REPORT BY THE

Comptroller General

OF THE UNITED STATES

Legislative Changes Are Needed To Authorize Emergency Federal Coal Leasing

The Department of the Interior has established emergency leasing regulations to make federal coal available to existing operators with an urgent need for it Existing law requires the Secretary of the Interior to issue federal coal leases, including emergency leases, on a competitive basis

Although reasonable in concept, Interior's emergency leasing regulations have been difficult to administer within a competitive framework, mainly because there is an inherent lack of competitive interest for emergency tracts which are located next to an ongoing mining operation and are needed to sustain it The low value of these tracts on the open market contrasts with their substantial economic value to the adjacent operator needing the coal

In view of the need for emergency leasing, GAO recommends that the Congress amend the Mineral Lands Leasing Act of 1920 to authorize emergency federal coal leasing and to allow Interior to use negotiated, rather than competitive, lease sale procedures to carry it out Such legislative changes would recognize the unique objectives of emergency leasing and allow Interior to administer it in a more pragmatic manner

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C 20548

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The Honorable Jim Weaver
Chairman, Subcommittee on Mining,
Forest Management, and Bonneville
Power Administration
Committee on Interior and Insular Affairs
House of Representatives

This report evaluates several issues affecting the Department of the Interior's administration of its emergency federal coal leasing program. In response to your letter dated June 15, 1983, the report discusses the difficulties Interior has encountered in administering emergency coal leasing under the all-competitive leasing program required by law and the need for legislation authorizing negotiated coal lease sales for emergency leasing situations.

Copies of the report are being sent to the Director, Office of Management and Budget, and to the Secretary, Department of the Interior.

Charles A. Bowsher
Comptroller General
of the United States

Enclosure

COMPTROLLER GENERAL'S REPORT TO THE CHAIRMAN, SUBCOMMITTEE ON MINING, FOREST MANAGEMENT, AND BONNEVILLE POWER ADMINISTRATION, HOUSE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

LEGISLATIVE CHANGES ARE NEEDED TO AUTHORIZE EMERGENCY FEDERAL COAL LEASING

D I G E S T

The Mineral Lands Leasing Act of 1920, as amended, generally requires the Secretary of the Interior to issue federal coal leases by competitive bidding and not to accept any bids that are less than the fair market value, as determined by the Secretary of the Interior. Existing law makes no distinction between leasing to meet the needs of existing coal operators and leasing to encourage the development of new competitive mining operations on federal coal lands.

Although Interior is required to issue federal coal leases on a competitive basis, Interior has established a process and regulations for holding lease sales at the request of producing mining operators who can demonstrate an emergency need for the coal on adjacent tracts to sustain their mining operation. Among other things, Interior's emergency leasing regulations state that applicants must require the coal within 3 years to maintain current production or that such coal, if not leased, would be bypassed and not likely to be mined by another producer in the foreseeable future. (See p. 8.)

Emergency lease sales are held under competitive bidding procedures, but Interior's emergency leasing regulations restrict such sales to situations in which competitive interest is unlikely to exist. Competitive interest is lacking because the existing operator is usually the only one capable of developing the coal in an economic manner. Thus, it is questionable whether Interior can carry out emergency leasing in compliance with the statutory requirement that leases be issued on the basis of competitive bidding. (See p. 12.)

GAO performed this review to determine the need for legislative and administrative remedies for managing emergency coal leasing. Subsequent to its initiation, Congressman Jim Weaver, Chairman of the House Subcommittee on Mining, Forest

Management, and Bonneville Power Administration, requested GAO's evaluation of two specific issues: (1) the kind of difficulties Interior has encountered in administering its emergency leasing regulations under the competitive leasing program required by law, and (2) the need for legislation authorizing negotiated coal lease sales for emergency leasing or other situations.

GAO found that it has been difficult for Interior to carry out emergency leasing in a manner consistent with the statutory requirements of competitive bidding and receipt of fair market value. Because of these difficulties, GAO believes Congress needs to authorize negotiated lease sale procedures as an alternative for use in these leasing situations.

DIFFICULTIES IN ADMINISTERING EMERGENCY LEASING REGULATIONS WITHIN EXISTING STATUTORY FRAMEWORK

Interior's regulations limit emergency coal leasing to situations where the applicant requesting the sale has a clear economic and competitive advantage over other potential bidders. All 39 emergency leases issued since 1977 were for the purposes of maintaining current production and preventing mine closure as well as avoiding the bypassing, and thus the loss, of unleased coal. Consistently, these leases were offered to meet the needs of the applicant requesting the lease sale. Thirty-six of the 39 leases issued (92 percent) resulted in only one bidder, the applicant requesting the lease sale. Although the other three leases issued resulted in more than one bidder, the applicants were the winning bidders and obtained the leases. (See pp. 7-12.)

Although Interior has sought to administer its emergency coal leasing program to minimize abuses, it does not have specific statutory authority to establish lease terms and conditions consistent with emergency leasing situations. Interior's emergency leasing regulations require, as a basis for holding a lease sale, that the applicant must establish the need to begin mining the coal within 3 years from the date of the application. However, Interior has not issued regulatons or included provisions in leases requiring that mining begin within 3 years from the application date. As a result, the lessee cannot be required to begin mining

within 3 years from the application date. GAO found that between March 1979 and November 1980, Interior issued 21 emergency coal leases, 7 (or 33 percent) of which had not produced any coal as of November 1983, more than 3 years since their application date, and none of the leases have been terminated. (See p. 12.)

DIFFICULTIES OF ASSURING A FAIR RETURN TO THE GOVERNMENT FOR EMERGENCY TRACTS WITHIN EXISTING STATUTORY FRAMEWORK

Existing legislation requires the Secretary to reject bids for coal tracts that are less than fair market value. Generally, existing legislation assumes that the value of a coal lease is what it will bring in the open market.

The difficulty with this approach is the gap between the lease tract's value to buyers in general and its special value to the emergency coal lease applicant. Because the applicant is already mining next to the unleased federal coal and, under Interior's regulations, must demonstrate a near-term need for the coal, the applicant can generally mine it without additional outlays for equipment, planning and development, and acquisition of other coal holdings. Such coal has substantial economic value to the applicant, but not to another producer who would have to incur considerable front-end costs. Thus, the assumption of a normal, competitive situation tends to ignore the special economic circumstances of emergency leases. (See pp. 13-14.)

Moreover, the Department's assumption that more than one bidder may be interested in such emergency tracts has led to appraising the value as part of a hypothetical mining unit--consisting of the proposed tract and additional federal and nonfederal coal lands capable of supporting a theoretically designed mining operation. In such cases, Interior arbitrarily allocates a proportionate share of the total estimated value of the hypothetical mining unit to the emergency tract even though it is not able to sell the tract in its entirety, as would occur in a normal competitive lease sale. As a result, the value derived for the tract may not be realistic in terms of its worth to the applicant. (See pp. 14-20.)

NEED FOR LEGISLATIVE CHANGES TO AUTHORIZE NEGOTIATION OF EMERGENCY LEASE SALES

Amendments to the Mineral Lands Leasing Act are needed to authorize Interior to conduct emergency federal coal leasing and to administer such leases more efficiently and effectively. Because the normal competitive leasing program focuses on the regional needs for federal coal--as opposed to site-specific needs of ongoing operations--and takes several years to occur, it lacks the flexibility to enable Interior to respond quickly to the needs of specific operators experiencing emergency situations. In addition, although Interior has emergency leasing regulations, their legality is questionable under existing law governing federal coal leasing because the law requires competition and emergency leasing is inherently noncompetitive. Thus, a separate amendment to the Mineral Lands Leasing Act could eliminate these problems by distinguishing between regional and emergency coal lease sales and by authorizing Interior to conduct emergency leasing through negotiated lease sale procedures. (See p. 25.)

Such legislative changes, however, should include appropriate controls (e.g., public comment and expressions of competitive interest, guidelines for negotiators to follow, and issuance of regulations to implement emergency leasing) to minimize the noncompetitive leasing of tracts which otherwise might be of competitive interest and which should be offered through competitive bidding procedures. The use of negotiated lease sale procedures would reduce the uncertainties currently associated with the appraisal process. They would allow Interior and the potential lessee--within a framework of appropriate controls--to discuss and resolve differences and arrive at a reasonable value for the federal coal.

To facilitate these negotiations, such legislation should also authorize the Secretary of the Interior to have access to pertinent geologic, economic, and financial data from the applicant's existing operation. Absent access to information, it is difficult to judge the accuracy of the estimated value placed on a tract. This authority would allow Interior to evaluate lease tracts on the basis of actual mining conditions. (See pp. 22-25.)

RECOMMENDATION TO THE CONGRESS

To meet the emergency needs of existing mining operations, GAO recommends that the Congress amend the Mineral Lands Leasing Act to authorize the Secretary of the Interior to conduct emergency federal coal leasing using negotiated lease sale procedures for carrying it out. The legislation should provide for (1) a statement of objectives to be achieved through emergency leasing; (2) opportunity for public comment and expressions of competitive leasing interest before conducting negotiated sales; (3) development of guidelines by the Secretary for negotiators to follow which, at a minimum, provide for access to economic and geologic data; disclosure and protection of proprietary information; factors to consider in negotiating lease terms and reasonable value for the federal coal; and public disclosure of lease sale results; and (4) promulgation of regulations by the Secretary for designing and implementing an emergency coal leasing program consistent with the legislation's objectives for such a program and the above standards.

AGENCY COMMENTS

Comments on a draft of this report were obtained from the Department of the Interior. Interior stated that it was not prepared to provide comments on GAO's recommendation and the changes suggested in the draft report, because at that time the Commission on Fair Market Value Policy for Federal Coal Leasing--mandated by the Congress to study the federal coal management program--had not yet submitted a report. Subsequent to the publication of the Commission's report, Interior told GAO that it plans to respond to the recommendation in writing after GAO issues its final report.

Interior did, however, comment on specific points in GAO's draft. Interior generally agreed that emergency leases are of little interest to other coal producers and that the leases are more valuable to the applicants than to others. Interior, however, disagreed with GAO's statement that questioned the Department's authority to establish and enforce special emergency lease terms and conditions. Interior stated that because a lease is a contract it could include a lease term for future emergency

tracts requiring cancellation of the lease if production does not start within a stated period -thus new legislation is not required. GAO noted that although Interior could include provisions in future leases requiring production to start within a stated period, it has not done this to date. Interior also disagreed with GAO that its new lease sale procedures--adopted August 8, 1983--still do not assure a financial return that is fair and equitable to the government as well as to the lessee. GAO noted, however, that the new procedures, although emphasizing sealed bids, still do not resolve the problem for emergency leasing situations since the applicant is expected to be the only bidder to participate in an emergency sale. These and other Interior comments, along with GAO's responses, are further discussed in chapter 4.

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On February 17, 1984, the Commission on Fair Market Value Policy for Federal Coal Leasing issued its report. Further, on March 19, 1984, Interior responded to the Commission's recommendations. The Commission's report makes many recommendations, one of which pertains to the need for Interior to have authority to negotiate a fair price for noncompetitive tracts. In its response, Interior agreed with this recommendation and recognized that legislative action may be necessary. However, neither the Commission nor the Interior report dealt with the specific problems of emergency leasing. GAO believes that in view of the unique objectives of emergency leasing--which takes place outside the normal leasing program--there is a need for separate legislative change to authorize Interior to conduct emergency leasing and to allow the use of negotiated lease sale procedures to carry it out.

Contents

ABBREVIATIONS

EIS	Environmental Impact Statement
FCLAA	Federal Coal Leasing Amendments Act of 1976
GAO	General Accounting Office
NRDC	Natural Resources Defense Council

CHAPTER 1

EVENTS SHAPING THE EMERGENCY

COAL LEASING PROGRAM

From 1920 to 1976 the Secretary of the Interior, under the Mineral Lands Leasing Act of 1920 (30 U.S.C. 181, et seq.), had broad discretionary authority to offer for lease sale federal coal deposits to qualified applicants. The 1920 Act authorized the Secretary to award federal coal leases by use of competitive bidding or such other methods as adopted by general regulation.[1] The Congress enacted the Federal Coal Leasing Amendments Act (FCLAA) of 1976 (principally at 30 U.S.C. 201, et seq.) which, among other things, required that all federal coal leases be awarded by competitive bidding and that no lease be issued at less than fair market value, as determined by the Secretary of the Interior.

Although Interior does not have general authority to issue noncompetitive coal leases, Interior issues federal coal leases to existing producing mining operations which can demonstrate an "emergency" need for additional federal coal reserves under procedures which make competitive bidding unlikely. Two types of situations have been associated with emergency leasing. The first is where an existing mining operator, as part of his planned mining sequence, would soon bypass small parcels of unleased federal coal, making it uneconomical for him or another operator to later recover such coal. Thus, the bypass would result in a waste of federal coal lands as well as in the loss of royalty revenue to federal and state governments. The second situation is where a producing operator needs additional federal coal reserves to maintain his current production level or to supply coal under existing contract with electric utilities and other coal users. Not leasing in this case would result in mining disruptions and employee layoffs. Since 1973, when Interior first implemented such a leasing program, 52 emergency federal coal leases have been offered. All but six of these have been offered since the enactment of the FCLAA in 1976.

MORATORIUM AND USE OF SHORT-TERM LEASING CRITERIA AS INTERIM NONCOMPETITIVE LEASING MEASURE

From May 1971 to February 1973, the Secretary of the Interior imposed an informal moratorium on all federal coal

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[1]Competitive bidding means that otherwise qualified potential bidders cannot be prevented from bidding by limiting participation to a particular class of potential bidders.

leasing and prospecting permits.[2] This action was taken because of concern over low production levels of existing federal coal leases and the concern that the Interior Department's leasing processes were not environmentally adequate.

In February 1973, the Secretary instituted a formal moratorium on all federal coal leasing. As an interim measure--while Interior was to develop a new competitive coal leasing program and programmatic Environmental Impact Statement (EIS)--the Secretary decided to lease coal only when (1) it was needed to maintain an existing mining operation or (2) when coal was needed as a reserve for production in the near future. This marked the first time that short-term noncompetitive leasing criteria were adopted by the Interior Department.[3]

NEW LEGISLATION REQUIRING COMPETITIVE LEASING

Because of its concern with speculative holding of federal coal leases and inadequate financial returns from leasing federal coal lands, the Congress amended the Mineral Lands Leasing Act of 1920 by enacting the Federal Coal Leasing Amendments Act of 1976. In part, the FCLAA requires that all leases be issued by competitive bidding and that no bid be accepted which is less than fair market value. The FCLAA makes no distinction between leasing to meet the needs of existing producing mines and leasing to promote development of new competitive coal mines. Two exceptions, not covered by the emergency leasing regulations, are permitted from the requirement of competitive bidding. The first exception is a provision allowing a modification to an existing lease of up to 160 acres--not resulting in

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[2]Prospecting permits were issued by Interior under the 1920 Mineral Lands Leasing Act. These permits allowed an applicant to explore an area not classified for coal leasing for a period of 2 years. If such exploration led to the discovery of commercial quantities of federal coal, the applicant was entitled to a noncompetitive federal coal lease. The FCLAA terminated the issuance of prospecting permits. However, noncompetitive leases may still be issued pursuant to outstanding preference right lease applications based on prior permits.

[3]By July 1973 the Interior's Bureau of Land Management issued instructions implementing the Secretary's short-term coal leasing policy. The instructions included the requirement that the decision to issue leases should be based on sufficient indications that a prospective applicant needed coal to satisfy an existing market and intended to begin development within 3 years. Clearly, the emphasis was on the immediate needs of existing mining operations rather than on meeting the needs of new competitive operations.

a lease sale nor issuance of a new lease.[4] The second exception is a provision allowing Interior to sell federal coal, based on a negotiated fair market value, the removal of which is necessary and incidental to the exercise of a right-of-way permit [30 U.S.C. 201(a)(1)].

Other than the above two exceptions, no legislative authority was established to recognize noncompetitive emergency-type leasing situations falling outside competitive leasing standards. In addition, the FCLAA established no authority to allow the Secretary of the Interior to negotiate fair market value in other leasing situations where competitive bidding procedures are not appropriate.

In May 1977, the Interior Department issued revised coal leasing regulations outlining its coal leasing program, known as Energy Minerals Activity Recommendations System.[5] The regulations incorporated the requirements of the FCLAA. In addition to competitive leasing, the regulations included short-term leasing criteria which were effective through August 1979 when Interior issued new regulations. Specifically, the criteria state that applications for short-term coal leases will be accepted only if the applicant shows that (1) the coal is needed to maintain an existing mining operation, or (2) the coal is needed as a reserve for production in the near future.

The U.S. District Court for the District of Columbia in September 1977 ruled in NRDC v. Hughes, 437 F. Supp. 981, that Interior's 1975 final coal leasing programmatic Environmental Impact Statement, the basis for the July 1977 regulations, was inadequate. The court enjoined the Department from "taking any steps whatsoever, directly or indirectly, to implement the new coal leasing program, including calling for nominations of tracts for Federal coal leasing and issuing any coal leases, except when the proposed lease is required to maintain an existing mining operation . . . ."

In part, the court order included criteria for short-term (emergency) leasing to meet the needs of producing operations which were similar to those previously established by Interior. The criteria were intended as an interim measure until a

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[4]Section 13 of the Federal Coal Leasing Amendments Act (30 U.S.C. 203) allows an existing leaseholder to secure a modification of the original lease by including additional coal lands contiguous or cornering to those of the lease. However, in no event can the total area added to an existing coal lease exceed 160 acres, or add acreage larger than that in the original lease. Prior to the FCLAA, the Mineral Lands Leasing Act provided for modification and addition to leases without competition of not more than 2,560 acres.

[5]42 Fed. Reg. 25471 (1977).

competitive coal leasing program was developed and implemented. In regard to issuing leases to an existing mining operation, the court order stated that:

> ". . . the proposed lease is required to maintain an existing mining operation at the present levels of production or is necessary to provide reserves necessary to meet existing contracts and the extent of the proposed lease is not greater than is required to meet these two criteria for more than three years in the future."

This court order was subsequently amended in June 1978, 454 F. Supp. 148, to permit more leasing than was originally allowed by the court. The amended order permitted leasing of a limited amount of reserves to existing operations that met one of two criteria--bypass or maintenance--absent the 3-year criterion mentioned above.[6] By their very nature, these criteria have the effect of precluding effective competitive bidding. That is, the existing operation has a clear competitive advantage over other potential bidders.

These court-approved criteria remained in effect until the Interior Secretary approved a new federal Coal Management Program in June 1979. The Court's criteria influenced the shaping of the emergency leasing program and regulations that the Interior Department adopted in 1979 and revised in July 1982.

EMERGENCY LEASING BECOMES A SEPARATE PROGRAM

Interior's Federal Coal Management Regulations (43 C.F.R. 3400) provide a comprehensive leasing system for conveying federal coal deposits to the private sector for development. The regulations--which were issued in July 1979 and revised in July 1982--provide two components of the leasing process. These are (1) normal competitive leasing where Interior has established schedules for leasing federal coal over a period covering several years and (2) leasing-by-application for areas not having scheduled lease sales. The normal competitive leasing process focuses on the regional need for federal coal and consists of two steps--land use planning and activity planning--which take about 4 years to complete before holding a lease sale. During land use planning, the Bureau identifies areas environmentally acceptable for leasing and prepares comprehensive land use plans. At the activity planning stage, Interior's

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[6] Bypass. Permitted where federal coal may be otherwise lost if it is not developed by an existing mine because subsequent costs (either economic or environmental) would be much higher. Up to 5 years of reserves may be included in a lease issued under this provision. To qualify for a lease, mining operations must have been in existence on September 27, 1977.

Bureau of Land Management, with input from industry, state governments, the general public, and Indian tribes, identifies potential lease tracts within those areas deemed acceptable for leasing. The Bureau analyzes these potential lease tracts and ranks them on the basis of several factors, including environmental, geologic, socioeconomic, and overall economic conditions affecting the demand and supply for coal in the region. The overall objective of activity planning is to select and offer lease tracts capable of supporting new independent mining operators.

On the other hand, Interior's coal leasing regulations provide for a leasing-by-application process which allows Interior to conduct lease sales in certain areas without first having to go through the activity planning stage discussed above. These areas include those lands having substantial amounts of federal coal where an emergency need for the unleased federal coal is demonstrated by an existing mining operation between regularly scheduled competitive lease sales as well as lands where federal coal deposits are limited and scattered. According to the Bureau, in these areas it is not cost effective for the Bureau to conduct comprehensive land use planning and activity planning in preparation for a lease sale.

Interior's emergency leasing regulations established criteria that require the applicant to demonstrate a short-term need for the unleased coal to maintain its existing operation or avoid the bypass of the federal coal which is unlikely to be mined by another operator in the foreseeable future. The regulations also require the Bureau to prepare an environmental assessment of the application as well as an evaluation of the lease tract. The tract evaluation is conducted to ensure that the quantity of coal to be leased complies with the criteria and to estimate a pre-sale value of the offered coal.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this review to determine the need for legislative and administrative remedies for managing emergency coal leasing in the future. Subsequently, the Chairman, Subcommittee on Mining, Forest Management, and Bonneville Power Administration, House Committee on Interior and Insular Affairs, requested that our analysis address two specific issues: (1) the kind of difficulties that Interior has encountered in administering its emergency leasing regulations under the competitive leasing program required by law and (2) the need for new legislation specifically authorizing the Secretary to conduct emergency coal leasing and allowing the Secretary to carry it out through the use of negotiated lease sale procedures. (See app. I.)

We interviewed Department of the Interior and the Bureau of Land Management officials with responsibilities for the design and implementation of emergency coal leasing regulations in headquarters and field offices at Washington, D.C. and Reston, Virginia; Denver, Colorado; Casper, Wyoming; Salt Lake City,

Utah; Billings, Montana; and Alexandria, Virginia. In addition, we interviewed geologists, mining engineers, mineral economists, program analysts, and computer program analysts within the Bureau. We also interviewed representatives from coal companies and coal industry trade associations knowledgeable of emergency leasing and regulations.

We focused our review on Interior's regulations, procedures, and tract evaluation guidelines for emergency leasing. We analyzed Interior's tract appraisal techniques and their application in evaluating emergency lease tracts. We analyzed all emergency lease sales conducted since the enactment of the Federal Coal Leasing Amendments Act of 1976. The universe consisted of 46 emergency lease sales between March 1977 and March 1984, the most recent emergency lease sale at the time of our review. The 46 sales were conducted in six western states--Montana, North Dakota, Colorado, Wyoming, Utah, and New Mexico--and Alabama.

Our review addressed four major issues affecting administration of emergency leasing within the existing statutory framework governing federal coal leasing. These issues relate to whether (1) Interior's regulations limit emergency leasing to situations where competitive bidding is unlikely to exist; (2) Interior has the statutory authority to establish lease terms and conditions consistent with these leasing situations; (3) the economic aspects of emergency lease tracts limit the competitive interest of these tracts to other coal producers; and (4) competitive bidding procedures are appropriate for assuring that the government obtains a reasonable value for the coal in emergency situations.

This evaluation was conducted in accordance with generally accepted government auditing standards.

CHAPTER 2

DIFFICULTIES ADMINISTERING EMERGENCY LEASING UNDER EXISTING LEGISLATION

The previous chapter indicated that Interior established its emergency leasing program for the purpose of preventing the bypass of unleased federal coal and disruptions of coal supplies to electric utilities or industrial users of federal coal because of a shortage of leased federal coal. Although these objectives are appropriate from a public policy perspective, the carrying out of emergency leasing within the existing statutory framework governing federal coal leasing has caused several difficulties. These concerns, which are addressed and analyzed in this chapter, include:

--Interior's regulations, which are designed to avoid abuses of the emergency leasing process, require applicants to show a legitimate need for the coal, but in doing so limit such leasing to situations where competitive bidding is unlikely to exist;

--Interior has not established lease terms and conditions consistent with emergency situations and, therefore, there may be a need for a statutory requirement that Interior safeguard against abuses;

--Because emergency lease tracts are of little or no interest to other coal producers, their value on the open market is very low although they may have substantial economic value to the applicant; and

--In view of the noncompetitive features of emergency lease tracts, competitive bidding procedures do not assure that the government obtains a reasonable value for the coal.

EMERGENCY LEASING REGULATIONS RESTRICT LEASING TO NONCOMPETITIVE SITUATIONS

Interior established an emergency leasing process because of the need to relieve producing federal coal lessees of the hardship that might occur in certain cases if all leasing proceeded through normal procedures. Because of the special situations under which emergency leasing is conducted, competition is unlikely to occur. Planning for emergency leasing is applied site-specifically so that responses to applicants' needs can be made quickly rather than through the lengthy activity planning process of the normal competitive leasing process.

In establishing its emergency leasing process, Interior adopted certain criteria to guide the processing of applications for emergency lease sales. In 1979, when Interior formulated the regulatory framework governing emergency leasing, it established specific criteria for reviewing emergency lease sale applications and determining the need to conduct a lease sale. In July 1982,

Interior revised its emergency leasing regulations (43 C.F.R. 3425.1-4).[1] The regulations include the following criteria:

1. The coal reserves applied for must be mined as part of an existing mining operation that is producing coal on the date of the application.

2. The federal coal is needed within 3 years to:

   --maintain an existing mining operation at its current average annual level of production on the date of application, or to supply coal for contracts signed prior to July 19, 1979 (date of the previous regulations); or

   --if the coal deposits are not leased they will be bypassed in the reasonably foreseeable future and, if leased, some portion of the tract applied for will be used within 3 years.

3. The amount of coal leased is not to exceed 8 years of recoverable reserves at the rate of production under which the applicant qualified in (1) and (2) above.

4. The need for the coal deposits must have resulted from circumstances that were either beyond the control of the applicant or could not have reasonably been foreseen and planned in time to allow for consideration of leasing the tract under the regional leasing process.

These criteria have restricted emergency leasing to situations in which competitive interest in the proposed lease tract is unlikely to occur. For example, all 46 emergency lease sales conducted since the enactment of the FCLAA have been conducted for the purposes of (1) preventing the bypass of federal coal and the loss of royalty revenues to the government, or (2) providing an existing operation additional reserves to maintain production levels between regionally scheduled lease sales in order to mitigate the costs of unemployment due to mine disruptions or coal contract failures. Table 1 shows the classification of emergency lease tracts offered from 1977 through March 1984. Appendix II shows the results of these emergency lease sales. The following discussion analyzes the above criteria in greater detail.

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[1]In revising its emergency coal leasing regulations in 1982, Interior eliminated certain provisions which were included in its previous regulations. The eliminated provisions included (1) requiring that a mining operation produce coal for 2 years before the operator may apply for an emergency lease sale, (2) limiting an operator to no more than one emergency lease at a time for each operation, and (3) restricting competition at emergency lease sales to bidders meeting the emergency criteria.

Table 1

Summary of Emergency Lease Tracts Offered by Tract type

Year	Bypass	Production maintenance	Total
1977	1	1	2
1978	2	4	6
1979	8	6	14
1980	7	2	9
1981	2	5	7
1982	1	3	4
1983	2	1	3
1984	1	-	1
Total	24	22	46

Application Must Be From An Existing Mining Operation

The emergency criteria require that the applicant be producing coal at the time the application is filed with the Bureau and that the application lands will be mined as part of the operation. Emergency lease tracts are offered to meet the specific needs of the applicant's mining operation so as to maintain current production until the next regional competitive sale. In other cases involving potential bypass tracts, the applicants are capable of extending their mining operating sequences into these tracts without incurring significant additional costs (e.g., altering established mining plan sequences or moving heavy earth-moving equipment from distant mining sites). Because of these spatial characteristics of emergency lease tracts, the applicant is in a superior position--economically as well as technologically--compared to other potential producers to mine the coal profitably. Thus, as indicated by results of emergency lease sales conducted since 1977, little or no competitive bidding exists for such tracts.

Our review indicated that for those applications that met the criteria and qualified for a lease sale, the Bureau regarded the applicant as the logical producer of the proposed tract. In fact, the emergency criteria require that the reserves applied for must be mined as part of an existing operation that is producing coal at the date of application. The existence of a producing mining operation also has made it difficult for the Bureau to evaluate emergency lease tracts as if they could be mined independently of the adjacent operation as well as to obtain competition at lease sales.

Of the 46 emergency lease sales conducted, 39 leases were issued. Thirty six, or 92 percent, of the 39 emergency leases issued, involved only one bidder--the applicant--while the remaining 3 leases issued resulted in more than one bidder. In

these three cases, the applicant requesting the sale was the winning bidder and obtained the proposed lease tract.

Of the remaining seven emergency lease sales conducted, in three the applicants or other parties did not bid on the tracts and in three other sales the Bureau rejected the applicants' bids on the grounds that they were less than fair market value. The remaining lease sale conducted did not result in a lease being issued because the only bidder, the applicant, refused to accept the lease since the sale was delayed and the federal coal bypassed.

Three Year Mining Requirement and 8 Year Reserve Limits

The criteria require that for bypass and production maintenance situations the applicant must show a need for the coal within 3 years from the date of application. Interior's rationale for adopting this 3-year production rule was to discourage companies from creating "artificial by-pass" problems. That is, Interior's preference was to make decisions about new mines through the activity planning stage of the normal competitive leasing process. In promoting this objective Interior has sought to discourage companies from opening mines with insufficient reserves on nonfederal coal lands adjoining unleased federal coal and then attempting to qualify for the federal coal under the emergency leasing process. However, it recognized the potential abuse to the competitive leasing process through the creation of bypass situations as a way of avoiding a competitive lease sale. In this regard Interior has stated that "No operator who opened a mine with insufficient reserves in the expectation of acquiring a Federal lease would be considered to have a legitimate need for the coal."[2]

However, Interior believed that if the applicant could demonstrate that the coal was legitimately needed within 3 years of the application date, then issuance of a production maintenance or bypass lease could be considered. Interior indicated that such an approach offered the following advantage:

> "Three years is less than the lead time required to open a new mine. If an operator is that close to opening it, it can be assumed that the decision to open the mine has been already made, independent of any future federal leasing. Since the design of the operation would be more efficient if the federal coal were available it might be advantageous to process the application during the mining plan approval stage rather than waiting until the mine has already been in production for 2 years."[3]

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[2]47 Fed. Reg. 33124 (1982).

[3]US Department of the Interior, Secretarial Issue Document for the Federal Coal Management Program, June 1979, Volume I, page T25.

Considering the time and expense of developing a new mining operation, few potential bidders other than the applicant would be able to demonstrate the need for the coal within 3 years from the date of lease application. Interior regards the applicant to be in a superior position relative to other potential bidders in meeting the 3-year criterion. For example, in the preamble to its July 19, 1979, federal coal leasing regulations Interior stated that:

> "Some comments requested that the three-year period within which the operator would reach the coal in an emergency lease application be extended. This was not adopted; the three-year period is consistent with the purpose of this subpart and the amount of time necessary to process a lease application, hold a sale, and issue a lease in time to reach production."[4]

Also, the Bureau delineates emergency leasing tracts with the intention of limiting the amount of coal for each application. For example, emergency leasing criteria limit the amount of reserves (equivalent to 8 years of production) to an applicant, based on the applicant's average annual production record. Interior documents show that the reserve limitation was adopted because Interior believed that leasing large numbers of years of reserves under the emergency leasing system could compromise the regional leasing process. Interior also thought by adopting the 8-year criterion it would avoid criticism of capriciousness, inconsistent application of criteria, or favoritism to any one applicant. Interior restricted the maximum number of years of reserves that can be leased in any one emergency lease sale to eight. This number was selected because Interior thought it would be sufficient to tide the operator over until the next competitive lease sale in the region. According to the June 1979 Secretarial Issue Document on the coal leasing program, the actual amount of reserves leased to any emergency lease sale applicant may be less than 8 years if only a limited amount of unleased federal coal lies within the applicant's projected mining unit. The point is that this criterion focuses on the applicant's needs as opposed to the potential competitiveness of the tract on the open market.

Circumstances Must be Beyond the Control of the Applicant

As an additional measure to prevent existing coal mining operations from using the emergency leasing process to evade or frustrate the normal competitive leasing process, Interior established the following criterion in its previous coal leasing regulations issued in July 1979, and which is still a part of its current emergency leasing regulations:

> "That the need for the coal deposits shall have resulted from circumstances that were either beyond the control of the applicant or could not have been

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[4] 44 Fed. Reg. 42595 (1979).

reasonably foreseen and planned in time to allow for consideration of leasing the tract under the provisions of section 3420.3 of this title."[5] [43 C.F.R. 3420.3 refers to the competitive leasing process for identifying, ranking, analyzing, selecting, and scheduling lease tracts after land use planning has been completed.]

In explaining this criterion in its preamble to its previous coal leasing regulations, Interior stated that bypass coal lease tracts can and will be leased under the provisions of the normal competitive leasing process. It also stated that because of the mixed ownership patterns that exist in many cases, it may be easy for an operator to create a bypass situation intentionally. Interior, however, believes that such actions will not subvert the normal leasing process, even if minor amounts of coal are lost. Further, Interior asserts that an applicant for an emergency lease sale who does not actively participate or fails to prevail in the normal competitive leasing process "will not generally be allowed a 'second chance' through emergency leasing."[6]

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In view of the above analysis of Interior's emergency leasing regulations, it is questionable whether the regulations and emergency leasing process comply with the statutory requirement that leases be issued on the basis of competitive bidding. Specifically, what is brought into question is the legality of a procedure which permits bidding by any otherwise qualified bidder but limits leasing to situations in which the applicant has such a clear economic and competitive advantage over other potential bidders as to make the competitive bid process illusory. As discussed in chapter 1 of this report, the Secretary of the Interior does not have specific authority to issue noncompetitive leases in the circumstances described by the emergency leasing regulations. Under the Mineral Lands Leasing Act, as amended, two exceptions, not covered in the emergency leasing regulations, are permitted from the requirement for competitive bidding. These exceptions are the modification of up to 160 acres to an existing lease and a sale of federal coal necessary to the exercise of a right-of-way permit.

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[5]47 Fed. Reg. 33141 (1982).

[6]44 Fed. Reg. 42594 (1979).

NEED FOR STATUTORY AUTHORITY TO SAFEGUARD AGAINST ABUSES

Interior's emergency leasing regulations require that the applicant must establish the need to begin mining some portion of the emergency tract within 3 years of the application date. However, the 3-year production requirement is used only in the application screening process and is not legally binding since issued leases are only subject to a statutory provision that requires production in commercial quantities to begin by the end of the tenth year from the date of lease issuance or the lease will be terminated.

As discussed above, the 3-year production criterion was established for the purpose of avoiding abuses to the normal competitive leasing process. Interior's emergency leasing criteria and lease terms, however, make no provision as to the consequence if a lessee does not begin to mine any coal in the emergency tract within 3 years from the date of application. Thus, if an applicant or any other party obtains an emergency lease and does not begin mining within 3 years, he is not subject to any penalty for not producing within this timeframe.

Interior, in its comments on our draft report, indicated that a future lease term for production maintenance tracts could be that the lease is cancelled if the lessee has not commenced to mine coal within a stated period. Although the basis for approving an emergency lease sale application is the need to start mining within 3 years from the application date, Interior has not issued regulations or included provisions in leases requiring mining to begin within the 3-year period. Our review indicated that between March 1979 and November 1980, the Bureau leased 21 emergency coal tracts, 7 (or 33 percent) of which had not begun to produce coal as of November 1983. Thus, in the case of these seven leases (five of which were designated as bypass leases), 3 or more years have passed since the date of their application for the lease sale, and none has been terminated.

In view of Interior's failure to deal with the above nonproducing emergency leases, there may be a need--in connection with establishing new statutory authority for noncompetitive leasing (see p.21)--to include safeguards against abuses. Such legislation could include the requirement that Interior prescribe a timeframe for the start of production that is consistent with the basis for the applicant's request for an emergency lease sale. This would provide assurance that the emergency leasing program is not abused by an applicant who does not begin mining in accordance with his application. Thus, an applicant who obtains an emergency lease on the basis that mining would begin within 3 years would be required to do so under the terms of the lease.

EMERGENCY TRACTS ARE OF LITTLE VALUE ON OPEN MARKET--BUT MAY HAVE SUBSTANTIAL VALUE TO THE APPLICANT

Existing legislation requires the Secretary of the Interior to follow competitive bidding procedures and not to accept bids for coal tracts that are less than fair market value. Soon after the enactment of FCLAA, however, Interior encountered problems leasing emergency tracts through competitive bidding because of the lack of competition at such sales. The basic problem has been determining fair market value for emergency tracts regarded as an extension of a producing operation, and how such tracts should be offered when the applicant is expected to be the only bidder to participate in the sale. Emergency lease tracts are of little or no economic value (i.e., they have poor prospects of providing a profitable operation) to producers other than the applicant. All but 3 of the 42 emergency lease tracts that received bids in sales conducted since 1977 involved only one bidder, the applicant requesting the coal lease sale.

In Interior documents relating to federal coal lease sale procedures and fair market value, Interior indicated that small lease tracts, such as those offered through the emergency leasing process, are not expected to be of competitive interest on the open market.[7] This stems from the existence of a mining operation adjacent to the proposed lease tract as well as coal and surface ownership patterns which limit access to the tract by other producers. These factors often cause the federal coal to be of value only to one potential bidder, the adjacent operator requesting the lease sale. Because of this condition Interior has found it difficult to establish a reliable presale value for the proposed tracts.

In emergency leasing situations the applicant is already mining coal next to the unleased federal coal and, in fact--under Interior's regulations--must demonstrate a near-term need for the coal as a part of his mining operation. The applicant generally is able to mine the coal with little or no additional outlays for equipment and the like. Thus, such coal has substantially more economic value to the applicant in relation to other potential bidders. However, the value of the tract to a specific operator situated adjacent to the unleased federal coal is not necessarily the same as the tract's fair market value.

Fair market value is an appraisal term defined by the courts to mean the value the property would be sold for by a knowledgeable seller willing but not obligated to sell to a

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[7]U.S. Department of the Interior, Secretarial Issue Document for the Federal Coal Management Program, June 1979; and Memorandum from the Director of the Bureau of Land Management to the Secretary of the Interior, concerning Background Material Relating to Fair Market Value for Federal Coal Leases, July 22, 1983.

knowledgeable buyer who desires but is not obligated to buy. Generally, existing legislation governing coal leasing assumes that the value of a coal lease is what it will bring in the open market. In this regard, fair market value ideally is based on an appraisal of the property in terms of the lease tract's value to buyers in general without taking into consideration the special value that the lease tract may have to an adjoining operator. Because of the noncompetitive nature of emergency lease tracts, however, their worth on the open market generally is very low to a producer other than the adjacent operator.

The total bonus bids received for the 39 emergency leases issued through May 1984 amounted to about $4.7 million. Because of certain complexities affecting emergency lease sale results (i.e., bonus bids and royalty rates)--such as Interior's use of different procedures for valuating and offering tracts, the unique economic circumstances underlying each lease sale, and changes in the value of royalty payments over time--we did not estimate the value of the 39 emergency leases issued through May 1984. These complexities make it difficult to estimate lease values and to make comparisons of such values over time or among different points in time.

COMPETITIVE BIDDING PROCEDURES DO NOT ASSURE FAIR RETURN TO GOVERNMENT

In carrying out its emergency leasing process, Interior has recognized the low value that emergency lease tracts have on the open market and that competitive interest in these tracts is unlikely to exist. Because such tracts usually contain relatively small quantities of coal and are located next to an adjacent operator, they are not capable by themselves of supporting a new operation independent of the adjacent operator. Moreover, the purpose of the emergency leasing process is to offer lease tracts that respond to the needs of the applicant rather than tracts that will be of competitive interest to other producers. Thus, the use of competitive bidding procedures is not an appropriate way of offering these tracts when only one producer, the applicant, is in a position to mine the coal.

However, the FCLAA requires that all federal coal leasing be conducted through the use of competitive bidding. Thus, the law provides Interior no alternative to competitive bidding for leasing emergency lease tracts. As a result of this statutory requirement, the Bureau has felt constrained to evaluate and appraise coal tracts under an emergency application on the assumption that more than one bidder would be interested in leasing and mining the coal.

Soon after the enactment of FCLAA, the Bureau encountered problems in estimating the value of proposed emergency lease tracts which were not expected to attract competition. According to Interior internal memoranda, the problems of estimating such a value focused on the methods that the Bureau should use for

appraising emergency lease sale tracts and whether the Bureau should publicly disclose a minimum bid value for the proposed lease tract before holding a sale.

Method for Evaluating Emergency Lease Tracts

Consequently, the Bureau adopted tract evaluation procedures for appraising emergency lease tracts which focused on the concept of a hypothetical mining unit. A hypothetical mining unit is an area of coal land which includes the application lands, and may also include parts or all of the applicant's coal lands as well as other adjacent federal and nonfederal coal lands that may or may not be under the control of the applicant. By including other coal lands, a hypothetical mining unit is formed which theoretically can be viewed as containing a sufficient quantity of coal reserves to support an independent mining operation. The Bureau uses the hypothetical mining unit to conceptually design a mining operation and to estimate the value of the proposed lease tract. In estimating the economic value of the hypothetical mining unit and the proposed lease tract, the Bureau makes assumptions concerning mining methods and costs which may have little relationship to the actual circumstances involved. In determining the value of an emergency lease tract within the context of the hypothetical mining unit, the Bureau allocates a portion of the hypothetical mining unit's total estimated value to the emergency tract on an acreage or tonnage basis. For example, if the emergency tract accounts for 20 percent of the total acreage (or tonnage) of the entire hypothetical mining unit, then 20 percent of the entire unit's total value is allocated to the emergency tract in determining its economic value. The Bureau also takes into account recent coal transactions in the area.

Generally, the hypothetical mining unit is a reasonable evaluation concept. However, Interior has encountered difficulties in using the concept specifically to evaluate emergency coal lease tracts. Bureau officials have identified important limitations in using the hypothetical mining unit concept. For example, in a 1979 memorandum prepared by the Bureau's Montana State Office, the following problems were identified:

- --The adjoining operation (the applicant) is in a superior position, hence the sales are not competitive.
- --The value of the proposed lease tract is sensitive to the scale of the operation. This means that the larger the hypothetical mining unit the lower the average mining cost per ton of coal to the existing operator but not necessarily to other bidders.
- --Even if there could be other successful bidders, the only coal reserves available to them are those contained in the proposed lease tracts which often are uneconomical to mine as independent mining units.

--Evaluations ignore the factual circumstances involved. In actuality, the operator may possess significantly different equipment and be operating in an entirely different mining pattern than the hypothetical one used by the Bureau for evaluation. The operator may also be committed to prior contracts with a significantly different sale price than that used in the evaluation.

In addition to these problems, proposed emergency lease tracts often are adjacent to coal and surface rights under the control of the applicant. In these situations the Bureau assumes that other potential bidders can gain access to the applicant's holdings as well as to the proposed lease tracts without incurring substantial costs. Such an assumption ignores the realities of emergency leasing situations. Furthermore, the Interior lacks specific statutory authority to allow the Bureau to evaluate nonfederal coal lands as it does federal coal lands that will be mined along with the proposed lease tract.

As a result of the above problems, it has been difficult for the Bureau to estimate the prelease sale value of emergency tracts as part of hypothetical mining units. This has been difficult to do because the Bureau must make many assumptions in estimating the quantity and availability of coal in the hypothetical mining unit, mining cost, coal selling price, and mining sequences in developing the coal. In view of these uncertainties, the Bureau uses these estimated values for judging the reasonableness of bids submitted at emergency lease sales. Since these judgments must be made in the absence of a competitive sale involving tracts having a low value on the open market, the Bureau is not always sure whether the value it places on a tract is too high or too low for any given leasing situation. For example, on the one hand, if the bidder does not meet the estimated value, there is no way of knowing whether he would have bid higher in a competitive situation. On the other hand, if the bidder does not meet the Bureau's estimated value, rejecting such a bid could mean the permanent loss of mineable coal as well as production royalties.

Methods for Announcing Minimum Bid

In recognizing the above valuation problems, Interior has experimented with different methods--none of which is still being used--of announcing minimum bids for proposed emergency lease tracts before holding a sale. The Bureau used these methods in order to increase the likelihood of successful lease sales in situations where competition is unlikely to occur. For example, one method used in offering seven emergency tracts between June 1977 and April 1979, was to announce royalty rates above the 12.5 percent statutory minimum (ranging from 15.5 percent to 21 percent) and a minimum bid of $25/acre. This method was used to avoid high front-end cash payments which the Bureau believed to be a burden on the applicants requesting the lease sales.

Another method used by the Bureau was to announce a minimum bid of $25/acre and royalty rates of 12.5 percent for surface coal

and 8 percent for underground coal. This method required bidders to submit sealed bids and was followed by oral bidding. This method was used for offering 24 emergency lease tracts from 1978 to late 1981. All but two of these sales attracted one bidder.

In addition, between late 1980 and mid-1983, the Bureau set some minimum acceptable bids at 50 percent of the estimated economic rent of the tract.[8] In our previous report on the competitive coal leasing program[9] we criticized Interior for using this procedure in evaluating proposed lease tracts. Subsequent to the report, Interior dropped the use of the procedure.

Still another procedure was used for leasing situations in which the operator--unlike the above situation--could mine around (i.e., bypass) the federal coal without financial hardships, resulting in a permanent coal bypass and loss of royalties. In these cases, Interior accepted bids at the regulatory minimum level of $25/acre, regardless of the value of the coal offered. The bids offered for this coal generally were at or close to this regulatory minimum price. In adopting this procedure (which was effective from December 1980 through mid-1983), Interior provided the following rationale:

> "Where the [Bureau] can make a determination that the applicant or potential bidder can continue an ongoing operation by mining around the proposed lease tract with little or no economic sacrifice, the Department should recognize the reality of this type of bypass situation by foregoing its (potentially significant) normal share of the excess profits accrued from mining the tract . . . . The rationale for setting this MAB [Minimum Acceptable Bid] level regardless of the isolated tract's worth is that the company applying for the lease cannot be forced to charge its customer, usually a utility under long-term contract, more for the bypass coal than the coal on surrounding lands already under its control at substantially cheaper costs. But this is just what the Department would be attempting if the MAB were set to capture more than minimum rates from the tract. . . The probable economic loss to the government stemming from the applicant's greater likelihood of refusal to bid or mine these

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[8]Economic rent, referred to as "producer surplus" or "excess profits," is a concept from economic theory of markets. In coal property evaluation, economic rent is represented by the present value difference between the market price of the mined coal and the costs, including "normal" returns to capital, of producing the coal.

[9]Analysis of the Powder River Basin Federal Coal Lease Sale: Economic Valuation Improvements and Legislative Changes Needed, GAO/RCED-83-119, May 11, 1983, pp. 37-38.

tracts would exceed the potential loss of revenue engendered by setting the MAB at $25/acre with an 8 or 12-1/2 percent royalty. The MAB would, therefore, reflect the expected true value of the tract in the market . . . ."

Our review indicated that the above methods of announcing minimum bids before a lease sale did not resolve the problems of the lack of competitive interest in emergency lease tracts and assuring the receipt of a fair return to the government.

New Sale Procedures Adopted by Interior

On August 8, 1983, Interior adopted new coal lease sale procedures (effective September 1983) which address concerns about previous deficiencies in the competitive leasing program.[10] The new procedures, however, do not resolve the above problems associated with the valuation and offering of emergency coal lease tracts. Among other things, Interior's new coal lease sale procedures require the Bureau to perform an appraisal of all offered tracts--before holding a lease sale--and to determine final appraisal value for each lease tract offered after a lease sale has been conducted. The procedures also require that sealed bidding only will be permitted and that all tracts are to be offered at a minimum of $100 (rather than $25) per acre. According to the new procedures, this minimum bid is to be viewed as an administrative floor price that bears no relation to the fair market value of a tract.

In adopting the policy of offering all lease tracts in the Notice of Sale at the regulatory minimum of $100/acre, Interior provided the following reasoning:

"At the core of this decision is the policy question of whether the minimum bids posted in the Notice of Sale should primarily serve to advertise the Department's presumed acceptance standard, or to establish a floor so that only serious bidders participate in lease offerings. In support of announcing the Department's acceptance standards are the following points:

- For "noncompetitive" tracts in particular, furnishing an acceptance standard or reservation price follows a negotiation-like strategy. Negotiation is, in theory, the preferred approach for setting prices when there are two equally matched parties. In setting and announcing its value estimates the Department states its reservation price. If no bids are submitted, a tract may be reoffered at a later date.

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[10]48 Fed. Reg. 36007 (1983).

- From a practical standpoint, many tracts (including new production tracts) receive only one bid. Therefore, competition cannot usually be relied upon to guide bid acceptance decisions. By letting bidders know the BLM's acceptance level, the BLM would probably realize a higher successful leasing rate (while receiving fair market value) than would be achieved by offering tracts at a floor of $100/acre.

Setting minimum bids at the $100/acre regulatory minimum would be the preferred approach in consideration of the following objectives:

- Sealed bidding works best when bidders have as little information as possible about the value placed by an owner on the object being sold. Thus there is a good chance that successful bidders will pay more than the Department's pre-sale estimates, provided minimum bid levels are nominal and bear no relationship to these estimates.

- Setting minimum bids at estimated fair market value runs the risk that the minimum bids may actually exceed the market value of the tracts, since precise valuation of coal tracts is extremely difficult under the best of circumstances. If that is the case, minimum bids could turn into artificially high entry barriers. Setting minimum bids that may have been out of touch with market conditions was a major justification for abandoning the MAB system used in 1981 and early 1982."[11]

Interior believes its new lease sale procedures will provide additional information that normally is not available before competitive lease sales for use in deciding whether to accept or reject bids, such as number of bidders interested in each lease tract, and the amount of their bids. However, these procedures are not appropriate in the case of emergency coal leasing, where the applicant is expected to be the only bidder in the sale. Little, if any, new information will be available concerning the value of the tract on the open market. Thus, we believe that Interior is in no better position than before for assuring a financial return for emergency tracts that is fair and equitable to the government as well as to the lessee.

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[11]U.S. Department of the Interior memorandum from the Director of the Bureau of Land Management to the Secetary of the Interior, concerning Transmittal of Decision Document and Background Material Relating to Fair Market Value for Federal Coal Leases, pages 7 and 8, July 22, 1983.

CHAPTER 3

LEGISLATION AUTHORIZING AND SAFEGUARDING EMERGENCY LEASING IS NEEDED

Because of (1) the basic incompatibility between emergency leasing situations and the competitive leasing framework required by the Federal Coal Leasing Amendments Act of 1976 (as discussed in chapter 2) and (2) the significant number of applications for emergency lease sales anticipated through 1987, new legislation is needed. New legislation would correct the problems by specifically authorizing the Secretary of the Interior to conduct emergency federal coal leasing using noncompetitive negotiated sale procedures, coupled with appropriate safeguards. Negotiated sales would also allow more effective use of Interior's resources in issuing emergency leases with terms and conditions consistent with the basis for the emergency lease sales, and also help assure a reasonable and equitable financial return to the government.

In a previous report on the competitive coal leasing program,[1] we recommended that the Congress amend the Mineral Lands Leasing Act to authorize Interior to use negotiated lease sale procedures for certain tracts now offered at regionally scheduled lease sales. However, it is important that a distinction be made between leasing situations occurring under the normal regional leasing process and those occurring under the emergency leasing process. Such a distinction is important because the two processes differ in their objectives, timing of lease sales, and procedures for screening and offering lease tracts. Thus, in view of this distinction, separate legislative changes are needed to authorize Interior to conduct emergency leasing and to use negotiated lease sale procedures to carry it out.

FUTURE EMERGENCY LEASING IS ANTICIPATED TO BE AN IMPORTANT ACTIVITY

Emergency leasing will continue to play an important role in the future. According to the Bureau's planning and budgeting document for the coal program, 160 applications for coal lease sales are expected to be processed between fiscal years 1984 and 1987. According to the Bureau's field personnel, about 66 of these applications are anticipated to be requests for emergency coal lease sales. The remaining applications would be requests for lease sales in areas outside major coal production regions having small and scattered amounts of federal coal. In addition, as of mid-July 1983, 13 emergency lease sale applications in Utah, Wyoming, and Colorado were being reviewed by the Bureau for potential lease sales in the near future. This indicates that emergency leasing will continue to be an important part of the

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[1]GAO/RCED-83-119, May 11, 1983, pp. 37-38.

federal coal leasing program. In addition, Bureau officials informed us that the actual number of anticipated emergency lease sales could be greater in the event that scheduled regional competitive coal sales are postponed or delayed.

LEGISLATION IS NEEDED TO AUTHORIZE EMERGENCY LEASING

Existing legislation does not make a distinction between leasing to meet the needs of ongoing mining operations and competitive leasing to encourage development of new mining operations independent of existing operations. It requires the use of competitive bidding for all leasing and does not authorize use of other leasing procedures more appropriate for emergency leasing. New legislation to specifically authorize emergency leasing could provide for the use of negotiated leasing procedures, with appropriate safeguards. Such procedures would allow emergency coal leasing to be carried out in a more efficient and effective way.

Noncompetitive negotiated lease sale procedures would be appropriate for those leasing situations restricted to ongoing mining operations. In such instances, it would not be necessary to trigger the full competitive leasing process to dispose of tracts which clearly are noncompetitive. Also, negotiation would enable Interior to establish lease terms and conditions consistent with emergency situations and to value coal on the basis of actual costs, market conditions, geologic, and other factors relating to the applicant's existing coal operation. This would help assure that the government receives a reasonable value for its coal.

Interior has previously indicated that emergency leasing is basically noncompetitive in substance and has recognized the need for new legislation.[2] For example, in 1977, in its annual coal leasing report to the Congress, Interior made several recommendations for improving coal resource management on federal lands. Noncompetitive leasing was one recommendation. The report states:

> "There may be situations where the Department should be allowed to issue noncompetitive coal leases. This would require an amendment to the FCLAA. Two such situations frequently occur: when the coal will otherwise be bypassed or where coal underlies a right-of-way application for access to other coal and would be extracted during tunnelling."

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[2]Annual Report on Coal, Fiscal Year 1977, U.S. Department of the Interior annual report under section 8 of the Federal Coal Leasing Amendments Act of 1976, p. 62, and Transmittal of Decision Document and Background Material Relating to Fair Market Value for Federal Coal Leases, from Director of the Bureau of Land Management to the Secretary of the Interior, July 22, 1983.

In 1978, the Congress further amended the Mineral Lands Leasing Act (P.L. 95-554), to allow noncompetitive leasing of federal coal for the exercise of rights-of-way permits. The law was not changed, however, for bypass leasing situations. Thus, although noncompetitive in nature, such situations must still be handled through the competitive leasing process.

In reviewing the alternative of negotiated sales, we identified several advantages and disadvantages. We also identified safeguards which would be appropriate to compensate for the disadvantages. Some of the advantages of negotiated sales are as follows:

--They would recognize the realities of emergency leasing. Being essentially noncompetitive in nature, emergency lease sales should be negotiated rather than conducted under competitive bidding procedures. Negotiations would be based on the facts of the situation. Under current procedures, emergency lease tracts are evaluated on the basis of professional judgment involving hypothetical economic and mining conditions. Negotiated sales would reduce uncertainties and use of hypothetical conditions by allowing the government and the applicant to determine a reasonable price for the coal leased based on verifiable costs and actual mining conditions, something which is not possible under current legislation.

--They would result in a more effective use of Interior personnel. Rather than preparing for a lease sale that would not be truly competitive, negotiation would allow Interior and the lessee to focus on the actual circumstances in a realistic manner.

--They would allow flexibility and the consideration of economic and technological factors which are precluded from emergency leasing criteria. For example, acreage limitations and the amount of reserves to be leased to any one applicant could be determined through negotiation, subject to controls and safeguards, in order to take mine safety, engineering, and economic factors into account. These factors are of importance in determining a reasonable value for the federal coal.

Disadvantages of negotiated sales, or any noncompetitive leasing procedures, relate to the potential abuses of the noncompetitive leasing process. In this regard, there is a concern as to the standards and procedures under which discretionary authority would be used for determining which emergency lease sale applications and situations warrant use of negotiated sale procedures. Thus, it is important that any new legislation state the objectives of emergency leasing and provide standards of accountability for preventing potential abuse of the competitive leasing program. The objectives of emergency leasing could be based on the goals which historically have been associated with this form of leasing. These goals include preventing bypassing of federal

coal resources; maintaining production levels of existing mining operations; and receiving a reasonable return for federal coal leased and produced.

STANDARDS FOR SAFEGUARDING NEGOTIATED EMERGENCY LEASE SALES

New legislation should provide standards aimed at achieving the objectives of emergency leasing in a manner that is efficient and equitable. Such standards should provide flexibility in administering emergency leasing effectively and minimize abuse to the competitive leasing process. In this regard, new legislation should require Interior to follow certain standards for developing and implementing an emergency leasing program. The responsibility for developing criteria and other details for implementing these standards should be delegated to the Department of the Interior.

The standards should provide for:

(1) Review of emergency lease sale applications and development of findings to warrant the use of negotiated sales. For example, one criterion should be that the coal be leased to avoid bypass of unleased federal coal which other operators are unlikely to recover in the foreseeable future.

(2) Opportunity for the public to comment on findings and to submit expressions of competitive interest in the coal lands under application. This opportunity should come after the Interior reviews an application and develops findings on the feasibility of holding a negotiated lease sale, but before making a final decision to do so. This would provide an important control measure to assure an open and equitable decision-making process. Its purpose would be to prevent the government from undertaking a negotiated lease sale when substantial competitive interests may truly exist. In the event evidence of competitive interest in the lands subject to application is submitted, established criteria could be used to determine its validity before the Secretary decides to conduct a negotiated lease sale. To achieve the objectives of emergency leasing, the criteria should eliminate speculation and potential disruption of existing mining operations committed to coal supply contractual arrangements. For example, criteria could require timely submission of expressions of competitive interest supported by reasonable evidence of mining capability and financial resources for carrying out this capability in a timely and efficient manner.

(3) Development of guidelines by Interior for negotiators to follow in conducting negotiations. For example, the Secretary should be required to develop the guidelines covering the following factors: formulation of lease terms; disclosure of economic information (costs, prices,

etc.), geologic information, and provision for protecting proprietary information; consideration of coal market conditions; determination of a reasonable and equitable value of the federal coal, taking all circumstances into account; probability of the federal coal being bypassed if not leased to the applicant; and public disclosure of the results of negotiations. The factor concerning determination of reasonable value warrants disclosure of the procedure as well as the results of negotiations. The determination of the coal's value depends on all the circumstances at the time of application. In short, the value of the coal will be the outcome of bargaining between the applicant and the government. Being the result of a bargaining process, the risks of not agreeing on a price acceptable to both parties are having the coal bypassed or leasing it at too low a value. To compensate for these risks, criteria are needed to guide negotiations in a manner that produces an efficient, timely, and equitable result.

(4) Promulgation of regulations by Interior for implementing an emergency coal leasing program consistent with its objectives and the above general standards.

In view of the many difficulties facing emergency coal leasing under existing law, we believe that the above standards would provide a framework for improving federal coal leasing management and accountability.

DISTINCTION BETWEEN REGIONAL AND EMERGENCY LEASING SITUATIONS NEEDED

As this report indicates, the objective of the emergency leasing process is to provide a quick response to site-specific needs of ongoing operations so additional quantities of federal coal can be made available in a timely manner to avoid mining disruptions or the waste of federal coal deposits. Emergency lease sales limit the amount of coal to be leased so as to tide the applicant over until the next scheduled regional lease sale. In contrast, because the competitive leasing program focuses on regional needs for federal coal and takes 3 to 5 years before a lease sale can be conducted, Interior is unable to respond quickly to the needs of specific operations experiencing emergency situations. Thus, a separate amendment to the Mineral Lands Leasing Act of 1920 is required to make a distinction between regional and emergency coal lease sales. The amendment should specifically authorize Interior to conduct emergency coal leasing and to use negotiated lease sale procedures for carrying it out in a manner consistent with the standards and criteria discussed earlier in this chapter.

In a previous report analyzing the coal leasing program,[3] we recommended that the Congress amend the Mineral Lands Leasing Act to specifically authorize Interior to also negotiate "production maintenance" tracts that are now offered at regionally scheduled lease sales. Production maintenance tracts are similar to emergency tracts in that they are a logical extension of the operations of an adjacent mine and are basically noncompetitive. However, unlike emergency tracts, the need for production maintenance tracts can be identified early enough in the planning process so as to permit the necessary time (3 to 5 years) to include them in regionally scheduled lease sales. Because separate processes are involved, legislation is needed to authorize use of negotiated sale procedures in both situations--for emergency tracts in emergency lease sales and for production maintenance tracts in regional lease sales.

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[3]GAO/RCED-83-119, May 11, 1983, p. 78.

CHAPTER 4

CONCLUSIONS, RECOMMENDATION, AND AGENCY COMMENTS

The Mineral Lands Leasing Act of 1920, as amended, generally requires that federal coal leases be issued through competitive bidding and that the Secretary of the Interior not accept any bids less than the fair market value of the offered coal. Although Interior does not have authority to issue noncompetitive leases to adjacent, ongoing operators, Interior has established special regulations and a leasing process--referred to as emergency leasing--for issuing leases which in substance are noncompetitive. The purpose of Interior's emergency leasing process is to respond to the needs of producing operators who are able to demonstrate--in accordance with Interior's regulations--a need for federal coal within a 3-year period in order to maintain production at current levels in supplying coal under existing contracts or to avoid the waste of unleased federal coal that is unlikely to be mined by another operator. Emergency leasing is restricted to ongoing operations needing coal that is not of competitive interest to other producers. However, under existing law, Interior is required to hold a competitive-type lease sale even though such leases are noncompetitive in nature. Since 1977, Interior's Bureau of Land Management has conducted 46 such emergency lease sales which have resulted in the issuance of 39 federal coal leases. Although the objectives of Interior's emergency leasing program are in the public interest, carrying out this type of leasing within the existing statutory framework has been made difficult because of its basic incompatibility with the requirements of obtaining competitive bidding and fair market value. Our review identified and analyzed four problems that Interior has encountered in conducting emergency leasing under existing law.

DIFFICULTIES IN ADMINISTERING EMERGENCY LEASING UNDER EXISTING LAW

First, we identified that Interior's emergency leasing regulations, which are designed to avoid abuses of the emergency leasing process, require applicants to demonstrate a legitimate need for the coal, but in doing so limit leasing to situations where competitive bidding is unlikely to exist. In addition, the regulations limit the quantity of coal leased to any one application, based on the applicant's current rate of production. Because the emergency leasing regulations were offered to meet the needs of the applicant as opposed to offering coal that would be of competitive interest to producers in general, these lease tracts have attracted little or no competition. For example, of the 39 emergency leases issued since 1977, 36 (or 92 percent) resulted in only one bidder, the applicant requesting the lease sale. The other three emergency leases issued resulted in more than one bidder but the applicant was the winning bidder in each sale and obtained the lease.

A second difficulty is that because Interior has not established lease terms and conditions consistent with emergency leasing situations, lessees are not subject to any special requirements. Interior's emergency regulations require the applicant to begin mining the coal within 3 years from the date of application. Even though the regulations place emphasis on the applicant's need for the coal within a 3-year period, the applicant or any other party who obtains an emergency lease and does not begin mining within 3 years is not subject to any penalty since the lease does not require mining to start before the end of the tenth year. Between March 1979 and November 1980, Interior issued 21 emergency coal leases, 7 (or 33 percent) of which had not produced any coal as of November 1983, more than 3 years since the date of application requesting the sale.

A third difficulty is that emergency lease tracts are of little value on the open market because potential bidders other than the applicants requesting the sale would have to incur substantial front-end costs before they could gain access to the lease tract and develop the limited quantity of federal coal made available. Such front-end costs include acquiring adjacent coal lands and possibly the applicant's existing coal holdings and surface rights as well as acquiring equipment. On the other hand, the applicant, since he is already mining next to the proposed lease tract and supplying coal under existing contracts, would have to incur little or no additional cost in continuing his logical mining sequence into the lease tract. Thus, the coal may have substantial value to the applicant because of his superior position.

The fourth difficulty is that competitive bidding procedures do not assure that the government obtains a reasonable value for the coal. Interior has recognized the limited value of emergency tracts in the open market by appraising these tracts as part of a hypothetical mining unit, taking into account recent transactions involving coal lands believed to be comparable to the lease tract. A hypothetical mining unit combines the proposed lease tract with other adjacent coal lands into a conceptually designed mining operation for the purpose of estimating the value of the proposed lease tract, even though all the lands in the unit may not be available for development. Interior appraises emergency tracts this way because the statutory requirement of competitive bidding forces Interior to assume that more than one bidder will be interested in leasing and mining the coal. In appraising emergency lease tracts as part of a hypothetical mining unit, there are many uncertainties and assumptions affecting the estimated value of the lease tract. Because competitive interest is unlikely to exist for these tracts--36 of 39 lease tracts issued had only one bidder--it has been difficult for the Bureau to judge the reasonableness of bids submitted at lease sales. Because of the difficulties in determining fair market value in these kinds of situations, the Bureau has experimented with various methods for offering emergency lease tracts. None of the methods really provided assurance that the government obtained a reasonable value for the coal.

In view of the Interior's emergency leasing regulations, it is questionable whether the regulations and emergency leasing process comply with the statutory requirement that leases be issued on the basis of competitive bidding. Specifically, what is brought into question is the legality of a procedure which permits bidding but limits leasing to situations in which the applicant has such a clear economic and competitive advantage over other potential bidders as to make the competitive bid process illusory. The Secretary of the Interior does not have specific authority to issue noncompetitive leases in the circumstances described by the emergency leasing regulations. Under the Mineral Lands Leasing Act, as amended, two exceptions, not covered in the emergency leasing regulations, are permitted from the requirement for competitive bidding. These exceptions are the modification of up to 160 acres to an existing lease and a sale of federal coal necessary to the exercise of a right-of-way permit.

LEGISLATIVE CHANGES ARE NEEDED TO AUTHORIZE NEGOTIATION OF EMERGENCY LEASE SALES

The need to have a special leasing process for administering federal coal leasing to meet the unique needs of existing mining operations has been generally accepted by the Congress, courts, and the Department of the Interior as being in the public interest. However, the Mineral Lands Leasing Act, as amended, does not provide the necessary flexibility to enable Interior to conduct emergency-type leasing in the manner that is appropriate for the circumstances.

Because Interior does not have specific legislative authority to conduct emergency coal leasing, there is a need for corrective legislation. Legislative changes could provide a proper framework within which emergency coal leasing could be administered effectively. Such legislation also could authorize the Secretary of the Interior to issue emergency coal leases through negotiated lease sale procedures. Legislation should also include appropriate controls to minimize the noncompetitive leasing of coal tracts which otherwise might be of competitive interest and which should be offered through competitive bidding procedures.

In a previous report on the competitive coal leasing program,[1] we recommended that the Congress amend the Mineral Lands Leasing Act, as amended, to authorize Interior to use negotiated lease sale procedures for tracts now offered at regionally scheduled lease sales. However, it is important that a distinction be made between leasing situations occurring under the regional leasing process, which takes 3 to 5 years to complete, and those occurring under the emergency leasing process, which take place on short notice between regionally scheduled lease sales. Such a distinction is important because the two processes

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[1] GAO/RCED-83-119, May 11, 1983, pp. 78.

differ in their objectives, timing of lease sales, and procedures for screening and offering lease tracts. Thus, in view of this distinction, separate legislative changes are needed to authorize Interior to conduct emergency leasing and to use negotiated lease sale procedures to carry it out.

RECOMMENDATION TO THE CONGRESS

To meet the emergency needs of existing mining operations, we recommend that the Congress amend the Mineral Lands Leasing Act of 1920, as amended, to authorize the Secretary of the Interior to conduct emergency federal coal leasing using negotiated lease sale procedures for carrying it out. The legislation should provide for (1) a statement of objectives to be achieved through emergency leasing; (2) opportunity for public comment and expressions of competitive leasing interest before conducting negotiated sales; (3) development of guidelines by the Secretary for negotiators to follow which, at a minimum, provide for access to economic and geologic data, disclosure and protection of proprietary information, factors to consider in negotiating lease terms and reasonable value for the federal coal, and public disclosure of lease sale results; and (4) promulgation of regulations by the Secretary for designing and implementing an emergency coal leasing program consistent with its objectives and the above standards.

AGENCY COMMENTS AND OUR EVALUATION

Comments on a draft of this report were solicited from the Department of the Interior. In its February 3, 1984, letter responding to our draft report (see app. III), Interior stated that it was not prepared to provide comments on our recommendation and changes suggested in our draft because the Commission on Fair Market Value Policy for Federal Coal Leasing mandated by Congress had not yet submitted a report. While not providing comments on our recommendation, the Department did comment on specific points in our draft. Those comments and our responses are discussed below. Those comments not specifically addressed below were considered of an editorial nature which we generally accepted, and we have made appropriate changes to recognize them in the various sections of our final report. In the interest of avoiding repetition, we have combined several of Interior's comments into appropriate subject matter groupings as presented in our report and shown below. Subsequent to the publication of the Commission's report, Interior told GAO that it plans to respond to the recommendation in writing after GAO issues its final report.

Purpose Of Limiting The Quantity Of Coal Leased In Emergency Sales

Interior stated that our draft report incorrectly characterized the purpose of limiting the quantity of coal leased under the emergency leasing regulations. According to the Department, the purpose is to prevent using emergency leasing to bypass the normal regional lease sales, and not "to discourage speculators from participating in the emergency leasing process."

Interior's comment is in reference to an abbreviated statement of the purpose included in our draft report digest--not to the more specific discussion of purpose included in the body of the draft. The body of the draft did address concerns about the use of the emergency leasing process by operators to avoid normal competitive regional sales. In deference to Interior's comments, we have added more specific language in the final report digest, recognizing the purpose cited by Interior. We have also retained the reference to speculators, however, since this issue is cited as a relevant purpose in Interior's preamble to its July 30, 1982, revised coal leasing regulations.

Need For Statutory Authority To Safeguard Against Abuses

Interior questioned our conclusion that its limited authority to establish lease terms makes it difficult, if not impossible, to enforce the emergency leasing regulations. In this regard, Interior asserted that because a lease is a contract it could include a lease term for future bypass and production maintenance tracts requiring cancellation of the lease if production does not commence within a stated period. Thus Interior stated that, in its judgment, new legislation was not required. Although we recognize that Interior could include provisions in future leases requiring production to begin within a stated (shorter) period, Interior has not done so to date.

Emergency Tracts Are Of Little Value On Open Market--But May Have Substantial Value To The Applicant

Interior agrees that emergency leases generally are of little or no interest to other coal producers and that such leases are considerably more valuable to the adjacent operator than to others. But, Interior noted that there have been exceptions, such as when a coal broker or other coal companies want to acquire an emergency tract for resale to the initiating company or as bait for private exchanges of coal land. Interior stated this apparently has occurred a few times, and that its future occurrence could serve as an incentive, under current sealed-bid procedures, for bids to be based on the full value of the tracts.

Our report recognizes that there have been exceptions when more than one bidder--i.e., someone other than the applicant requesting the lease sale--has participated in emergency lease sales. Specifically, it notes that, since 1977, 3 of the 46 emergency lease sales involved more than one bidder. In each of the three cases, however, the applicant requesting the sale was the winning bidder and obtained the proposed lease tract. There have been no emergency lease sales in which a coal broker or other coal companies obtained the proposed lease and resold it to the initiating company. We certainly agree that competition is desirable and that every effort should be made to obtain it under the normal regional leasing program. However, realistically--except for a nuisance bidder--someone other than the applicant is unlikely to have a serious interest in emergency leasing

situations because these tracts generally are too small to be mined alone and the applicant has a significant competitive advantage relative to others. Even in the highly unlikely case where another bid is made, it cannot be construed as creating a truly competitive situation. Therefore, competition cannot be relied on as an incentive for bids to approach the full value of the lease tract, as Interior suggested. In addition, in view of the objectives of emergency leasing--i.e., avoiding bypass of federal coal and disruption to ongoing mining operations--encouraging speculation may not be desirable because it could result in the bypass of federal coal and mining disruptions. Thus, we believe that in view of the noncompetitive nature of emergency lease tracts, negotiated lease sale procedures would enhance the reliability of data used in setting a reasonable value for the coal, taking all circumstances into account.

Competitive Bidding Procedures Do Not Assure Fair Return To Government

In regard to the use of the hypothetical mining unit concept to evaluate lease tracts, Interior stated that our draft report passed over the point that the concept is a reasonable one. Interior also stated that in most cases the hypothetical mining unit is based on the equipment, costs, and scale of operations of the adjacent operator because the operator is in the best position to determine the most efficient mining method. Interior further stated that our use of the term "reasonable value" rather than fair market value was ambiguous.

We agree with Interior that the hypothetical mining unit is a reasonable concept, and our draft report so stated. However, our review indicated that Interior's emergency tract evaluations are not based on mining equipment, costs, and scale of the adjacent operator. Rather, hypothetical information is used, not information reflecting specific details of the adjacent operation. Based on our discussions with Interior lease tract evaluation officials, this is done in order to avoid criticism of modeling an existing operation, thus biasing the competitiveness of the tract.

We used the term "reasonable value" rather than fair market value in discussing emergency lease tract valuation because of the noncompetitive nature of such tracts. That is, our report indicates that fair market value is based on an appraisal of the property in terms of the lease tract's value to buyers in general without taking into consideration the special value that the lease tract may have to an adjacent operator. Because of the noncompetitive nature of emergency lease tracts, their worth on the open market generally is very low to a producer other than the adjacent operator. In view of this, we used the term reasonable value because it reflects all relevant circumstances associated with emergency leasing situations, including the special value of the tract to the adjacent operator requesting the lease sale.

Interior also disagreed with our statement that it is not authorized to evaluate nonfederal coal lands, noting that there is no law preventing it from doing so. Our position on this matter

is unchanged. Our draft report indicated that Interior lacks statutory authority to evaluate nonfederal coal lands. In response to a previous GAO report on the coal leasing program,[2] a former Interior Assistant Secretary for Policy, Budget, and Administration stated that Interior does not have statutory or regulatory authority to evaluate the development potential of nonfederal coal lands and that it is not Interior's mandate to make judgments on the economic value of privately held resources. He also stated that federal appropriations under the Federal Coal Leasing Amendments Act are specifically earmarked for the investigation of federal coal lands, not nonfederal lands.

Finally, Interior disagreed with our statement that the Bureau is in no better position under its new coal lease sale procedures--which were adopted on August 8, 1983--than it was before to assure a financial return for emergency tracts that is fair and equitable to the government as well as to the lessee. In part, the new procedures require that sealed bidding will be permitted in contrast to a combination of sealed and oral bidding that Interior used under its previous procedures. On this point, Interior stated the following:

> "Sealed bidding is clearly preferred to oral bidding in emergency leasing cases. Not only are the new procedures better, but more comparable sales data are available and Departmental personnel have more experience in using such data."

Interior's new procedures do not resolve the difficulties associated with the valuation and offering of emergency coal lease tracts. Our draft report indicated that the new procedures are not appropriate in the case of emergency leasing situations where the applicant is expected to be the only bidder to participate in the lease sale. In such leasing situations the selection of competitive bidding techniques (oral vs. sealed bidding) has little substantive effect since competition is unlikely to exist. In developing our report, we found no factual data that would tend to support Interior's assertion that sealed bidding is preferred to oral bidding in emergency leasing situations. In addition, the February 1984 report issued by the Commission on Fair Market Value Policy for Federal Coal Leasing concludes that there is insufficient experience and data on the effects of different bidding methods on coal lease sales to warrant a specific choice of bidding methods at this time. The Commission's report also discusses several deficiencies in Interior's management of the coal leasing program, including the need for more comparable sales data, the need to replace the loss of experienced, high-quality personnel so Interior can perform lease appraisals effectively, and the need for Interior to improve appraisal methods. Thus, we question the appropriateness of Interior's statement that more comparable sales data are now available and that Department personnel have more experience in using such data.

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[2]Mapping Problems May Undermine Plans For New Federal Coal Leasing, EMD-81-30, Dec. 12, 1980, pp. 57 and 58.

Finally, Interior explained its reasons for using the policy of setting minimum acceptable bids at one-half of the tract's "full economic value" (the so-called 50-50 split). It is noted that Interior itself rejected that reasoning when, in mid-1983, it dropped the use of the 50-50 split policy. We agree with the Department's decision.

Advantages of Negotiated Sales

Interior stated that it does not understand why our draft report assumes use of negotiated sales will improve the information used for reaching a sales price. According to the Department, it now can acquire data on verifiable costs and actual mining conditions of the applicant's operation since a company must show that there is an emergency, and companies have been cooperative in providing data describing an existing operation.

Although Interior believes that it can obtain actual and verifiable economic/financial data on the adjacent mining operation, its regulations only require applicants to submit general information describing the existing operation. Even if Interior obtained such detailed data on the adjacent mining operation, it would be of limited use to Interior in determining the fair market value of the proposed lease tract on the open market since it is based on the value to buyers in general. Additionally, if Interior tried to use the data as its sole basis for establishing fair market value on an emergency lease tract, this would be improper since it would not establish the value to buyers in general. New statutory authority to allow Interior to negotiate emergency leases would permit Interior to use such detailed information in the negotiation process as the basis for arriving at a sales price for the coal since the value would be based on its worth to the adjoining tract.

In a related comment, Interior stated that it is not clear whether negotiation would be a more or less effective use of government personnel and that bargaining sessions can require wasteful repetition of analysis and meetings. Interior also stated that under its current system field personnel do look at the actual circumstances in a realistic manner.

We believe that Interior's comments concerning the effective use of personnel do not focus on the proper issue--i.e., that emergency leasing is noncompetitive in nature and that competitive bidding procedures are not appropriate in such leasing situations. As noted above, our draft report questioned the legality of Interior's emergency leasing process, stating that the situations covered by the regulations make the competitive bid process illusory. Thus, we believe that the appropriate issue relates to the need for legislative change to allow Interior to conduct noncompetitive leasing with the use of negotiated lease sale procedures, rather than defending the current system on the basis of the perceived shortcomings of the negotiation process.

Distinction Between Regional And Emergency Leasing Situations Needed

Lastly, Interior suggested that we broaden our report so that it would be consistent with the rest of the coal leasing program. Interior stated that emergency leasing is a subtype of maintenance and bypass leasing. Interior also stated that if existing legislation were amended to allow negotiated sales of maintenance and bypass tracts, then negotiated sales would also apply to emergency lease tracts.

We agree with Interior that, in general, emergency leasing is similar to bypass and maintenance leasing in that leasing takes place next to an existing operation. Because of the similarity of circumstances, negotiated lease sale procedures would be appropriate for both leasing situations. However, we disagree with Interior that our report should be cast in broader terms so that it would be more consistent with the rest of the leasing program. In its response, Interior does not recognize the distinction between maintenance and bypass leasing as conducted under Interior's emergency leasing regulations. The normal regional leasing process focuses on the regional need for coal and requires about 2 years of tract preparation before Interior is in a position to conduct a lease sale. On the other hand, emergency leasing was designed specifically to respond quickly to applications and site-specific leasing situations falling outside the normal leasing process. Interior's emergency regulations require that the reserves applied for must be mined as part of an existing operation and that the coal is needed within 3 years to maintain the operation's production level. Furthermore, the regulations limit the quantity of federal coal reserves (equivalent to 8 years of production) that may be leased to an applicant, as based on the applicant's production record.

That is, the emergency leasing procedures were designed to respond to situations where an existing operation can demonstrate an emergency need for additional federal coal to tide it over until the next regional sale scheduled in the area. Otherwise, the coal could be bypassed and not recovered in the future. To be effective, the emergency leasing process must be able to respond quickly enough to avoid such bypassing of federal coal or the disruption of mining operations. Thus, we believe a separate amendment to the Mineral Lands Leasing Act of 1920 is required to make a distinction between regional and emergency coal lease sales and to specifically authorize Interior to conduct emergency leasing outside the normal regional leasing process, using negotiated sale procedures for carrying it out.

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On February 17, 1984, the Commission on Fair Market Value Policy for Federal Coal Leasing issued its report. Further, on March 19, 1984, Interior issued its report responding to the Commission's recommendations. The Commission's report makes many recommendations, one of which pertains to the need for Interior to have authority to negotiate a fair price for noncompetitive tracts. Interior agreed with this recommendation in principle and recognized that legislative action may be necessary. However, neither the Commission nor the Interior report dealt with the specific problems of emergency leasing. We believe that in view of the unique objectives of emergency leasing--which takes place outside the normal leasing program--there is a need for separate legislative change to specifically authorize Interior to conduct emergency leasing and to allow the use of negotiated lease sale procedures to carry it out.

APPENDIX I

COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

June 15, 1983

The Honorable Charles A. Bowsher
Comptroller General of the United States
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

I understand that the General Accounting Office is conducting an evaluation of the Department of the Interior's emergency Federal coal leasing program. In view of the Subcommittee's interest in your recent report on the Powder River Basin coal lease sale, I am requesting that your work be directed to the Subcommittee. I realize that the emergency coal leasing program has objectives and procedures which differ from those of the regional competitive leasing program. In light of these differences, I am requesting that your evaluation discuss the following issues:

1. What kind of difficulties has the Department of Interior encountered in administering the emergency leasing program and regulations under the competitive leasing program required by law?

2. Is there a need for legislation authorizing negotiated lease sales for emergency leasing or other situations?

Please let me know when you expect the evaluation will be available to the Subcommittee.

Sincerely,

JIM WEAVER, Chairman
Subcommittee on Mining,
Forest Management and
Bonneville Power Administration

JW:nw)

APPENDIX II

Emergency Federal Coal Lease Sales
Analyzed by GAO

Lease ID	State	Tract type (note a)	Mining method (note b)	Tract size: Tons (million)	Tract size: Acres	Publicly announced value: Bonus ($ per acre)	Publicly announced value: Royalty rate	Sale results: Bonus ($ per acre)	Sale results: Royalty rate	Sale date	Number of bidders
M35740	MT	PM	S	7.3	200	N/A	12.5	N/A	N/A	04/77	1[c]
C16284	CO	BP	S	1.5	263	N/A	15.5	1.00	15.5	06/77	1
C25079	CO	PM	U	1.9	311	N/A	8.0	100.05	8.0	03/78	2
M34985	ND	BP	S	0.5	80	25.00	12.5	25.00	12.5	09/78	1[e]
C20900	CO	PM	S	1.0	420	25.00	16.0	25.50	16.0	09/78	2
U33454	UT	PM	U	3.4	440	100.00	9.5	125.00	9.5	09/78	1
M34980	ND	PM	S	2.6	441	25.00	12.5	25.00	12.5	10/78	1
U32083	UT	BP	U	2.6	476	25.00	9.2	50.38	9.2	12/78	1
W48330	WY	BP	S	1.9	130	4,171.92	12.5	-	12.5	03/79	1[c]
W49338	WY	BP	S	0.9	110	25.00	16.1	-	-	03/79	0[d]
M35734	MT	BP	S	11.8	480	25.00	21.0	25.00	21.0	03/79	1
M35735	MT	BP	S	10.7	447	25.00	21.0	25.00	21.0	03/79	1
C19885	CO	BP	S	1.7	125	25.00	17.0	35.35	17.0	04/79	1
C22644	CO	PM	S	15.6	1,790	25.00	18.3	25.00	18.3	04/79	1
C22676	CO	PM	S	1.2	402	25.00	12.5	112.75	12.5	06/79	1
C27432	CO	PM	U	5.6	854	25.00	8.0	102.10	8.0	07/79	1
C27103	CO	PM	U	.9	290	25.00	8.0	106.00	8.0	08/79	1
NM24005	OK	PM	S	.2	140	25.00	12.5	100.50	12.5	08/79	2
M21209	ND	PM	S	17.8	1,668	25.00	12.5	25.00	12.5	08/79	1
W48330	WY	BP	S	1.6	130	25.00	12.5	25.00	12.5	12/79	1
M35736	MT	BP	S	14.7	530	5,523.63	12.5	-	-	12/79	0[d]
C25948	CO	BP	S	.4	85	25.00	12.5	25.00	12.5	12/79	1
C27911	CO	PM	S	0.7	90	25.00	12.5	30.75	12.5	02/80	1
MA2381	MT	BP	S	1.9	61	25.00	12.5	25.00	12.5	02/80	1
U37045	UT	BP	U	1.9	698	521.53	8.0	521.53	8.0	03/80	1
W58095	WY	BP	S	4.1	1,280	25.00	12.5	25.00	12.5	03/80	1
W49338	WY	BP	S	5.1	735	25.00	12.5	25.00	12.5	03/80	1
ES16968	AL	BP	S	.7	520	25.00	12.5	25.15	12.5	03/80	1
M31053	ND	BP	S	2.1	160	25.00	12.5	25.00	12.5	03/80	1
C22777	CO	PM	S	4.9	770	25.00	12.5	25.00	12.5	05/80	1
M43083	ND	BP	S	1.3	80	25.00	12.5	25.00	12.5	08/80	1
M37604	MT	BP	S	21.8	440	25.00	12.5	25.00	12.5	04/81	1
C30168	CO	PM	S	.5	140	25.00	12.5	-	-	05/81	0[d]
C29125	CO	PM	U	.8	180	25.00	8.0	52.00	8.0	08/81	1
C31805	CO	PM	S	1.2	376	25.00	12.5	25.68	12.5	09/81	1
UA7080	UT	PM	U	13.8	1,158	775.00	8.0	809.00	8.0	09/81	1
W69981	WY	BP	S	27.8	360	25.00	12.5	25.00	12.5	10/81	1
NM44130	OK	PM	S	.05	200	25.00	12.5	40.00	12.5	12/81	1
U50722	UT	PM	U	3.7	400	2,750.00	8.0	2,750.00	8.0	08/82	1
U48492	UT	PM	U	4.9	950	100.00	8.0	286.00	8.0	10/82	1[c]
U49332	UT	PM	U	4.8	642	100.00	8.0	2,221.46	8.0	10/82	1
NM52786	NM	BP	S	.48	160	100.00	12.5	100.00	12.5	12/82	1
C34886	CO	PM	S	2.1	90	465.00	12.5	617.28	12.5	06/83	1
U52341	UT	BP	U	.7	120	100.00	8.0	1,167.67	8.0	08/83	1
M59727	ND	BP	S	1.8	380	100.00	12.5	110.00	12.5	12/83	1
C36446	CO	BP	U	.7	79	100.00	8.0	101.27	8.0	03/84	1

[a]BP=Bypass, PM=Production maintenance.

[b]S=Surface mining, U=Underground mining.

[c]Bid rejected by BLM on grounds that it was less than the Bureau's estimate of fair market value of the coal.

[d]No bid received.

[e]Applicant refused the lease because of lease sale delay; federal coal was bypassed.

Source: Compiled by GAO using Department of the Interior data.

APPENDIX III

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

FEB 3 1984

Mr. J. Dexter Peach
Director, Resources Community and
Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed the draft report entitled Legislative Changes Are Needed to Authorize Emergency Federal Coal Leasing prepared by your office. We have enclosed our comments on specific points made in the report.

The Department of the Interior is not prepared to provide a response to your recommendation and the changes suggested by the text at this time because, as you know, the (Linowes) Commission on Fair Market Value Policy for Federal Coal Leasing mandated by Congress has not yet submitted a report. We believe it would be premature to provide our response to the GAO's recommendation before the Commission presents its report to the Congress and the Secretary and there has been ample opportunity to evaluate it.

We hope you can appreciate the circumstances under which this limited response is made. We look forward to providing further review and comment, including statements on the draft report's recommendation, as soon as we have had time to evaluate the Linowes Commission report.

Thank you for the opportunity to comment.

Sincerely,

Assistant Secretary for
Land and Minerals Management

Enclosure

Page 11*: The report characterizes the purpose of limiting the quantity of coal leased under emergency leasing regulations incorrectly. The purpose is to prevent using emergency leasing to bypass the normal regional lease sale. The purpose is not, as stated on page iv of the Digest, "to discourage speculators from participating in the emergency lease process."

Page 7, Second Concern: Although, as the report points out, Interior's authority to establish lease terms is limited, why does this make "it difficult, if not impossible" to enforce regulations?

Page 7, Third Concern: The report is correct that emergency lease tracts generally have little or no interest to other coal producers, but there have been exceptions. Other coal companies may want to acquire an emergency tract for resale to the initiating company or as bait for private exchanges of coal land. This apparently has occurred a few times, and the threat of its occurring is, under current sealed-bid procedures, an incentive for bids to be based on the full value of the tract.

Page 7, Fourth Concern: Interior procedures must assure that fair market value is obtained for all leases. The report's use of a "reasonable value" standard for Federal coal sold in emergency lease sales is ambiguous.

Page 11, Top Paragraph: As you note at the bottom of page 10, the regulations require that applicants demonstrate a need for the coal within three years, not that the applicant be in a position to mine the coal in three years as you state here.

Page 12, Second Complete Paragraph: The report fails to note that since August, 1982, regulations have allowed any otherwise qualified entity to bid on tracts offered under emergency leasing criteria. Except for the remaining preference right lease applications, all coal leases are offered competitively.

Page 13, First Complete Paragraph: A lease is a contract. A future lease term for production maintenance tracts could be that the lease is cancelled if the lessee has not commenced to mine coal within a stated period. In our judgment, this does not require new legislation.

Page 13, Last Sentence: The authors of this report might note that the problem of valuing tracts offered under emergency leasing criteria also applies to many tracts offered at regional coal sales. The problem applies to some extent to any tract that cannot by itself be mined as an efficient mine.

Page 14, Last Sentence: This statement is true only if no consideration is given to the possibility of a coal broker or another company purchasing and reselling the small tract to the adjacent operator. It is certainly true that the tract's "value in use" to an adjacent operator in most cases would be

*Page numbers have been changed to reflect pagination in GAO's final report.

considerably more than to a non-adjacent operator.

Page 15, Last Paragraph and Page 16: Although the mining units modeled for evaluation are hypothetical and theoretical, they are reasonable. This point is passed over by this paragraph.

Page 16, Problems Identified: In most cases the hypothetical mining unit is based on the equipment, costs, and scale of operations of the adjacent operator because the operator is in the best position to determine the most efficient mining method.

Page 16, Last Sentence: There is no law preventing Interior from valuing non-Federal coal lands. The Department might not have access to some private cost and drill hole data, but certainly the quantity and price of coal sold can be obtained The Department does acquire good data from private coal lands that are being mined along with Federal leased lands.

Page 17, Last Paragraph: During this period most of the evaluations were made using discounted cash flow (DCF) analysis, which theoretically estimates all of the economic rent of a property. It is commonly recognized that the resource owner, unless he produces the resource himself, normally will not receive 100 percent of the "economic rent" even if there are several potential buyers. It is even more unlikely that under conditions of bilateral monopoly (one buyer and one seller) the seller would receive 100 percent of the economic rent. Emergency leasing tracts are examples of bilateral monopoly. There is no economic theory that yields a precise answer as to how the rent will be shared between the buyer and seller. The Department had assumed that if each party was equally informed and skilled in neogotiation, each party would get about one half of the economic rent to arrive at its 50% rule.

Page 20, Last Sentence: We do not believe your statement that Interior is in no better position "for assuring financial return" for these tracts with its new procedures is supported by the facts. Sealed bidding is clearly preferred to oral bidding in emergency leasing cases. Not only are the new procedures better, but more comparable sales data are available and Departmental personnel have more experience in using such data.

Page 23, First Advantage: We do not understand why the report assumes use of negotiated sales will improve the information used for reaching a sales price. Under the current system, in most if not all evaluations involving emergency lease tracts, the Department can acquire the data specified by GAO. We acquire these data since a company must show that there is an emergency. Also, most such tracts involve mines containing other Federal coal leases which are inspected by the Department. Most companies are very cooperative, and acquiring data for describing an existing operation is not a problem.

Page 23, Second Advantage: It is not clear whether negotiation would be a more or less effective use of government personnel. The bargaining sessions that sometimes characterize negotiation can require wasteful repetition of analyses and meetings. This would be true especially in the first years of such a program, when coal companies would be testing the government representatives' mettle. We believe that under the current system Interior field personnel do look at the actual circumstances in a realistic manner. It is not clear that there are savings.

Page 25, Last Sentence and Next Page: Without commenting on the merits of the recommendation, we suggest that the authors may want to consider casting it in broader terms so that it would be more consistent with the rest of the coal leasing program. Emergency leasing is a subtype of maintenance and bypass leasing. If the Mineral Leasing Act were amended to allow negotiated sales for all maintenance and bypass tracts, then negotiated sales will automatically apply to emergency lease tracts.

Page 38 Table: Sale M 34985 shows 0 bids received, but a high bid of $25. Sale W48330 shows one bidder, but the footnote says 0 bidder. For tract C16284, which was reoffered, does publicly announced value and high bid apply to first or second offering? Did the royalty rate change?

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