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United States General Accounting Office
Washington, DC 20548

November 29, 2000

The Honorable Larry E. Craig
Chairman, Subcommittee on Forests
and Public Lands Management
Committee on Energy and Natural Resources
United States Senate

Subject: Timber Management: Forest Service Has Considerable Liability for
Suspended or Canceled Timber Sales Contracts

Dear Mr. Chairman:

This letter responds to your request for information concerning the contractual liability of the U.S. Department of Agriculture's (USDA) Forest Service under timber sales contracts that it suspended or canceled to protect threatened or endangered species. From October 1992 through June 1996, the Forest Service paid \$6.5 million to settle claims on 48 suspended or canceled timber sales contracts. In 1996, we reported that timber purchasers had filed 73 pending claims, totaling about \$61 million, against the Forest Service for suspended or canceled contracts.¹ We also estimated that timber companies could file claims for at least an additional \$198 million, depending on the outcome of numerous court cases. At that time, we recommended that the Forest Service finalize new regulations for canceling timber sales contracts and a new standard timber sales contract that it had been developing since the late 1980s. The regulations and contract would have limited the government's liability on canceled or suspended timber sales contracts and redistributed the risk between the government and the purchaser.

This report addresses the Forest Service's (1) current potential liability for timber sales contracts that it suspended or canceled to protect threatened or endangered species, (2) progress in finalizing its timber sales cancellation regulations and standard timber sales contract, and (3) efforts to substitute timber (replacement timber) in lieu of paying to settle suspended or canceled timber sales contracts. In summary, we found the following:

¹See *Timber Management: Opportunities to Limit Future Liability for Suspended or Canceled Timber Sales Contracts* (GAO/RCED-97-14, Oct. 31, 1996). In that report, as well as in this one, we limited our work to reviewing environmental claims related to protecting threatened or endangered species. Other claims can arise when conditions, such as natural resource damage, cause contracts to be modified, suspended, or canceled. These claims were outside the scope of our work.

- Forest Service information shows, as of October 31, 2000, pending claims of about \$51 million for timber sales contracts suspended or canceled to protect threatened or endangered species. This does not include future claims that purchasers may file as a result of favorable rulings on current claims on similar issues. However, all estimates of future liability are speculative because the outcome of ongoing and future litigation is unpredictable and could result in the award of less in damages than the timber sale purchaser's claim. For example, the Forest Service paid one purchaser \$15,000 for a \$6.2 million claim and paid another purchaser \$2,544 for a \$71,692 claim. In other instances, the Forest Service has paid purchasers the total amount of the damages claimed.
- The Forest Service has not finalized the regulations for canceling timber sales contracts or the new standard timber sales contract even though the agency claimed it was near doing so when we completed our previous work in October 1996. At that time, USDA expected to publish a final rule for canceling timber sales contracts in December 1996 and to seek public comments on the proposed new timber sales contract in 1997. According to Forest Service timber management officials, the need to conduct more detailed economic analyses delayed the issuance of the regulations. They said that higher-priority work, such as revising the Forest Service's planning regulations, took precedence over finalizing the new timber sales contract. A recent court decision has affirmed the validity of the existing contract provisions that limit the government's liability for timber sales contracts suspended or canceled for environmental reasons. However, good business practices would dictate that the Forest Service finalize its cancellation regulations and new standard contract to ensure that the implementation of the contract language approved by the court will be transparent for the purchasers and consistently implemented across the country by Forest Service personnel.
- Although the Forest Service has sometimes used replacement timber to reduce or eliminate claims associated with suspended or canceled timber sales contracts in California, Oregon, and the state of Washington, several problems, including the lack of available replacement timber within the sale area, have inhibited its use. In addition, even when the Congress acted to expand the area of consideration for replacement timber beyond the sale area and the Forest Service identified available replacement timber, its use has been limited because the replacement timber was of such poor quality that the purchasers would not accept it.

Background

The Forest Service awards contracts to individuals or companies to harvest and remove timber from the federal lands under its jurisdiction. Forest Service timber sales contracts set forth specific terms and provisions of a sale, including the estimated volume of timber to be removed, the time period of the removal, the price to be paid to the government, and the environmental protection measures to be taken. However, the agency's regulations and procedures specify that it can extend the time for completing a timber sales contract under certain circumstances and that it can modify, suspend, cancel, or partially cancel a timber sales contract for various

reasons, including the need to protect threatened or endangered species and their habitat.

Each timber sales contract contains provisions describing the liability that the Forest Service will incur if it cancels a sale or cannot successfully negotiate a contract modification with the purchaser following a suspension. The contract limits the Forest Service's liability to out-of-pocket expenses incurred as a direct result of a suspension. If the Forest Service cancels a contract to (1) be consistent with a forest plan; (2) comply with a court order; or (3) respond to a determination that continued timber harvesting would seriously degrade the environment; cause resource or cultural damage, and/or jeopardize sensitive, threatened, or endangered species, contract provisions provide that the purchaser is entitled to out-of-pocket expenses and to reasonable compensation for the cost of acquiring comparable timber to replace that lost through the cancellation.

Since the early 1990s, the Forest Service has suspended or canceled timber sales contracts for a number of reasons. In the early 1990s, various groups brought legal actions to suspend or cancel timber sales contracts. For example, in May 1991, the U.S. District Court for the Western District of Washington (State) ordered the Forest Service to stop selling timber in much of the area inhabited by the Northern spotted owl until the agency had prepared a management plan and environmental impact statement for the species.² The court found that the Forest Service had failed to produce plans that satisfied the requirements of such laws as the National Forest Management Act of 1976, the Endangered Species Act of 1973, or the National Environmental Policy Act of 1969.

Considerable Liability for Suspended or Canceled Timber Sales Contracts Remains

As of October 31, 2000, information from the Forest Service shows, pending claims of about \$51 million for timber sales contracts that were suspended or canceled to protect threatened or endangered species. This does not include future claims that could arise from purchasers as a result of favorable rulings on other claims on similar issues. Since all estimates of future liability are inherently speculative, the outcome of ongoing and future litigation is unpredictable and could result in the award of less damages than the timber sale purchaser's claim. For example, the Forest Service paid one purchaser \$15,000 for a \$6.2 million claim and paid another purchaser \$2,544 for a \$71,692 claim. According to Forest Service officials, the large difference can be attributable to various reasons, including disagreements over the value of replacement timber that the Forest Service offered to settle the claims. On the other hand, the Forest Service has sometimes paid purchasers the total amount of the damages claimed after the contracting officer validates the claim.

In total, since June 1996, the Forest Service, Department of Justice, USDA's Board of Contract Appeals, and/or Court of Federal Claims have settled 80 claims totaling over \$27 million on timber sales contracts suspended or canceled to protect threatened or endangered species. Although forest funds have been used to settle some of these

²*Seattle Audubon Society v. Evans*, 771 F.Supp. 1081 (W. D. Wash. 1991), aff'd, 952 F.2d 297 (9th Cir. 1991).

claims, the vast majority of funds to pay claims—almost \$26 million--has come from the Department of the Treasury’s Judgment Fund.³ The claims that have been settled since June 1996 have occurred primarily in three Forest Service regions—Region 3, Southwestern; Region 5, Pacific Southwest; and Region 6, Pacific Northwest.⁴

Federal agencies must reimburse the Department of the Treasury for Contract Disputes Act claims paid from the Judgment Fund, and reimbursement is becoming an increasing concern of the Forest Service. In a December 1999 memorandum to USDA’s Chief Financial Officer, the Director of Forest Management raised concerns that the costs of potential claims for suspended and canceled timber sales contracts was beyond the Forest Service’s ability to manage within existing budget constraints. The memorandum cited several conditions that made it “virtually impossible” for the Forest Service not only to reimburse the Department of the Treasury for previously settled claims but also for the estimated \$40 million needed to settle later claims. The memorandum noted that the outstanding liabilities far exceeded the less than \$1 million in claims historically paid by the Forest Service annually.

Cancellation Regulations and New Timber Sales Contract Have Not Been Finalized

The Forest Service has not finalized either the cancellation regulations for timber sales contracts or its new standard timber sales contract. In August 1990, the Forest Service published proposed regulations aimed at reducing its financial liability when canceling timber sales contracts. The proposed regulations were never finalized and underwent various modifications until December 1996, when they were again released for public comment. The proposed regulations would have (1) clarified when, why, and by whom contracts may be canceled; (2) provided a new formula for compensation when the government must cancel timber sales contracts; and (3) limited the financial liability of the United States on certain contracts. According to Forest Service timber management officials, the agency delayed issuance of the regulations because it needed to conduct a more detailed analysis of the impact of timber sales on minorities through a Civil Rights Impact Assessment and an analysis of the government’s potential liability.

In July 1993, at the direction of the Assistant Secretary of Agriculture for Natural Resources and Environment, the Forest Service reinitiated an effort started in the late 1980s to develop a revised standard timber sales contract. The new timber sales contract was intended to distribute liability and risk more equitably between the parties and bring the contract into conformity with standard business practices. For example, the new contract would have permitted the Forest Service to modify the contract to protect natural resources, including threatened or endangered species, and adjust the contract’s terms to allow the purchaser additional harvesting time or money in consideration of such modifications.

³The Judgment Fund is a permanent, indefinite appropriation available to satisfy final judgments against the United States (31 U.S.C. 1304). The Forest Service may owe the Judgment Fund additional funds for other than threatened and endangered species claims.

⁴Region 3 includes Arizona and New Mexico; Region 5 includes California, Hawaii, Guam, and the Trust Territories of the Pacific Islands; and Region 6 includes Oregon and the state of Washington.

The Forest Service expected that the new standard contract would be completed by October 1994 and later expected to issue it for public comments in 1997. Although the Forest Service completed its review of the new contract in September 1996, it was never finalized. Forest Service officials said that higher-priority work, such as the proposal to end the construction of roads on 43 million acres of Forest Service land and revising the Forest Service's planning regulations, took precedence over finalizing the new timber sales contract.

In the interim, a September 1999 decision of the U.S. Court of Appeals for the Federal Circuit has affirmed the validity of specific contract provisions that limit the government's liability for timber sales contracts suspended or canceled for environmental reasons. The court held that the timber purchaser was entitled only to limited compensation provided under the contract for a sale canceled because of spotted owl concerns.⁵ Although the court decision stated that the existing contract provisions and language control the government's actions, good business practices would dictate that the Forest Service finalize its cancellation regulations and new contract to ensure that implementation of the contract language approved by the court will be transparent for the purchasers and consistently implemented across the country by Forest Service personnel.

Replacement Timber Has Been Used to Settle Only a Limited Number of Claims

Although the Forest Service has sometimes used replacement timber to reduce or eliminate claims associated with suspended or canceled timber sales contracts in California, Oregon, and the State of Washington, several problems, including the lack of available replacement timber within the sale area, have limited its use. Even when the Congress acted to expand the area of consideration for replacement timber beyond the sale area and the Forest Service identified available replacement timber, its use has been limited because the replacement timber was of such poor quality that the purchasers would not accept it. As a result, the Forest Service has claims totaling over \$45 million pending for timber sales contracts suspended or canceled to protect threatened or endangered species in California, Oregon, and Washington.

The Forest Service believes that on the basis of a Comptroller General decision (B-177602, Apr. 20, 1973), the geographic area in which it can find replacement timber is limited. The Comptroller General's decision concluded that replacement timber must be provided from the same geographical location as that of the original sale. According to Forest Service officials, the consequence of the decision is substantial because suitable replacement timber may not be available in the same area. In California, for example, the Forest Service has settled six claims totaling \$10 million for contracts suspended or canceled to protect threatened or endangered species, but almost no replacement timber was used to settle the claims. The Forest Service has an additional nine pending claims totaling about \$19.2 million where it will be difficult to offer the purchasers replacement timber because it is either unavailable or of such poor quality that the purchasers would not accept it. In addition, Forest Service officials told us that because the timber within the original sale area had been

⁵Reservation Ranch v. United States, No. 98-5159, 30 ELR 20094 (Fed. Cir. 1999) *aff'g*, 39 Fed.Cl. 696 (1997).

subject to a competitive bid process, it would be inappropriate to substitute timber from outside the sale area on which the agency had not obtained competitive bids.

To help alleviate the problem of providing replacement timber in the Pacific Northwest, in 1995, the Congress enacted Public Law 104-19 that, among other things, required the Forest Service to provide “an equal volume of timber of like kind and value” for certain timber sales that had been canceled or suspended to protect the spotted owl and the marbled murrelet. The act did not limit the Forest Service to the original geographical location when finding alternative timber. After complying with the act’s various requirements, the Forest Service needed to provide alternative timber for 55 contracts. Of the 55 contracts, the Forest Service has provided replacement timber for 16 and settled, canceled, or bought out an additional 21 for a total of almost \$15 million. For the remaining 18 contracts, the Forest Service expects to buy out one and has found replacement timber for 17. Despite the agency’s efforts to comply with the Rescissions Act, purchasers have filed three claims totaling over \$24 million against the Forest Service related to the definition and calculation of “out-of-pocket expenses” and the suspension of timber sales contracts.⁶

According to Forest Service officials, the agency expected to meet the time frame for providing replacement timber for the remaining contracts. However, subsequent events, such as a lawsuit by the Oregon Natural Resources Council, have prevented the Forest Service from releasing the timber. In that lawsuit, the U.S. District Court for the Western District of Washington (State) held that that the Forest Service had not properly surveyed timber harvest areas as required under the Record of Decision in the spotted owl cases.⁷ In a December 1999 settlement, the Forest Service agreed to conduct extensive surveys for about 80 categories of species.

Agency Comments

We provided Forest Service timber management officials with copies of a draft of this report. These officials generally agreed with the content of the draft report and provided technical clarifications, which we incorporated where appropriate.

Scope and Methodology

To provide information on the Forest Service’s current potential liability for timber sales contracts that it suspended or canceled to protect threatened or endangered species, we obtained information on the number, amount, and location of pending claims. We also obtained information on claims settled since our October 1996 report, including the amount of the settlements and the source of the funds used to pay them. We compared the information obtained from Forest Service headquarters with that available from two of its regional offices—Pacific Northwest and Pacific Southwest—to verify the data obtained. We also reviewed court decision relevant to the government’s contract liability.

⁶In the Pacific Northwest, the Forest Service has one other pending claim totaling almost \$1.5 million is that is not related to the Rescissions Act.

⁷*Oregon Natural Resources Council Action v. U.S. Forest Service and Bureau of Land Management*, 59 F. Supp. 2d 1085 (W.D.Wash. 1999).

To obtain information on the current status of the revised timber sales cancellation regulations and the new timber sales contract, we discussed progress to date with Forest Service timber management officials as well as officials from USDA's Office of General Counsel.

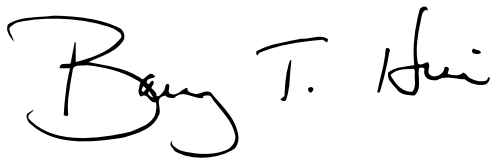
To obtain information on using replacement timber to settle pending claims, we met with Forest Service timber management officials. We compared the information provided by Forest Service headquarters officials with that provided by officials in its two major regional offices—the Pacific Northwest and Pacific Southwest—who are primarily responsible for finding such timber.

We conducted our work from June 2000 to October 2000 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Honorable Ron Wyden, Ranking Minority Member of your Subcommittee; appropriate congressional committees; the Honorable Daniel R. Glickman, Secretary of Agriculture; and the Honorable Michael Dombeck, Chief, Forest Service. We will make copies available to others upon request.

If you have any questions about this report, please call me on (202) 512-3841. Key contributors to this report were Margaret Armen; Jill Berman; John Kalmar, Jr.; and Mary Ann Kruslicky.

Sincerely yours,

A handwritten signature in black ink that reads "Barry T. Hill". The signature is written in a cursive style with a large initial "B".

Barry T. Hill
Director, Natural Resources
and Environment

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