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BY THE COMPTROLLER GENERAL

Report To The Chairman, Subcommittee On Oversight And Investigations House Committee On Energy And Commerce

OF THE UNITED STATES

Need For Guidance And Controls On Royalty Rate Reductions For Federal Coal Leases

The Secretary of the Interior has used his authority to reduce royalty rates on eight Federal coal leases--amounting to $12 million in reduced Federal revenues. Requests for royalty rate reductions were precipitated by recent legislative enactments and a 2-year departmental experiment that raised royalty rates on coal leases to significantly higher levels. Because the Secretary is authorized to readjust the royalty rates on 438 leases by 1990, more requests for royalty reductions are likely in the future.

The Interior Department has not clearly defined its policy and procedures on royalty rate reductions. The approval process is inconsistent, and accounting and auditing expertise needed to evaluate reduction requests have not been used adequately.

GAO recommends that Interior develop a more clearly defined policy and accompanying regulations on royalty rate reductions, determine when audits of applicants' financial statements are needed, and better use existing financial expertise in its evaluations of reduction requests.

GAO/EMD-82-86
AUGUST 10, 1982

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-206153

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

This report discusses problems encountered by the Department of the Interior in its procedures for granting or denying requests for royalty rate reductions on Federal coal leases. During our review you requested that our final report be transmitted to you upon issuance.

We are sending copies of this report to the Secretary of the Interior and the Director, Office of Management and Budget.

Sincerely yours,

Charles A. Bowsher

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS, COMMITTEE ON
ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

NEED FOR GUIDANCE AND
CONTROLS ON ROYALTY
RATE REDUCTIONS FOR
FEDERAL COAL LEASES

D I G E S T

The Mineral Lands Leasing Act of 1920, as amended, grants the Secretary of the Interior the authority to reduce the royalty rates on Federal coal leases. The Department of the Interior has interpreted this authority as allowing for reductions in order to encourage maximum recovery of the coal resources; to promote development; and when a lease cannot successfully operate at the royalty rate established in the lease terms.

Since 1979, the Department has received 11 requests for royalty reductions involving 16 Federal coal leases. The Secretary has used his authority to reduce royalty rates on eight of these, amounting to estimated reductions of $12 million over the life of the leases. (See pp. 2 and 16.)

These requests for reduced royalty rates were precipitated by provisions in the Federal Coal Leasing Amendments Act of 1976. In addition, a 2-year departmental experiment whereby royalty rates were increased in order to reduce front-end cash bonus requirements also contributed to requests for reduced rates. The 1976 act raised the royalty rates on new Federal coal leases to significantly higher levels of 8 percent (underground) and 12.5 percent (surface) of the coal's value and required the royalty rates on pre-1976 leases to be readjusted to these higher levels when the original lease term expired. Future requests for royalty rate reductions are anticipated between 1982 and 1990 as 438 current coal leases are subject to readjustments in the lease terms. (See pp. 1 to 3.)

GAO performed this review to determine the Minerals Management Service's effectiveness in administering the royalty rate reduction program on Federal coal leases. The Department has developed procedures in the form of guidelines to its field offices for evaluating

applications for reductions and deciding whether to grant or deny the request. Inconsistent use and inequitable application of royalty reduction guidelines have made the approval process erratic. In addition, the Department has not sufficiently used its existing accounting and auditing expertise to review reduction applications.

INTERIOR'S ROYALTY RATE REDUCTION GUIDANCE NOT WELL DEFINED

The Interior Department's policy and procedures for granting or denying a reduction in a coal lease's royalty rate are not well defined. The Secretary's reduction authority was delegated to the Minerals Management Service without a clear statement of purpose and scope. The Service's guidelines for reviewing and processing reduction applications merely restate the Department's reduction authority without defining important terms such as profit, rate of return, or a successful operation. Although the guidelines state the requirements of the applicant, the Department relies on the applicant to define the conditions under which the request will be reviewed. (See pp. 5 to 9.)

Frequently, reduction guidelines were changed to accommodate either a specific applicant's circumstances or a group of similar applicants such as those with experimental leases that contained royalty rates in excess of the 12.5- and 8-percent minimums. The result is an inequitable treatment of royalty reduction requests, since the successive revisions have expanded some applicants' opportunities while limiting others. (See pp. 9 to 12.)

The Department should better define the four conditions under which the Secretary has the authority to grant reductions. Policy directives will assist the Service in developing its procedures for entertaining reduction applications. Also, the Department should subject its reduction policy and procedures to public review and comment and issue regulations. (See pp. 17 to 19.)

INCONSISTENT AUDITING PRACTICES

The Service procedures for verifying the accuracy of lessee data differ among field offices. Disparities center on requirements for certified

information from applicants and the practice of auditing company records to assess the validity of the data submitted. The Service has not provided guidance to field offices on when to conduct audits of the financial statements of companies requesting a royalty reduction. (See pp. 12 and 13.)

In addition, the Service staff in the region most active in reviewing reduction applications largely consists of non-accountants that have acknowledged problems with reviews of the complex financial data submitted by coal operators. The Department has accounting expertise in its Royalty Management Program, but it has not been used sufficiently in past reviews of royalty reduction requests. Such expertise should be used more extensively in future reviews of reduction requests. (See pp. 13 and 14.)

COAL LEASE READJUSTMENTS INCREASE LIKELIHOOD OF FUTURE REDUCTIONS

The Federal Coal Leasing Amendments Act of 1976 authorizes the Secretary of the Interior to readjust the terms of coal leases at the end of the 20-year primary term and every 10 years thereafter, if extended. Departmental regulations state that leases issued before the act are subject to readjustment at the end of the current 20-year period and at the end of each 10-year period thereafter. Before 1976, coal leases carried a flat royalty rate of $0.15 to $0.20 per ton. Imposition of the 8- and 12.5-percent royalty will effectively increase rates to equivalent levels of $0.80 and $1.25 per ton, respectively (assuming a $10.00 coal selling price).

Five recent royalty reduction applications cited financial losses attributed to the higher Federal royalties as the primary reason for a reduction. As more leases are readjusted in the future, Service officials anticipate more requests for royalty reductions. Since the decrease in Federal royalties as a result of recent reductions is nearly $12 million, the potential for greater lost revenues is significant. (See pp. 14 to 16.)

RECOMMENDATIONS TO THE SECRETARY OF THE INTERIOR

As future requests for royalty rate reductions may arise, GAO recommends that the Secretary of the Interior

--develop a departmental policy and accompanying procedures on royalty rate reductions that define the limits and conditions under which a reduction would be entertained and granted,

--submit the Department's reduction policy and procedures to public review and comment and promulgate appropriate royalty rate reduction regulations,

--provide guidance to field offices on when the Service can audit the financial statements of companies requesting a royalty rate reduction, and

--direct the Service to better use its existing financial and auditing expertise in evaluating royalty rate reduction requests by (1) requiring the various Economic Evaluation Sections to use the financial assistance in the Royalty Management Program or (2) transferring to the Royalty Management Program the authority to either review or review and approve all royalty rate reduction requests.

AGENCY AND COAL COMPANY COMMENTS

Comments on a draft of this report were obtained from the Department of the Interior and three coal companies cited in the report. The Department expressed general agreement with GAO's conclusion that a need exists for policy guidance and procedural controls on royalty rate reductions. Interior also indicated that it will implement several of GAO's recommendations, including the need to better use the existing financial and auditing expertise in the Royalty Management Program for reviewing reduction applications.

The Department, however, rejected GAO's recommendation calling for the promulgation of royalty reduction regulations. Instead, it proposes to submit the royalty reduction guidelines for public comment but not complete the regulatory process by issuing regulations.

GAO disagrees with this approach since it circumvents the regulatory process which, in GAO's view, is the proper vehicle to use in order to establish a framework for making equitable and consistent reduction decisions. (See pp. 21 and 22.)

The coal companies' comments were favorable to this report and in several instances the companies suggested further areas in the coal management program that need to be addressed. All the companies called for formalizing the reduction guidelines, generally through the regulatory process. (See pp. 22 and 23.)

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ABBREVIATIONS

DCF	discounted cash flow
EES	Economic Evaluation Section
FCLAA	Federal Coal Leasing Amendments Act
FMV	fair market value
GAO	General Accounting Office
MLA	Mineral Lands Leasing Act
OCLPC	Office of Coal Leasing, Planning and Coordination

CHAPTER 1

INTRODUCTION

THE ISSUE

The Secretary of the Interior has granted reductions in the royalty rates paid to the Government for coal mined on federally leased lands as provided by the Mineral Lands Leasing Act (MLA) of 1920 (30 U.S.C. 181, et seq.). This statute was intended to encourage recovery or conservation, promote development, and ensure the successful operation of coal on Federal lands. Interior's Minerals Management Service is charged with entertaining requests for reduced royalty rates.

Two recent measures have precipitated an increase in requests for royalty rate reductions: the Federal Coal Leasing Amendments Act (FCLAA) of 1976 (30 U.S.C. 207) 1/ and a 1978-80 departmental experiment whereby coal lands were offered at royalty rates above the statutory minimums in order to reduce cash bonus requirements.

FCLAA raises royalty rate levels

FCLAA established a royalty rate of 12.5 percent of the value of the coal as the minimum rate applicable to surface mining. (See 30 U.S.C. 207.) By regulation, underground mining carries a minimum royalty rate of 8 percent. (See 43 C.F.R. 3473.3-2.) These rates are significantly higher than pre-1976 rates of between $0.15 and $0.20 per ton. 2/

FCLAA further authorizes the Secretary of the Interior to readjust the royalty rates on Federal coal leases at the end of the 20-year primary term and every 10 years thereafter, if extended. Departmental regulations state that leases issued before the act are subject to readjustment at the end of the current 20-year period and at the end of each 10-year period thereafter. (43 C.F.R. 3451.1.) Between 1982 and 1990, Interior will readjust the roylaty rates on 438 leases from existing levels of between $0.01 to $0.25 per ton to the higher 8- and 12.5-percent rates for underground and surface coal, respectively. Several requests for royalty rate reductions were submitted by applicants whose royalty rates were readjusted to the higher levels.

1/The act established higher Federal royalty rates for new coal leases and required the readjustment of pre-1976 leases to higher statutory levels.

2/A 12.5-percent royalty rate, assuming a selling price of $10 per ton, would yield an equivalent royalty of $1.25 per ton. Coal is generally selling at $7 to $20 per ton.

Table 1

Royalty Rate Reduction Requests and Agency Action

Lease No.	Lessee	Lease terms (note a)		Requested reduction to	Agency action
b/C-07518 b/C-07519	Utah International	12.50% 8.00%	S U	$0.15/ton	Denied
C-27103 b/D-042921	Western Slope Carbon	8.00%	U	5.0%	Denied
b/C-031135 b/C-027239	Hardy Hall Coal Co.	12.50% 8.00%	S U	5.0%	Approved to 5.0% for 2 years
b/D-047201	Western Fuels Assoc.	8.00%	U	5.0%	Denied
U-28297	Coastal States Energy	11.68%	U	5.0%	Denied
ES-16968	Stovall-Files Coal Co.	12.50%	S	7.5%	Approved to 7.5% for 1 year
M-35734 M-35735	Western Energy Co.	21.00%	S	12.5%	Approved to 12.5% for 9 months
C-22644 C-20900	Energy Fuels Corp.	18.30% 16.00%	S S	5.0%	Approved to 12.5% for 3 years
C-27931	Wyoming Fuel Co.	12.50%	S	5.0%	Approved to 5% for 1 year
C-22777	Kerr Coal Co.	12.50%	S	5.0%	Denied
b/P-058300	National King Coal	8.00%	U	5.0%	Pending

a/S=Surface, U=Underground.

b/Lease readjustment.

Source: GAO compilation.

The bonus royalty concept

A 1978-80 departmental policy that resulted in the issuance of 11 coal leases with royalty rates above the 8- and 12.5-percent minimums also has precipitated requests for reduced royalty rates. As discussed in chapter 2, the Department tried to ensure a successful lease sale by reducing the up-front cash bonus requirements while increasing the royalty rate requirements (a bonus royalty). Surface mining leases were issued with royalty rates of between 15 and 20 percent, and underground mining leases contained royalty rates of between 8.5 and 12 percent.

The bonus royalty experiment, coupled with the new royalty provisions in the Federal Coal Leasing Amendments Act, have precipitated royalty reduction requests; future requests are anticipated. In developing criteria for evaluating royalty reduction requests, the Department has encountered numerous problems. The problems with the royalty reduction process are discussed in chapter 2; suggestions for improving the process are located in chapter 3.

OBJECTIVES, SCOPE, AND METHODOLOGY

Since the royalty rate structure has changed from one based on a flat fee to one based on a percentage, the resultant cost increases have prompted more requests for royalty reductions. We performed this review to determine (1) whether the policies, procedures, and guidelines of the Interior Department's Minerals Management Service adequately clarify the circumstances for granting royalty rate reductions; (2) whether the Service equitably applies its guidelines to each rate reduction request; and (3) whether the Service adequately uses its existing accounting and auditing expertise to review royalty reduction requests. The Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, requested that we report our findings to the subcommittee.

We focused on the Interior Department's procedures for entertaining requests for reduced royalty rates on Federal coal leases. During our reviews, we analyzed Interior's guidelines, correspondence, and task force reports related to royalty reductions and fair market value requirements.

We interviewed Interior, Minerals Management Service, and Bureau of Land Management officials with responsibilities for the design and implementation of the coal leasing and royalty reduction programs at headquarters and in the field. This included Service and Bureau officials in their respective headquarters at Reston, Virginia; and Washington, D.C.; and field offices in Denver, Colorado; Casper, Wyoming; Alexandria, Virginia; and Washington, D.C. Royalty rate reduction requests submitted to Interior were granted/denied by these field offices. In addition to operations officials, we contacted various technical personnel within the Department, including field geologists and mining engineers. Coal

companies interviewed included representatives from Energy Fuels Corporation, Colorado Westmoreland, ARCO Coal Company, Wyoming Fuel Company, and Kerr Coal Company. After reviewing the royalty rate reduction cases, we selected these companies because they experienced notable problems with the reduction process. In addition, we obtained comments on a draft of this report from Utah International, Inc., and Western Energy Company.

Our methodology centered on analyses of all the royalty reduction applications and supporting documents submitted to the Service by the coal operators (applicants). The universe included 11 requests for reductions covering 16 Federal coal leases. (See table 1.) All but two reduction requests were from applicants with operations in Colorado, Utah, and Montana. The two remaining applicants were operating in Oklahoma and Alabama. In addition, we reviewed Bureau leasing and production statistics on the number of Federal coal tracts under lease and those currently in a production stage. Estimates of revenues lost due to royalty reductions were primarily derived from the operator's royalty payment statements. We believe that our analysis is representative of the data included in the royalty reduction files.

This evaluation was conducted in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

CHAPTER 2

ROYALTY RATE REDUCTION PROCEDURES LACK GUIDANCE AND TECHNICAL REVIEW EXPERTISE--FUTURE PROBLEMS MAY ARISE

Since 1979, when the Department first received a request for a reduced royalty rate on a coal lease, its Minerals Management Service has been obligated to define the criteria for evaluating a reduction in royalty rates. The broad royalty rate reduction authority granted the Secretary by the MLA has not been translated into a well-defined policy on when and under what circumstances a reduction would be granted to an applicant.

The Service developed procedures, in the form of "guidelines" to its field staff, for accepting or rejecting reduction applications. The guidelines are broad in application and several problems have ensued. For example

--guidelines have not been used consistently and often have been revised to accommodate a specific applicant's needs for a rate reduction,

--auditing practices have not been used consistently to verify the accuracy of financial and production data submitted by royalty reduction applicants,

--the Service has given special consideration to requests for royalty reductions on coal leases with higher than minimum royalty rates, and

--the staff charged with reviewing royalty reduction requests often lack accounting and auditing expertise.

More applications for reductions are anticipated as FCLAA provisions will require the readjustment in the royalty rates on 438 coal leases between 1982 and 1990. Prevailing rates of $0.01 to $0.25 per ton will increase to the current minimum rates of 8 and 12.5 percent of the value of the coal.

INTERIOR'S ROYALTY RATE REDUCTION GUIDANCE IS NOT WELL DEFINED--INEQUITIES RESULT

The Interior Department's policy and procedures for granting or denying a reduction in a coal lease's royalty rate are not well-defined. Broad discretionary authority given the Secretary by the Mineral Lands Leasing Act of 1920, as amended, was delegated to the Minerals Management Service without a clear statement

of purpose and scope. 1/ As a result, the Service developed the procedures for accepting/rejecting a reduction request which relied excessively on the immediate needs of individual applicants (coal operators).

The authority to grant reductions in Federal coal royalties is provided in section 39 of MLA (30 U.S.C. 209):

> "The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal * * * and in the interest of conservation of natural resources, is authorized to * * * reduce the royalty on an entire leasehold, or on any tract or portion thereof segregated for royalty purposes, whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein."

The Service has interpreted this authority as allowing it to reduce royalty rates (1) in order to encourage ultimate coal recovery, (2) in the interest of conservation, (3) to promote development, and (4) when a lease cannot successfully operate at the royalty rate established in the lease terms.

However, these criteria were not clearly defined in either departmental manuals or Service guidelines. The Minerals Management Service has developed guidelines for its field offices for processing an application to reduce royalties--the submittal requirements of the applicant, the review responsibilites of different sections within the Service, the length of a reduction, etc. However, the guidelines are procedures without clear policy direction; they merely restate the Department's MLA authority without defining what constitutes a successful operation or the circumstances that lead to reductions for promoting development or conserving coal.

Instead of a filter-down process, whereby general policy guidance is promulgated at the departmental level and operating procedures are established at the bureau level, the Department requests applicants to define the conditions under which their request will be reviewed. Specifically, the guidelines ask the applicant (the coal operator) to state:

--The reason(s) in detail why a reduction would be in the interest of conservation of coal and why a reduction would promote development and/or make the operation successful. 2/

1/Formerly the responsibility of the U.S. Geological Survey.

2/December 1980 guidelines, pp. 6 and 7.

This applicant-driven approach has caused considerable confusion among coal operators seeking royalty relief and indecision among the Service staff reviewing these requests. Frequently, guidelines have been changed to specifically accommodate an applicant's circumstances; since April 1980, the Service has issued five versions of its royalty reduction guidelines. Consequently, an inequitable treatment of royalty reduction requests has occurred, since the successive revisions have expanded some applicants' opportunties for receiving a reduction while limiting opportunities for others. Although officials within the Service's field offices have consistently called for statements of goals and purposes in reduction policy, the Service has yet to clarify its position.

Specific changes in the guidelines, illustrative of the inequity problems, include the criteria for defining profit, a "successful operation," and an allowable rate of return; and financial statements required to obtain a reduction. In addition, special considerations were provided for leases containing high royalty rates.

Guidelines lack definitions of profit, successful operation, and rate of return

Since the first request for a royalty reduction in 1979, the Service has been confronted with the task of defining a successful operation. Albeit MLA provides for reductions when a successful operation is not assured, the Department and the Service have never defined what constitutes a successful operation. The task of defining a successful operation is relegated to the operator. Ancillary definitions of rate of return and profit have changed with each successive guideline revision, and an inequitable application of criteria among requests for royalty reductions has resulted.

The earlier guidelines of April and August 1980 provided little guidance on determining a successful operation. During this period, the Service used a successful operation definition that was approved for oil and gas royalty reductions: "that from which, on an annual basis, gross income exceeds operating costs." Accordingly, in order for a lease operation to be eligible for a reduction under the oil and gas definition, the operating costs had to equal or exceed gross income. As noted in the Service's December 1980 guidelines, this definition would effectively disallow a reduction if any profit were realized.

Reduction applications submitted by Hardy Hall Coal Company and Utah International, Inc., were founded on the argument that a successful operation implies a profitable one or that an adequate rate of return is required. However, the Utah International and Hardy Coal Company requests were evaluated by the Service using the "no profit" criterion. Both companies were found to be operating at a profit and therefore not allowed a reduction under the prevailing definition of a successful operation. Utah

International's request was denied. Hardy Coal Company's request was denied initially for not meeting the "no profit" criterion but was granted ultimately on the basis of promoting development.

After Hardy Coal's reduction grant, the Service dropped the "no profit" criterion in October 1980, claiming it was inappropriate for coal operations. Thereafter, the definition of a successful operation was relegated to the applicant. Nonetheless, officials within the Service consistently called for a departmental decision defining a successful operation and whether such definition allows for a rate of return. The Acting Chief, Branch of Economic Evaluation, stated in August 1980:

> "* * * we need to carefully define such terms as costs, profit, and rate of return. Such terms are subject to quite different interpretations and could create controversy, inconsistency, and litigation."

This concern was reiterated by the Central Region of the Service in September 1980. The regional Chief of the Economic Evaluation Section (EES) called for an early decision on defining a successful operation in order to permit consistent evaluation of pending royalty reductions and to eliminate differences arising from biased judgment.

As cited previously, current guidelines and proposed revisions relegate the task of defining a successful operation to the applicant. In addition, these guidelines request applicants to state their current rate of return on the operation and the rate of return that would be realized if a reduction were granted. The delegation of a rate of return analysis to the operator became a point of contention between the Central Regional Office in Denver, Colorado, and the Service's headquarters officials in Reston, Virginia. In November 1980, the EES Chief in Denver wrote:

> "We cannot see how consistent treatment of applications can be maintained if the rate of return of individual applicants are used in making royalty rate determinations. Different companies calculate rates of returns on different bases and set their own requirements as to the rate of return necessary on a project. To use company rates of returns would result in inequitable treatment of royalty reduction applications."

The April, August, and October 1980 guidelines provided no allowance for a rate of return to the company. The December 1980 guidelines established a 10-percent maximum allowable rate of return. The January 13, 1982, draft "Royalty Reduction Guidelines for Federal Coal Leases" once again provides no allowance for a rate of return. According to a Service official in the Central Region, at least one royalty reduction application denied using the earlier guides to rates of return may have been approved using the December 1980 guidelines. At a minimum, these constant revisions of

reduction guidelines, combined with the Service's practice of relegating the responsibility to define important criteria to the applicant, result in the inequitable application of guidelines among royalty reduction requestors.

Financial statement requirements have varied among applications for reductions

The guidelines require lessees to submit to the Minerals Management Service information on mining costs, production levels, and sales data for a 12-month period prior to the application date. The first guidelines specified that financial data was lease-specific, implying that the lease had to be producing in order to provide the Service with information on costs and revenues.

However, the first applications for royalty reductions covered leases that were not producing coal. The Service response was a revision in the guidelines that allowed applicants to submit comparable financial data derived from producing leases that were geologically similar. Not only did the Hardy Hall Coal Company's reduction request precipitate the revision, but the company benefited directly. Prior to the change, the Service planned to reject the application; after the change, the request was entertained and subsequently approved.

In the January 1982 draft changes to the guidelines, the Service expanded its definition of comparability by permitting applicants to submit projected costs and sales data developed in a "premining valuation study." According to a Service official, the premining valuation study could entail a simulation of the anticipated sales, production, and costs on a hypothetical mine plan. The Service would accept this information in cases where no geologically similar leases are available for comparison.

The Service recently rejected an application from Kerr Coal Company using the December 1980 guidelines. The request was partially rejected for lack of comparable information from geologically similar leases. Whether the information submitted by the company would be considered comparable under proposed changes is left to the discretion of the Service. However, the frequent guideline changes provide confusing information to the applicants and subject the Service to charges of inequitable and erratic application of its guidelines. And regardless of the information submitted by the applicant, the Service has no criteria for judging whether an adjacent or nonadjacent lease used to support a royalty reduction is in fact comparable.

Leases with high royalty rates granted special consideration

In June 1977, Interior implemented a policy of converting front-end cash bonuses into higher royalty rates (bonus royalty). Royalty rates were determined through an iterative discounted cash-flow process whereby the corresponding estimated bonus

values were decreased to the point where the results of the last iteration reached $25 per acre (the minimum acceptable bid). The resulting bonus royalty is that percentage amount over the statutory 12.5-percent royalty.

The purpose of this process was to capture the estimated economic rent 1/ in the form of royalty over the productive life of the lease. The Department believed that through this approach, it would be less onerous to potential bidders, since the bonus announced before lease sale would be acceptable. That is, the Department's view was that since bidders would be willing to accept modest royalty increases rather than a front-end bonus payment, the chances for successful lease sales might be increased while the Government's receipt of fair market value would occur over time, assuming production occurred.

Between June 1978 and January 1980, the Department issued 11 leases ranging from an 8.51- to 21-percent royalty rate. These rates were considerably higher than the 8-percent regulatory and 12.5-percent statutory levels. (See table 2.) Although the bonus-royalty procedure achieved its objective (successful lease sale), its use has created a new problem. Five of these 11 leases already have requested reductions; reductions were granted for all but one request.

Royalty reduction guidelines on leases with bonus royalties have changed with successive guideline revisions. A chronology of one particular case--Western Energy's reduction request 2/--illustrates the problems the Service experienced with bonus royalties and subsequent reduction requests. Western Energy's coal contracts allowed it to pass through all royalty expenses to the purchaser of its coal. Western Energy was granted a royalty reduction from 21 to 12.5 percent after special consideration was given to the company's claim that the high royalty rates on its two leases were inflationary. As a result of experiences with Western Energy Company and an earlier request from Energy Fuels Corporation, in February 1981, Interior issued a policy on royalty reductions for leases with bonus royalties. The Department's policy was designed in response to recommendations from a December 1979 Fair Market Value Task Force study and opinions from the Office of the Solicitor.

The new directive for these 11 leases, in effect, grants such leases special consideration if a reduction is requested and

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1/Economic rent, sometimes 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.

2/See app. I for detailed description of the case.

Table 2

Leases With Bonus Royalties

Year	Applicant/Lessee	Mine type (note a)	State	Acreage	Royalty rate (percent)	Bonus bid ($ per acre)
1978	Energy Fuels Corp.	S	Colorado	263	15.5	1.00
	Energy Fuels Corp.	S	Colorado	420	b/16.0	25.50
	Swisher Coal Co.	U	Utah	440	9.5	125.00
	Ryan's Creek Coal Co.	U	Kentucky	319	8.51	25.00
	Coastal States Energy Co.	U	Utah	2,632	c/11.68	227.37
1979	Kaiser Steel Corp.	U	Utah	476	9.2	50.38
	Peabody Coal Co.	S	Colorado	125	17.1	35.35
	Western Energy Co.	S	Montana	480	b/21.0	25.00
	Western Energy Co.	S	Montana	447	b/21.0	25 00
	Energy Fuels Corp.	S	Colorado	1,789	b/18.3	25.00
	Braztah Corp.	U	Utah	1,173	10.4	25.00

a/S=Surface, U=Underground.

b/Requested reduction approved.

c/Requested reduction denied.

Source: U.S. Department of the Interior.

exemplifies the continued patchwork approach Interior applies to the reduction process. As stated by the Office of the Solicitor, the integrity of the leasing system may be threatened by reductions in bonus royalties since the danger lies in the potential bad faith of a bidder who deliberately bids a higher rate, intending to seek a royalty reduction later.

INCONSISTENT AUDITING PRACTICES PREVENT ACCURATE REVIEW OF LESSEES' REDUCTION REQUEST

The financial information submitted by the applicant is the Service's basis for reviewing a royalty reduction request. The Service procedures for verifying the accuracy of lessee data on sales, production, costs, and substandard rates of return differ among field offices. Disparities center on requirements for certified/audited information from applicants and the practice of auditing company records to assess the validity of the data submitted.

In addition, the Service staff in one field office reviewing the applications largely consists of economists, mining engineers, and geologists. These non-accountants have acknowledged problems with their reviews of reduction applications and have suggested the need for additional accounting expertise in financial reviews. The Energy Fuels and Western Energy requests for royalty reductions illustrate the problems encountered by the Service in these accounting areas. These problems are summarized in the following sections and detailed in appendixes I and II.

Minerals Management Service audit authority to verify company financial data is unclear

The two Service field offices with experience in royalty reductions--the Central and North Central regions--have different methods for verifying the accuracy of financial data submitted by applicants. Using the same guidelines, each office approached two issues in different manners: (1) an acceptable financial statement from applicants and (2) access to company records to verify accuracy of financial data. A lack of specificity in the royalty reduction guidelines may have precipitated these differences, as exemplified in the Western Energy case processed by the North Central region and the Energy Fuels case processed by the Central region.

The current royalty reduction guidelines qualify the information an applicant must provide the Service. The guidelines require a certification of correctness by lessees or their authorized representative on the financial information submitted for a reduction. Further verification in the form of an audit of company records is neither permitted nor precluded by the Service guidelines. Service regulations do permit the Service to verify company accounts for royalty payment purposes, but whether this regulatory authority is applicable to royalty reduction requests remains unclear.

In the Energy Fuels case, the Central region accepted unaudited financial information on the lease's sales, production, and mining costs from the company. Also, the Service's field office did not audit the company's records to verify the data's accuracy. Energy Fuels did submit its annual audit report, but this report provided no specific information on the two leases for which a reduction was requested. As discussed in appendix II, the committee charged with reviewing the company's reduction request emphasized the need to conduct an audit of the company's records for verification purposes. Officials within the Central region cited problems associated with Government audits of private corporations as the reason an audit was not performed. Nonetheless, Energy Fuels was granted a 3-year royalty reduction to 12.5 percent of the gross sales value of the coal.

In contrast, the North Central region required audited financial statements from Western Energy and conducted an independent audit of the company's records to verify further the accuracy of the data submitted. According to Service officials, the audit did verify that the company's statements were true and correct, and Western Energy received a reduction to a 12.5-percent royalty rate for a period of less than 1 year. The reduction period ended in December 1981, but in June 1982, Western Energy submitted a request for an additional reduction. This request is pending review by the North Central region.

Use of accounting expertise differs among Service regional staff

The Energy Fuels case also exemplifies a unique problem within the reduction review group--the Economic Evaluation Section (EES). In the Central region, the EES professionals are mineral economists, mining engineers, and geologists. The North Central region has professionals with similar expertise as well as professional accountants. The lack of additional accounting talents within the Central region may have contributed to the review problems it experienced in the Energy Fuels case. The principals involved in the review of Energy Fuels' royalty reduction request state that the financial statements received from the company were exceptionally complex and confusing; assistance from an accountant was needed. Although an audit of the company's financial statements was recommended by the reviewing mining engineer, an audit was never performed.

Similarly, representatives from Energy Fuels Corporation cite a lack of accounting expertise among EES officials as an obstacle to smooth coordination of the Section's requests for additional financial information. The company also found the royalty reduction guidelines very vague and lacking definitions of profit, rate of return, and a successful operation. (Rate of return, for example, can be calculated using several accounting methods such as the percentage return on unamortized investment, average return on initial investment, or average return on average investment.)

In general, Energy Fuels' officials stressed the need for Government and industry to speak the same accounting language.

Accounting expertise is not lacking in the Minerals Management Service as a whole. The Service, through its expanding Royalty Management Program is in fact the nucleus of a collection system that emphasizes auditing and accounting standards within the Federal government. Since January 1982, the accounting and royalty collection functions for solid minerals (such as coal) are included in the Royalty Management Program headquartered in Lakewood, Colorado. This accounting expertise is available for review of all royalty-related functions of the Service. As one Service official in the North Central region stressed, "Where such skills (accounting) are lacking within the reduction review group, the Service's Royalty Management Program could provide the needed expertise."

READJUSTMENTS IN MANY COAL LEASES INCREASE LIKELIHOOD OF FUTURE REDUCTIONS

Since 1979, the Service has received 11 requests for a reduction in royalties on 16 Federal leases. As discussed in chapter 1, these requests were precipitated by (1) the use of the bonus royalty concept and (2) requirements in the Federal Coal Leasing Amendments Act of 1976 that raised the royalty rates of pre-1976 leases on renewal to higher levels. The FCLAA provisions will affect the future level of royalty reduction requests as 438 Federal coal leases will be readjusted to higher royalty rates by 1990.

FCLAA authorizes a readjustment in the terms of coal leases at the end of the 20-year primary term and every 10 years thereafter, if extended. Departmental regulations state that leases issued before the act are subject to readjustment at the end of the current 20-year period and at the end of each 10-year period thereafter. Between 1982 and 1990, 363 coal leases will be subject to readjustment. (See table 3.) In addition, Interior has identified 75 leases that are pending readjustment as of September 30, 1981.

The applicable royalty rates will increase from current levels averaging between $0.01 and $0.25 per ton to the regulatory and statutory minimum levels of 8 and 12.5 percent, respectively, of the gross sales value of the coal. In addition, the method for calculating the royalty payments due the Federal Government has changed from a tonnage to a gross sales basis. As illustrated on the following page, at a production level of 500,000 tons of coal, a $0.125 royalty would yield a royalty payment of $62,500. At the same production level, a 12.5-percent royalty would yield a return to the Government of $625,000 (assuming a coal selling price of $10.00 per ton).

Coal sold (tons)		Selling price ($/ton)		Royalty rate		Royalty payment
500,000	X	N/A	X	$0.125	=	$62,500
500,000	X	$10.00	X	12.5%	=	$625,000

The coal operator's royalty payments rise dramatically.

Since 1979, when the Department began the readjustment process, five royalty reduction applications entailing seven Federal leases cited financial losses attributed to the higher Federal royalties as the primary reason for a reduction. Officials within the Service anticipate more requests for reduced rates in the future and believe clear guidance is needed on how such requests are to be processed.

Table 3

Number of Coal Leases Subject to Readjustment 1982-90

Year	Royalty rate (cents per ton) 1-12.5	15-16	17	20	22-25	Total
1982	1	30	6	-	-	37
1983	1	16	9	1	-	27
1984	-	12	8	4	5	29
1985	-	1	8	55	1	65
1986	-	2	-	35	-	37
1987	1	4	17	55	6	83
1988	1	14	8	21	3	47
1989	-	4	8	2	4	18
1990	-	6	4	9	1	20
Total leases	4	89	68	182	20	a/363

a/Seventy-five additional leases were pending readjustment as of Sept. 30, 1981.

Source: GAO compilation.

Less Federal royalties received with royalty reductions

An obvious consequence of a reduced Federal royalty rate is reduced Federal revenues. Five companies received royalty reductions--Hardy Hall Coal Company, Stovall-Files Coal Company, Energy Fuels Corporation, Western Energy Company, and Wyoming Fuel Company. Since the first reduction was granted in October 1980, the decrease in royalties due the Federal Government as a result of reduced royalties is estimated at over $12 million. The Energy Fuels reduction amounts to nearly $10 million of this total. And, should Western Energy's reduction be extended, revenue intake will be reduced further. However, the loss in Federal revenues attributable to royalty reductions must be considered against the potential increase in coal production resulting from less royalty payments imposed on the operator. As one intent of a royalty reduction is to encourage the ultimate recovery of coal, reduced royalty requirements may act as an incentive for ultimate coal recovery or even the continued production of coal resources.

CHAPTER 3

CONCLUSIONS, RECOMMENDATIONS,

AND AGENCY AND COAL COMPANY COMMENTS

The expansive language in the Mineral Lands Leasing Act of 1920 grants the Secretary of the Interior broad discretionary power to reduce royalty requirements on Federal leases. The Secretary grants a royalty rate reduction: to maximize recovery, conserve resources, promote development, and ensure a successful operation. However, neither the Department nor the Minerals Management Service has a well-defined policy and accompanying procedures on when and under what circumstances a reduction would be granted.

The Service did develop and use broad guidelines for determining acceptance or rejection of royalty rate reduction requests. Our review of the Service's royalty reduction guidelines elicited several problems: (1) inconsistent promulgation and application of reduction guidelines, (2) lax standards for verifying the accuracy of data submitted by applicants, and (3) insufficient use of technical staff for evaluating applicants' financial data. These problems require immediate correction by the Service as increases in future royalty rate reduction requests are anticipated.

POLICY ON ROYALTY RATE REDUCTIONS NEEDED

The Department should better define its general policy concerning reduction in royalty rates for Federal coal leases. Such policy should define the criteria under which the Secretary has the authority to grant reductions. For example, the Department needs to clearly specify to the potential applicant the conditions that must exist on a lease before a reduction is granted on the basis of maximizing recovery, conserving natural resources, promoting development, and/or ensuring a successful operation. More specific questions also require departmental decisions: Does the criterion "to promote development" preclude reductions on those leases already in the development or production stages? Under the criterion "to promote a successful operation," what is the measure of success (rate of return, profitability)?

Of course, these decisions must be tempered by congressional intent to raise Federal royalty rates to significantly higher levels than were in effect prior to the Federal Coal Leasing Amendments Act of 1976. A decision that freely permits royalty reductions may undermine FCLAA's mandate and cause de-facto reductions of the statutory minimums. Conversely, a stringent policy that makes reductions virtually impossible might lead to situations where Federal coal is lost to future recovery.

Policy directives will assist the Service in developing its procedures for entertaining requests for reduced rates. Currently, the Interior Department leaves the responsibility to define

the appropriate criteria on royalty reductions to the applicant. It is the applicant (coal operator) who defines a successful operation, and it is the applicant who determines how a reduction will promote development.

As the Service responds to each applicant's individualized interpretation of the royalty reduction criteria, numerous revisions and interim amendments to prevailing royalty reduction guidelines have ensued. Requests have been denied or approved using different criteria for evaluation. The Hardy Hall and Western Energy cases illustrate how guidelines were changed to accommodate the specific needs of those applicants. As the Service relies on the requestors to define such important criteria as a "successful operation" or an "adequate rate of return," inequity in the evaluation of royalty reduction requests is exacerbated.

It is recognized that the Service has grappled with royalty reduction questions only recently--it is, in effect, "new to the business." However, at some salient point, the Service should have recognized that continual revisions to royalty guidelines merely consumed the time of its own staff and that of reduction applicants.

ROYALTY RATE REDUCTION REGULATIONS ARE NEEDED

We believe that Interior, through its Minerals Management Service, should take immediate steps to develop and issue a policy and accompanying procedures on royalty reductions--specifically through the regulatory process that subjects agency action to public review and comment. The Service's past decisions to grant or deny an application for reduced royalty rates were evaluated using guidelines that acted as regulations but were not developed within a regulatory framework. Such action permits the operating agency excessive discretion.

By submitting reduction procedures to public review and developing regulations based on these comments, the Service will begin receiving valuable comments from those operators directly affected by informal guidelines. It would also (1) reduce the chances for errors that might lead to reduced Federal royalties or bypassed Federal coal, (2) establish fairness and equity in royalty reduction procedures, (3) reduce the chance for a de-facto reduction of the statutory minimum royalty rates, and (4) alleviate the pressures placed on the Service to render politically expedient decisions.

The costs associated with promulgating royalty reduction regulations would be minimal compared to the benefits derived from less wasted time by both Government and industry in writing, revising, and deciphering vague guidelines. Since 438 Federal coal leases are to be readjusted to higher royalty rates, the need for well-defined policy and procedures on royalty reductions becomes more

imperative. With definitive guidance and procedures, operators can more readily ascertain whether their leases qualify for a reduction, and the Service can evaluate such requests in an equitable manner.

USE OF EXISTING FINANCIAL EXPERTISE NEEDED

The financial review and auditing practices of the Service are lax and not consistent among field offices. The Energy Fuels case typifies the problems encountered with verifying the accuracy of data submitted by applicants to corroborate their requests. Many calls were heard within the Service for certified accounting statements and audits of company records to verify the accuracy of applicant information. Action was never taken. Whether Energy Fuels' reduction should or should not have been granted is a decision we leave to the Service. But, without a substantiation of the information received by the company, the Service cannot assure that the reduction was justified.

Conversely, we commend the Service for its action in the Western Energy case. Certified financial statements were required and an audit was performed. Yet Service officials are not certain whether they have the authority to require a financial audit of a company requesting a royalty reduction. Existing regulations provide that "an audit of the accounts and books of lessees and permittees for the purpose of determining compliance with lease or permit terms relating to royalties may be required * * *." (30 C.F.R. 211.65.) According to an Interior associate solicitor, the current regulations may allow the Service to require financial audits involving royalty reductions. However, the Service has yet to request a Solicitor's opinion, and it is therefore important that the audit authority of the Service be clarified to the field offices.

The audit is a useful tool but only when performed by an auditor. Similarly, when reviews of the applicant's financial statements occur, the use of auditors and accountants becomes quite important. The accounting and auditing expertise within the Service has not always been used to review reduction applicants' financial information and, as a result, the validity of this information is not assured. We do not dispute the important role of economists, mining engineers, and geologists in the review of requests for reduced royalties. However, problems encountered with certain reduction applications were derived in part from insufficient review by professional auditors and accountants.

Clearly, the Minerals Management Service is not deficient in accounting talents; the Royalty Management Program has these needed skills--accountants, auditors, mineral economists, mining engineers, and geologists. The program monitors royalty payments and has current financial information on energy companies, and its services should be used for future requests for royalty reductions.

The Secretary has several options for improving the accounting standards within the Economic Evaluation Sections of the Service. The Royalty Management Program could be used in an advisory capacity to those sections that lack accounting and auditing skills. Or, the authority of the Royalty Management Program could be further expanded by granting it the responsibility to either (1) review all financial statements submitted for royalty reduction requests and conduct audits where necessary or (2) review and approve all royalty reduction requests.

The Federal Government may lose Federal royalties due to reductions. The five reductions granted since October 1980 have resulted in less royalties flowing to the Federal Government--over $12 million. As more Federal coal leases are readjusted to higher royalty levels and more royalty requests are submitted, it becomes even more important for the Department of the Interior to assure that the public interest is protected by the collection of the appropriate royalties.

RECOMMENDATIONS TO THE SECRETARY OF THE INTERIOR

As future requests for royalty rate reductions may arise, we recommend that the Secretary take immediate steps to correct the problems cited in this report.

Specifically, we recommend that the Secretary of the Interior

--develop a departmental policy and accompanying procedures on royalty rate reductions that define the limits and conditions under which a reduction would be entertained and granted,

--submit the Department's reduction policy and procedures to public review and comment and promulgate appropriate royalty rate reduction regulations,

--provide guidance to field offices on when the Service can audit the financial statements of companies requesting a royalty rate reduction, and

--direct the Service to better use its existing financial and auditing expertise in evaluating royalty rate reduction requests by

(1) requiring the various Economic Evaluation Sections to use the financial assistance in the Royalty Management Program or

(2) transferring to the Royalty Management Program the authority to either review or review and approve all royalty rate reduction requests.

AGENCY AND COAL COMPANY COMMENTS

Comments on a draft of this report were solicited from the Department of the Interior and four coal mining companies cited in the report--Energy Fuels Corp. (Kerr Coal Company), Utah International Inc., Western Energy Company, and Hardy Hall Coal Company. Their responses are included as appendixes IV, V, VI, and VII, respectively. Hardy Hall Coal Company did not respond. Only sections of the draft report relevant to each coal company were provided to them for comment; conclusions and recommendations were excluded. In general, the responses of the Department, as well as the three companies, were favorable.

The Department of the Interior provided detailed comments on certain aspects of this report including each recommendation. We have made technical changes in the body of this report, where appropriate, to recognize certain comments. Others are addressed in the following analysis of the agency's comments.

Interior comments

The Department of the Interior's June 16, 1982, response to our draft report (see app. IV) indicates general agreement with our conclusion that a need exists for policy guidance and procedural controls on royalty rate reductions for coal leases. In addition, Interior indicated that it presently is implementing several of our recommendations, including the need to better use existing financial and auditing expertise in the Royalty Management Program. In subsequent discussions, a Service official indicated that the Minerals Management Program must seek concurrence with the Royalty Management Program on whether to grant or deny a royalty reduction request. The document that will define each group's responsibility has not been completed as of July 1982.

Interior disagrees with the methods we suggest for implementing our recommendations. Specifically, Interior rejects our recommendation that the royalty reduction guidelines be subject to the regulatory process and that royalty reduction regulations be promulgated accordingly. Instead, it proposes "to submit a royalty reduction policy and procedures for public review and comment in the Federal Register * * * in the form of 'guidelines' rather than regulations." The Department indicated that it will not publish any additional regulations "in the interest of not increasing the volume of burdensome Government regulations."

We commend the Department for its intention to submit the guidelines for public review and comment. However, we disagree with its desire to refrain from promulgating royalty reduction regulations. As cited throughout this report, the flexible use of continuously changing guidelines has resulted in inequitable decisions--to the benefit of some and the detriment of others. The past decisions of the Service to grant or deny a reduction application were evaluated using guidelines that acted as regulations

but were not developed within a regulatory framework and thus did not hold the Service accountable for its internal decisions. The current guideline procedures permit the operating agency excessive discretion. Regulations would limit the erratic nature of the reduction process and force accountability on the Service.

In regards to the "burden" that regulations would impose on the public, we submit that such regulatory burden would in fact be less than the present burden placed on reduction applicants who often submit supplemental documentation to the Service because the guidelines are constantly changing. Under current procedures, the burden is on the coal industry in that it must not only remain aware of the latest guideline revision but respond to guideline changes with the appropriate information that is required. And the burden is on the Service in that it appears to expend considerable time writing and revising royalty reduction guidelines.

In another comment on this report, Interior states that it "believes that adequate authority already exists to perform [royalty reduction] audits," and that "it is already the policy of the Department to have audits performed of the financial statements of companies requesting a royalty reduction whenever such audits are requested by the District Mining Supervisors." As cited in this report, the Office of the Solicitor has commented to us that current regulations provide the Department with audit authority that would be applicable to royalty reduction cases. Yet, the discrepancies we discovered in the audit procedures of the Service's North Central and Central regional offices resulted from insufficient direction from headquarters officials as to when audits would be required. Most responsible officials involved with the Energy Fuels' case believed that the complex financial statements submitted by the company necessitated an audit of the company's records. The Department's audit authority may be adequate and clear to those officials in Washington, D.C., but such vision has not been conveyed to the field offices.

Coal company comments

Relevant sections of the draft of this report were submitted to four coal mining companies that had applied to the Service for a royalty reduction. Three of the four companies responded. Overall, their comments were favorable and, in several instances, the companies suggested further areas in the coal management program that need to be addressed.

Kerr Coal Company (Energy Fuels Corp.) concurred with our assessment of the ad hoc nature of the royalty reduction procedures and suggested that formal rulemaking is "the appropriate means for formulating standards for royalty reductions." Kerr further agreed that undefined and ambiguous terms such as "successful operation, rate of return, promote development and comparable operations" must be better defined by the Department.

Utah International Inc., indicated that our draft report accurately identified the problems it encountered with the current reduction process. Utah stated that the problems it experienced stemmed from the Service's over-reliance on guidelines which "do not receive the scrutiny or have the stability of regulations." The company recommended that "most of the reduction procedures need to be defined by regulations following industry, government and public review, but without eliminating all flexibility." Utah suggested further study on the complex issue of whether Federal royalty rates force a displacement of Federal coal in favor of developing less expensive (low royalty rate) State and private coal.

Western Energy Company saw "a definite need for formalizing the royalty reduction criteria" to assure "consistency, fairness and flexibility." The company suggested two areas for further consideration: (1) the applicability of the 12.5 percent coal royalty rate that was "based on the methodology established for oil and gas royalties" and (2) the inflationary effects of the percentage royalty.

The detailed comments of these three companies are located in appendixes V, VI, and VII.

THE WESTERN ENERGY COMPANY'S CASE: SPECIAL ALLOWANCE FOR LEASES WITH BONUS ROYALTY PROVISIONS

In August 1979, Western Energy Company was awarded two Federal leases located in Montana's Powder River Basin. The leases contained an estimated 22.5 million tons of recoverable reserves and were adjacent to Western Energy's ongoing operations. When the tracts were offered for sale, the Bureau of Land Management gave potential bidders the option of bidding either a $25-per-acre bonus with a 21-percent royalty rate or a bonus over $3,400 per acre with a 12.5-percent royalty rate (the statutory minimum). Western Energy was the only bidder and chose the former option. In March 1980, Western Energy petitioned the Minerals Management Service to reduce the 21-percent royalty rate to 12.5 percent, which the Service granted 1 year later. The Service's procedures used to determine the original lease terms of 21 percent royalty and its review of Western's royalty reduction request illustrate the problems with the bonus royalty concept and subsequent requests for rate reductions.

THE PRE-LEASE FAIR MARKET VALUE DETERMINATION

Western Energy filed an application to lease tracts M-35734 and M-35735 in November 1976. The Service, in its capacity to determine a fair market value (FMV) of the leases, conducted a discounted cash flow (DCF) analysis in December 1978. The first lease was evaluated as a stand-alone operation and determined to be an economic by-pass situation, i.e., it could not be economically mined independently of an existing operation.

Extrapolating the "by-pass" results to the additional lease, the Service combined the two leases with adjacent land into a logical mining unit for a second DCF analysis. The Economic Evaluation Section of the Service first recommended to the Bureau that the leases be offered for sale at a bonus of $25 per acre and a royalty rate of 29.6 percent. The Service's Tract Evaluation Committee, however, recommended a 21-percent royalty rate based on an assumed coal selling price less than the Economic Evaluation Section's assumption. The recommended royalty rate became the basis of contention between the Service and the Bureau.

In January 1979, the Montana State Bureau Director, in a letter to the headquarters Bureau Director, called the 21-percent royalty rate excessive and stated it would result in the by-passing of the public coal resource. Specifically the Director said:

> "* * *the appraisal technique [DCF] used may not arrive at the FMV of the coal. The Service's logical mining unit approach tends to maximize the value of the coal in by-pass and production maintenance situations.

* * * * *

"* * * forcing a sale because of the applicant's vulnerablity violates the FMV concept."

ROYALTY REDUCTION PROCEDURES

In October 1979, Western Energy requested Interior's Deputy Under Secretary to review the coal evaluation procedures used in establishing the royalty and bonus levels in their recently acquired leases. The company complained that the 21-percent royalties were both inequitable and inflationary. Western Energy acknowledged that under the prevailing guidelines, it could not qualify for a reduction since clauses in its coal contracts allowed for the pass-through of royalty costs to its buyers.

Western Energy formally requested a royalty reduction in March 1980. On May 28, 1980, the Secretary announced his decisions on options contained in a departmental task force report "Fair Market Value and Minimum Acceptable Bids for Federal Coal Leases." The Secretary's decisions supported the recommendation of the task force to refrain from issuing coal leases at higher than minimum royalty rates. The study found that high royalty rates could have various negative effects such as lower recovery rates and premature abandonments. In addition, higher Federal royalties were likely to be copied in non-Federal leases, magnifying the cost impact on the consumer.

In September 1980, the Office of Coal Leasing, Planning, and Coordination (OCLPC) questioned the Service's presale lease valuation procedures and warned that the division could wind up under unwanted scrutiny if Western Energy's application was rejected solely on narrow procedural or technical grounds. The Office of Coal Management in the Service similarly recommended in October 1980 that a policy decision was needed on the definition of FMV with respect to its impact on the consumer. Future royalty reduction requests based on "inflationary royalty rates" were anticipated.

During this time, EES was reviewing the financial data submitted by Western Energy. In November EES conducted an audit of the financial records of Western Energy and verified that the economic and financial data submitted by the company were true and correct.

EES used the August 1980 guidelines as the basis for evaluating Western Energy's royalty request. These guidelines had no provisions for reductions based on the inflationary consequences of higher than minimum royalties. The October guideline revision directed the regional offices to disregard bonus royalties in reduction requests if the bonus royalty portion could be passed through to the consumer. As indicated in Western Energy's application, its coal contracts did allow all royalties to be passed-through. Since Western Energy could not show substandard rates of return, it did not technically qualify for a reduction.

However, in view of the comments received by the OCLPC and the FMV task force, the Economic Evaluation Section recommended on February 6, 1981, that Western Energy receive a royalty reduction to 12.5 percent for the remainder of 1981. Events subsequent to the EES recommendation have both questioned and confirmed the decision to grant a reduction.

On February 13, 1981, the Office of the Solicitor ruled that Section 39 of the MLA did not preclude the reduction of bonus royalties. However, the Solicitor's opinion further stated

> "* * * such a reduction could threaten the integrity of the competitive bidding system * * *. The danger to bidding arrangements involving optional royalty rates, as in Western Energy's case, lies in the potential bad faith of a bidder who deliberately bids a higher rate with the intent of seeking a royalty reduction * * *."

On February 25, 1981, the Deputy Assistant Secretary for Land and Water Resources established a new policy for evaluating coal leases having above minimum royalty rates that would attempt to "correct the inflationary tendencies of excess royalties." The Service was directed to treat all bonus royalties as an expense the lessee must bear. (Expenses are normally passed through to the coal purchaser.) This procedure was to be used even if the lessee's coal contracts included pass-through provisions for all royalties. Using actual price and cost data supplied by the lessee, the Service would determine, through a new DCF analysis, a royalty rate that allowed the lessee a fair return. The December 1980 guidelines were amended to include this change.

The reduction granted Western Energy expired in December 1981, and the company submitted a request for a renewal of the reduction in June 1982. Officials in the Service indicate that the procedure outlined in the Deputy Assistant Secretary's directive will be used in evaluating the company's new royalty reduction request.

THE ENERGY FUELS CORPORATION'S CASE: USE OF THE AUDIT TO VERIFY COMPANY'S FINANCIAL DATA

Energy Fuels Corporation received two Federal leases in 1978 and 1979 that carried royalty rates of 16.0 percent and 18.3 percent, respectively. As with the Western Energy leases, these leases were part of the Interior Department's experiment to reduce front-end bonus requirements by incorporating bonuses into royalties.

On September 30, 1980, Energy Fuels applied for a reduction in royalty rates on these two leases; a royalty rate of 5 percent was requested. Energy Fuels contended that its coal contracts did not allow for the pass-through of bonus royalties, and with an absorption of the bonus royalties, the company projected a net loss on its operations. The company submitted to the Service financial data on sales, production, and costs in an unaudited form even though the prevailing reduction guidelines stated that all applicant information was to be certified as correct by the applicant or his authorized representative.

Consequently, the Central Region of the Minerals Management Service had no independent evaluation of the accuracy of the data received from the company. Between October 1980 and April 1981, the Economic Evaluation Section (charged with reviewing the applicants' financial data) engaged in correspondence with the lessee to ascertain the validity of the company's information. In February 1981, EES first recommended a reduction to a 5-percent royalty for 1 year on both leases. This recommendation was rejected by the Deputy Conservation Manager--Mining as an excessive reduction. His rejection of the 5-percent level was premised on fear that such a reduction would open the floodgate to future royalty reduction requests:

> "* * * Once a royalty reduction is granted, in this case there doesn't appear to be a way to avoid granting future reduction, subsequently, the die would be cast and the Government would eventually end up losing untold millions of dollars worth of royalty * * *."

In March 1981, the Service headquarters in Reston, Virginia, accepted the Deputy Conservation Manager--Mining's recommendation for a 1-year reduction to 12.5 percent but requested a "new royalty rate determination less subjective than the 12-1/2 percent." On April 13, 1981, the mining engineer charged with reviewing the Energy Fuels request in Reston recommended an Inspector General audit or a Certified Public Accounting firm audit of the company's financial statements. However, an audit was never performed, and Energy Fuels was granted a 3-year royalty reduction to the 12.5-percent rate.

The April 29, 1981, final recommendation of the committee charged with reviewing the Energy Fuels' request concluded:

> "* * * although differences of opinion exist among the personnel on allowable cost items for EFC [Energy Fuels Corp.], the general consensus of opinion was that an audit would be necessary for verification * * *. The decision to recommend the 12-1/2 percent royalty rate was based primarily upon the opinion that all is not well with EFC and that without an audit to verify factual information, it would be difficult to allow any royalty rate reduction below the standard 12-1/2 percent * * *."

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MICHAEL F. BARRETT, JR.
CHIEF COUNSEL/STAFF DIRECTOR

April 30, 1982

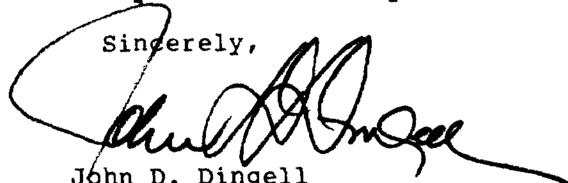
The Honorable Charles A. Bowsher
Comptroller General of the
United States
U. S. General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Bowsher:

It has recently come to our attention that GAO is nearing completion of a review of the Department of the Interior's program for granting royalty rate reductions on Federal coal leases. The Subcommittee on Oversight and Investigations is aware that the Interior Department has procedures for evaluating applications for reduced royalties.

In light of our concern about the adequacy of internal administrative and financial controls, we are requesting that you report your findings and recommendations for improving the program to our Subcommittee. It would be appreciated if the report were available by the end of July 1982.

Sincerely,



John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

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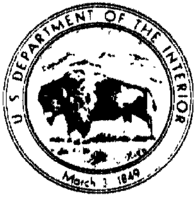


United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

JUN 16 1982

Honorable J. Dexter Peach
Director, Energy and Minerals
Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed the GAO draft report entitled: "Need for Policy Guidance and Procedural Controls on Royalty Rate Reductions for Federal Coal Leases" and generally agree with its conclusions. However, there is one rather significant factual error on page 8 of the draft report. Page 8 refers to January 1982 "Proposed Guidelines." These "guidelines" are merely an internal working document. The document is handwritten in part and has not been subject to an internal Minerals Management Service (MMS) review. Citing it as proposed MMS policy is, therefore, incorrect.

The Department is currently reviewing its procedures for royalty rate reduction and is considering many of the issues raised by the GAO report. It is important to recognize the difficulties involved in writing definitive regulations that reflect a diversity of geologic, economic and mining conditions. For example, the granting of reductions based on "conservation of the resource" inherently involves the professional judgment of mining engineers and geologists.

Specific comments regarding the draft report recommendations follow:

Recommendation:

Develop Department of the Interior (DOI) policy and procedures on royalty reductions that define the limits and conditions under which a reduction would be entertained and granted.

Response:

The Department is working to refine royalty reduction procedures and to identify areas requiring additional policy development or refinement.

[See GAO note, p. 32.]

Recommendation:

Submit the Department's reduction policy and procedures to public review and comment and promulgate appropriate royalty reduction regulations.

Response:

It is the intent of the Department to submit a royalty reduction policy and procedures for public review and comment in the Federal Register. Such publication will take the form of revised "guidelines" rather than regulations. In the interest of not increasing the volume of burdensome Government regulations, the Department does not intend to publish any additional regulations at this time.

Recommendation:

Clarify the authority of MMS to audit the financial statements of companies requesting a royalty reduction.

Response:

The Department believes that adequate authority already exists to perform such audits. Also, as part of a major revision of the Royalty Management regulations, we are proposing to include in that revision guidelines for royalty reduction applications so that there can be no question about the definitions of such terms as profit, cost base, rate of return, and other terms which presently are interpreted widely and with a variety of precision by various MMS field offices.

Recommendation:

Direct MMS to use its existing financial and auditing expertise in evaluating royalty reduction requests by

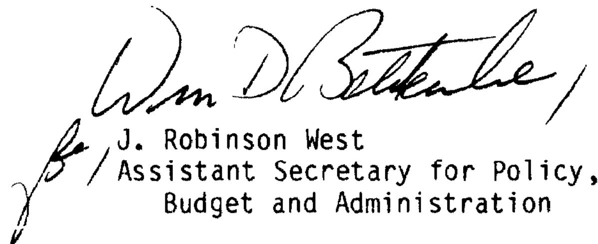
(1) requiring the various Economic Evaluation sections to use the financial assistance in the Royalty Management Program, or

(2) transferring to the Royalty Management program the authority to either review or review and approve all royalty reduction requests.

Response:

It is already the policy of the Department to have audits performed of the financial statements of companies requesting a royalty reduction whenever such audits are requested by the District Mining Supervisors. Under a recently drafted Division of Responsibility's document defining the responsibilities between the Minerals Management and Royalty Management Programs, the processing of applications for royalty reductions is a shared responsibility of both offices. Procedures are now being drafted to implement the Division of Responsibility document and in that document, Minerals Management Program officials will be required to request a Royalty Management audit of the financial support data for a royalty reduction when there is any question about the economic basis upon which the reduction is requested.

Sincerely,



J. Robinson West
Assistant Secretary for Policy,
Budget and Administration

GAO note: The page reference in this appendix has been altered to reflect its location in this final report.

kerr coal company

suite 900 • three park central • 1515 arapahoe • denver, colorado 80202 • (303) 623-8317

June 7, 1982

Mr. Ned Smith
General Accounting Office Evaluator
United States General Accounting Office
Room W 644, Columbia Plaza Audit Site
2401 E Street, N.W.
Washington, D. C. 20240

Re: Comments on Draft GAO Report - "Need for Policy Guidance and Procedural Controls on Royalty Reductions for Federal Coal Leases"

Dear Mr. Smith:

Pursuant to the request of Mr. J. Dexter Peach, Director, dated May 11, 1982, Kerr Coal Company ("Kerr") submits the following comments and observations on the draft GAO Report entitled "Need for Policy Guidance and Procedural Controls on Royalty Rate Reductions from Federal Coal Leases" (the "Draft Report"). We appreciate the opportunity to provide our comments on the Draft Report and we hope that our comments will be of assistance to you in finalizing the Report. For ease of reference, our comments have been divided into general comments on the Draft Report as a whole, followed by specific comments.

General Comments

The basic thrust of the Draft Report is that, since 1979, the Minerals Management Service ("MMS") has granted or denied requests for reductions in federal coal royalties on an ad hoc basis with little consistency or fairness. Decisions on royalty reduction requests have been made under guidelines which have changed with virtually every application for a royalty reduction. We agree with this assessment and we concur with the expressed opinion of the GAO that the policy of the Department of the Interior with respect to royalty reduction requests should be clearly set forth in an understandable and detailed format, so that the field offices and

Mr. Ned Smith
June 7, 1982
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the applicants can understand the basis upon which a royalty reduction request will be granted or denied. Royalty reduction applications should not be granted or denied on an ad hoc basis under constantly changing guidelines which leave terms that are essential to the decision on the application undefined and ambiguous. Specifically, terms such as "successful operation," "rate of return," "promote development," and "comparable operations" should be carefully and clearly defined. In addition, the MMS field offices should not be called upon to make important policy decisions regarding royalty reductions on a case by case basis. Rather, these policy decisions should be made by the Department of the Interior in Washington, D. C. after full opportunity for public comment. The field offices should be required simply to implement in a fair and equitable fashion those policy decisions.

In connection with the need for clear policy statements and guidance, we submit that the GAO in its Final Report should propose that the standards, criteria and definitions applicable to royalty reductions be proposed, and ultimately promulgated, as rules rather than as guidelines, not having the force of law. In our view, formal rulemaking, with full opportunity for public participation and comment, is the appropriate means for formulating standards for royalty reductions. Moreover, through the public comment process, the Department of the Interior will obtain valuable insight from other agencies, industry and the public which will assist the Department in defining the important terms in the regulations. In addition, a formal rulemaking will increase the likelihood that the Department of the Interior policies with respect to royalty reductions will be consistently applied.

Specific Comments

1. Title Page: The spelling of "Conrol" in the Title should be corrected to read "Control."

2. Pages 5 through 7 - Inequities: While we agree with the thrust of the statements made on pages 5 through 7 of the Draft Report, for the reasons identified above, we believe the GAO should suggest in the Final Report that a formal rulemaking be undertaken with respect to royalty reduction standards and criteria.

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3. Page 8 - the "no profit" Criteria: In our view the "no profit" criteria previously used by the MMS in the April and August 1980 guidelines is inconsistent with the clear meaning of Section 39 of the Mineral Land Leasing Act of 1920 and with the legislative history of the Federal Coal Leasing Act Amendments of 1976. Consequently, we believe the Final GAO Report should point out that the "no profit" criteria when applied was inconsistent with the intent of Congress and that such a criteria should not have been imposed.

4. Page 8 - Rate of Return Definition: We submit that the Final GAO Report should go further in its comments on allowable rates of return. Specifically, we believe that the GAO should take this opportunity to suggest that the 10% rate of return assumption currently used by the MMS is unacceptably low in light of current interest rates which exceed 16%. In addition, we believe it would be appropriate for the GAO to suggest an appropriate definition for rate of return in this context rather than simply identifying the problems created under existing guidelines which require the applicant to define the rate of return.

5. Page 9 - Charges of Inequitable Treatment: In connection with the statements made on Page 9 of the Draft Report regarding charges of inequitable and capricious treatment of applications, we would emphasize that the MMS denied in toto Kerr's royalty reduction request less than six (6) months after granting a similar request by Wyoming Fuel Company on a federal lease located immediately adjacent to the Kerr Mine. Importantly, Wyoming Fuel Company mines the same seam of coal as Kerr, sells its coal into the same market as Kerr, and we believe experiences virtually identical mining costs as Kerr. And yet, the royalty reduction request of Wyoming Fuel Company was granted and the royalty reduction request of Kerr was denied. Because of the clear inconsistency of decision in the Wyoming Fuel Company and Kerr cases, we believe the Final GAO Report should specifically point out the inequitable nature of the results obtained. This disparity in result, in our view, does more than lead to charges of inequitable and capricious application of the guidelines, it makes such charges undeniable.

[See GAO note, p. 36.]

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June 7, 1982
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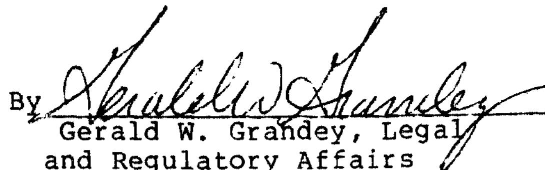
6. Page 14 - Accounting Expertise: We strongly agree with the Draft Report's emphasis on the importance of insuring that the MMS utilize the services of skilled and knowledgable accountants or financial analysts within the Economic Evaluation Section to evaluate royalty reduction applications. Indeed, we believe that the aura of mistrust which often develops in royalty reduction cases is a result of the failure on the part of agency personnel to understand the financial presentations in the application. The misunderstanding and consequent aura of mistrust could be avoided in most instances if the staff of the Economic Evaluation Section possessed greater financial expertise and familiarity with accounting procedures and techniques. The Energy Fuels Corporation application provides a clear example of the problem presented by an unsophisticated review. At the local level the staff was troubled by a number of costs shown in the financial statements which reflected transactions with affiliates of Energy Fuels Corporation. Most of these transactions were complex and were entered into to maximize income tax benefits for the Company and its owner, Robert W. Adams; but in effect they imposed no greater costs on the Company than would have been the case with identical transactions involving third parties. The local staff failed to understand their purpose and their true impact on Energy Fuels Corporation, and it was only upon Washington D.C. staff review that many of the local staff's misimpressions were dispelled. Unfortunately, the Washington, D.C. staff review came too late in the process to affect the outcomes of the reduction request.

In closing, we reiterate our appreciation for the opportunity to provide the GAO with our comments on the Draft Report. If you or anyone on your staff has any questions regarding any of the comments made, please do not hesitate to contact Brad L. Doores at the address indicated above. We look forward to reading the Final GAO Report on this matter.

Sincerely,

KERR COAL COMPANY

By 
Gerald W. Grandey, Legal and Regulatory Affairs

GAO note: Page references in this appendix have been altered to reflect their location in this final report.

GWG/BLD/bb

FEDERAL EXPRESS

UTAH INTERNATIONAL INC.
BOX 187 - CRAIG, COLORADO 81626
303-824-4401

June 4, 1982

Mr. Dexter Peach, Director
Energy and Minerals Division
United States General Accounting Office
Room W644 - Columbia Plaza
2401 E. Street, N. W.
Washington, D. C. 20240

Dear Mr. Peach:

I am writing to provide comments on your draft report "Need for Policy Guidance and Procedural Controls on Royalty Rate Reductions for Federal Coal Leases" as requested by your letter of May 11, 1982, to our Mr. Scott Strain.

Your draft report accurately identifies many of the difficulties Utah International Inc. encountered in attempting to obtain a royalty reduction.

As the report points out, the royalty reduction process has been fraught with changing ground rules and a lack of direction for the regional offices. We believe much of this problem stems from depending too heavily on guidelines to deal with too many crucial issues. While guidelines may be desirable and necessary for certain functions of government, they do not receive the scrutiny or have the stability of regulations. There are simply too many extremely important procedures in the royalty reduction process to be left solely to guidelines.

The language of section 39 of the MLA as amended refers to "conservation of natural resources". This has been interpreted by the USGS to apply to conservation of mineral resources. In fact, the language of the statute appears to have a much broader connotation, encompassing air, water, land-use, wildlife and other natural resources. Coal precluded from mining at an existing project because of financial limitations will presumably be replaced by mining elsewhere, eventually resulting in more mines and more areas of disturbance.

We are pleased to note that inflationary effects were considered legitimate reasons for reducing the royalty rate for Western Energy. In conjunction with inflationary impacts, the competitive ability of a project needs to be considered. Coal prices should not be forced above the prevailing market value simply because such cost increases can be passed to the customer under a long-term fuel agreement.

At Utah International Inc.'s (Utah) Trapper Mine, the increased royalty rate made the operation non-competitive in the spot sales market. At the time Utah applied for a royalty reduction, the effect of the royalty increase had already forced termination of spot sales. The mine was in a position where it could not prove that a lower royalty would result in resumed spot sales. Neither could

Mr. Dexter Peach, Director
Energy and Minerals Division
June 4, 1982
Page 2

the mine consumate a spot sales agreement without being certain of a lower royalty rate. The mine was operating at a near break-even point under a long-term fuel agreement with the Craig Station and, therefore, could not convince the USGS of the need for a royalty reduction. Consideration for the competitive ability of the project in the review of the royalty reduction request may have helped alleviate the problem. This is especially important if one looks at the schedule for coal lease renewals in the western United States. Since Utah holds some of the oldest producing leases in the region, our leases were up for renewal and subject to increased royalty rates well in advance of our competitors. While this situation will slowly correct itself over the years, it has created gross differences in royalty rates for projects vying for the same market.

The draft report implies in a number of places that the USGS is remiss for not defining all important criteria for preparing and processing a royalty reduction request. While this has certainly contributed to inconsistencies and difficulties, we would urge that procedures be kept somewhat flexible to allow for unique or unanticipated situations.

With respect to a rate of return for a project, we feel it is essential that it be allowed in the royalty reduction procedures. A project is not successful if it is only breaking even or making less than an alternate investment could. If a rate of return is not realized, coal operators will be forced to close and be discouraged from future investments in coal mining operations.

On page 16, the report points out that income from federal royalty payments is less if reductions are granted. This is a complex issue that bears further consideration. As federal royalties increase, state, county and fee coal become more attractive economically and can potentially replace federal coal that would otherwise be mined. Such a reduction in the production of federal coal would also lessen royalty income. Moreover, as coal prices are driven up by royalties and other costs, it becomes a less attractive commodity for use at home as well as becoming less able to compete on the international market. This can also serve to retard coal production and reduce royalty income.

In summary, the royalty reduction issue is complex and much in need of review such as your report attempts to do. Most of the reduction procedures need to be defined by regulation following industry, government and public review, but without eliminating all flexibility. Impacts to resources other than just mineral resources should be considered. The competitive ability of coal operators should be considered and customers should not be forced into footing the bill for high royalties because of pass-through provisions in long-term fuel agreements. Federal coal is a commodity that must be competitive on the national and international market or it is likely to be replaced. In the long term, replacement may more seriously lower revenues from royalties than will reduced royalty rates.

[See GAO note, p. 39.]

Mr. Dexter Peach, Director
Energy and Minerals Division
June 4, 1982
Page 3

Thank you for the opportunity to review your report. We hope our comments are constructive and helpful.

Sincerely,

Wayne E. Sowards
Assistant to the Mine Manager
Trapper Mine

WES/js

cc: R. C. Diederich
D. L. Humphreys
G. M. Stubblefield
F. P. DiBartolo
file

GAO note: The page reference in this appendix has been altered to reflect its location in this final report.

WESTERN ENERGY COMPANY

GENERAL OFFICES: 107 EAST GRANITE, BUTTE, MONTANA 59701
(406) 723-3151

June 8, 1982

J. Dexter Peach
Director, Energy & Minerals Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

Western Energy Company has reviewed the draft report on the need for policy guidance and procedural controls on royalty rate reductions for federal coal leases. We were not entirely clear on the objective of this report. Under the section entitled Objectives, Scope and Methodology there was discussion about the procedures, the means and the methodology for the analyses. We were not sure of the intent of the study or what you hoped to accomplish. If the intent was to show a need for policy guidance and procedural controls on royalty rate reductions for federal coal leases, then this probably was accomplished. We also see a definite need for formalizing the royalty reduction criteria. There is a need for consistency, fairness, and flexibility.

The GAO report touches on, but does not adequately address, the main problem with coal percentage royalties. The original percentage royalty structure was based on the methodology established for oil and gas royalties. The USGS has had problems in implementing all aspects of the new coal royalty structure because the oil and gas royalty structure is not, in our opinion, directly transferrable to coal industry due to the vast differences between the industry and the oil and gas industry. Oil and gas are commodities and coal is not. Each industry has different cost and pricing parameters and different tax structures. Also, they have different sales methods, for example, coal sales especially in the West are characterized by long-term contracts with pass-through provisions for royalty payments. It was this pass through provision that prohibited Western from initially meeting the necessary criteria for a royalty reduction. However, the inflationary effects of the higher royalties were recognized by the Department of Interior and thus resulted in a royalty reduction.

Letter
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Page 2

In one section of the report you mentioned the obvious consequence of a reduced federal royalty rate is reduced federal royalty revenue. However, the report also pointed out that a reasonable royalty level is important from a conservation of resource standpoint, i.e., to encourage ultimate recovery of coal and to allow the continued production of existing coal resources. We agree with this analysis. It is hoped that the 30 CFR 211 regulations will also redress the major inflationary impact of the percentage royalty. Presently, the value of coal includes the operating costs, the profit, state production taxes, federal royalty payments, federal black lung, federal reclamation fee, and then all of these items interact with the percentage royalty for the final royalty to be paid. It is our contention that Congress did not intend this mathematical inflation of the price of coal by the interaction and the percentage royalty and the percentage taxes.

We urge that any policy recommendations made by GAO to Interior will encourage maximum resource recovery while alleviating the inflationary aspects of the high percentage royalties. It is not in the economic best interests of this nation to drive up the cost of coal with its resultant ripple effect throughout the economy. Thank you for this opportunity to review this draft document.

Sincerely,

William J. Robinson
Manager, Corporate Development

WJR/ah

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