter. They said they did not know why the USGS recommendations had not been accepted because BIA no longer employed the officials involved in approving the lease. The BIA officials also agreed that the lack of an adjustment provision in the 1957 Navajo lease was not favorable to the tribe and they said that they did not know why an adjustment provision was not considered when the 1957 lease was amended in 1962 and in 1965.

Employment preference provisions

All the Navajo and Hopi leases contain employment preference provisions whereby the lessees are to (1) employ Indians in all positions for which they are qualified and to pay them the prevailing wages, (2) use the services of Indian contractors whenever feasible, and (3) make a special effort to work Indians into skilled, technical, and other higher level jobs connected with the lessee's operations under the leases. Such employment provisions offer an opportunity for substantial benefits to the tribes.

Officials of 1 company said that about 80 percent, or 105, of its employees engaged in mining operations under its lease were Indians. Officials of another company said that 10 of 30 employees engaged in mining operations under its lease were Indians and that, when mining operations were expanded, they planned to have Indians in 75 to 80 percent of the jobs.

TRIBAL OFFICIALS' EVALUATION
OF LEASE PROVISIONS

Tribal officials told us that they believed the provisions of the Indian leases were equitable at the time of negotiation, but that the lease revenue provisions currently may not be adequate in light of the energy crisis and the increased demand for coal. Navajo tribal officials further said that they were concerned about the lack of adjustment provisions in some of the leases and the 10- to 20-year adjustment periods in the remaining leases. They would prefer provisions for adjusting rental and royalty rates every 5 years, and they have begun exploring the possibility of inserting such provisions in all the leases.

The vice chairman of the Navajo Tribe said that the tribe's objective was to obtain a majority ownership interest in future mining ventures on the reservation. He stated that the tribe would benefit from the increased control of mining operations and resultant income and would not have to rely solely on coal royalties. The vice chairman further said that the tribe did not plan to enter into additional coal leases with private coal and utility companies unless it obtained a majority ownership interest in all the mining operations.

CONCLUSION

We believe that the provisions of the Navajo and Hopi coal leases, except those of the 1957 Navajo lease and its 1962 and 1965 amendments, are as good as or better than the provisions of most Federal, State, and private coal leases issued during the same period. Because the 1957 Navajo lease and its 1962 and 1965 amendments do not provide for periodically adjusting royalty rates, the tribe will not be able to share in the increased value of its coal resources if the demand for coal increases and if the selling price of coal rises.

AGENCY COMMENTS

In its letter of November 16, 1973 (see enc. II), commenting on our report, the Department of the Interior said that it was pleased that the provisions of five of the six Indian leases we reviewed were as good as or better than the provisions of most Federal, State, and private coal leases issued during the same period.

The Department said also that it was aware the 1957 Navajo lease and its 1962 and 1965 amendments did not provide for periodically adjusting royalty rates, but that if, in the future, both the lessor and the lessee were to agree to open the lease terms for modification, the Department planned to request reconsideration of the royalty rates and to provide for periodically adjusting the royalty rate. The Department stated further that it would recommend to tribal officials that all future tribal coal leases provide for computing royalties on the basis of the selling price of the coal when it is favorable to the tribal interests.

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They believe this feature should eliminate the need for the contract clause providing for periodically adjusting the royalty rate.

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We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script, reading "James P. Stacks". The signature is written in dark ink and is positioned centrally on the page.

Comptroller General
of the United States

Enclosures - 2



UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

NOV 18 1973

Mr. Max Hirschhorn, Deputy Director
Resources & Economic Development Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Hirschhorn:

The Department has carefully considered the Draft Report to Congress entitled "Review of Leases Entered into by the Navajo and Hopi Indian Tribes, Bureau of Indian Affairs, Department of the Interior."

We are pleased the review found that 5 of 6 leases examined contain provisions as good as or better than the provisions of most Federal, State and private coal leases issued during the same period of time.

The Department, through its Bureau of Indian Affairs, is aware of the lack of provision for periodic adjustment of royalty rates in the excepted lease. The Bureau is prepared, if and when in the future both the lessor and lessee agree to open the lease terms for modification, to request reconsideration of the royalty rates and adding a provision for periodic adjustments of the rate.

We will recommend to Tribal Government officials that all future tribal coal leases issued provide for computing royalties on the basis of the selling price of the coal, the USGS newly established method, where this is favorable to the tribal interests. This feature should eliminate the necessity for the contract clause providing for the periodic adjustment in the rate itself.

We appreciate the opportunity to review this report in draft.

Sincerely yours,


Allan L. Reynolds
Director of Audit and Investigation