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STATEMENT OF
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RESOURCES, COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON MINING, FOREST MANAGEMENT,
AND BONNEVILLE POWER ADMINISTRATION,
HOUSE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS



Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to be here today to discuss the implications of our recent report entitled "Analysis of the Powder River Basin Federal Coal Lease Sale: Economic Valuation Improvements and Legislative Changes Needed" (GAO/RCED-83-119).

Our report raises--on the one hand--some serious questions regarding Interior actions related to the sale and the reasoning behind them. On the other hand, it recognizes that Interior faces the very difficult task of trying to sell--competitively--leases many of which are attractive only to adjacent mining operations and of little interest to the rest of the industry. Thus, our message is that several features of the Department's program need revision, but, to make Interior's task practicable, congressional action is also needed.

Our objective today, rather than restating the various specific findings in our report--which have been well publicized

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as the result of two previous hearings--is to briefly highlight the most important ones and then to provide some perspective for interpreting what they mean in the context of Federal coal leasing. Toward this end, I will address the question of whether Interior's current program already considers our report recommendations, and elaborate on our position regarding the need to postpone scheduled lease sales.

CHANGE TO ENTRY LEVEL BIDDING

At a March 19, 1982, meeting, senior Interior Department officials decided to change the bidding system to be used at the April sale. The new system--called the entry level system--was patterned after the auction principle of starting the bidding at a "floor" or entry level price well below its real estimated value. Thus, instead of publishing and using the Department's presale estimates of fair market value as minimum acceptable bids (MABs)--its normal approach--lower "entry" level prices, to start the bidding, were published and later used at the sale.

Interior headquarters officials had no records documenting and could provide no written quantitative basis supporting the need to change the bidding system, just six weeks prior to the sale. At the sale, the new system did not spur bidding competition as Interior had envisioned.

DID POWDER RIVER COAL LEASES SELL AT FAIR MARKET VALUE?

Most of our report is directed at answering this basic question. Based on our evaluation, we believe that most Powder River leases sold for less than fair market value. Before

reaching that conclusion, however, we made numerous analyses of the

--economic valuation methods employed by the Department's own experts on the North Central Regional Economic Evaluation Team,

--criticisms of the regional team's methods voiced at Interior headquarters, and

--procedures for determining--after the sale--whether or not bids received represented fair market value.

We found that the method used by the regional evaluation team to estimate the value of Powder River leases--which resulted in the original MABs--was not unreasonable considering the less than perfect competitive coal market that existed in the region. However, revisions to eliminate the effects--which turned out to be quite significant--of some unnecessary features of their analysis were needed. On the other hand, we found Interior headquarters officials' criticisms of the team's methods neither supportable nor warranted since the officials could not provide us detailed information documenting weaknesses in the methods used. Interior's contention that the regional team's estimates of lease value were too high was not accurate. Our analysis, using the regional team's estimating approach and correcting for several inappropriate adjustments, showed these estimates were too low.

Interior's postsale procedures for determining whether bids offered for Powder River leases represented market value were conceptually flawed and improperly administered. Though the procedures used after the April and October sales differ slightly, both suffer from the same conceptual illness--an overdependence on data from the actual sale itself. Put simply, the

procedures unrealistically anticipated genuine bidding competition. In addition, they were unclear and confusing in parts and also included bid acceptance criteria which were unrelated to determining market value.

From our analysis we found that most Powder River coal leases sold for less than fair market value. In fact, actual selling prices for leases sold in April and October were roughly \$100 million below our estimates of their value. Of the five new production tracts--those that can be economically mined by themselves--only one was clearly acceptable. Two sold for less than 30 percent of our revised value and thus in our opinion were clearly unacceptable, while the two remaining tracts sold at 48 and 60 percent of our revised value and thus while not clearly unacceptable--considering changes in demand for new coal production--were at least questionable. In our opinion, none of the seven maintenance tracts--those tracts designated to be a logical extension of an adjacent mining operation--sold at fair market value. All should have been rejected.

FEDERAL LEASE LAWS
ARE NOT REALISTIC

As you know, under the Mineral Lands Leasing Act of 1920, as amended by the Federal Coal Leasing Amendments Act of 1976 [30 U.S.C. 201(a)(1)], the Secretary of the Interior must award coal leases by competitive bidding. However, the many laws influencing the Federal Coal Management Program tend to restrict leasing to areas where coal is already being mined.

Present law assumes all coal lease tracts are competitive. It does not recognize that many essentially noncompetitive production maintenance tracts not only exist--8 out of 13 Powder River tracts, for example--but are in many cases desirable. As a result, the manner in which the Government leases coal does not correspond to the way industry is developing the resource. Continuing to sell production maintenance tracts at regional

Coal sales only creates the pretense of competition and offers little assurance that the Government will receive a reasonable return for its coal. In our view this problem of "maintenance leasing" deserves congressional attention.

RECOMMENDATIONS

Our report recommends that Congress and the Secretary of the Interior take several actions to ensure a reasonable return to the Government for leased coal. We specifically recommend that Interior postpone scheduled regional coal sales until the Department has revised several features of its program. Although Interior did implement different procedures for its October sale, we do not believe they adequately address the concerns. Let me briefly state the main thrust of each recommendation and outline what actions Interior might take to satisfy it. We recommend that Interior develop

--A detailed analysis of the economic and geologic variables affecting the value of a Federal coal lease, including how changes in one variable affect others.

Interior's regional economic evaluation team in Casper, Wyoming, has identified many of the economic and geologic variables affecting coal lease value and in this sense has completed much of the work needed to satisfy this recommendation. However, a better understanding is needed of how these variables relate to one another--e.g., the relationship between stripping ratios and production rate factors, as noted in our report. It is not clear that each variable has a unique and separate impact on tract value. Thus, some additional study is still needed.

--New internal procedures for conducting coal lease valuations, including criteria for comparable sales analyses--refining the technique used to develop original minimum acceptable bids for the April 1982 Powder River sale.

Interior does not have uniform procedures for conducting coal lease valuations. In addition, the simulation technique employed by the Casper regional team--which needs some refining--is not widely known or used. To satisfy our recommendations, Interior should develop (1) specific comprehensive sales analysis procedures and (2) detailed procedures for simulating coal mine operations--including uniform standards governing the number of simulations required. This latter point is a technical one, but important because as the number of simulations is increased so is the confidence--up to a point--that can be placed in the analyses. Our recommendation envisions Interior determining what an acceptable number of simulations might be.

--New guidelines for using untried or experimental bidding systems--such as entry level and intertract bidding--at regional coal lease sales, including limits on the percentage of the leasing target permitted under such experimentation.

This recommendation is pretty straightforward. To our knowledge Interior has not yet developed such guidelines.

--Minimum regulatory selling prices for coal leases in each Federal coal region on a cents per ton basis.

As you know, coal is a heterogenous resource occurring in various amounts, geologic formations, and qualities in different Federal coal regions. Regulatory minimums should be expressed in cents per ton in each coal region to properly reflect coal value. The current policy of setting regulatory minimums on a dollar per acre basis does not consider these resource occurrence differences and thus can result in significant undervaluation of Federal coal and receipt of less than fair market value. Interior's Office of Policy Analysis has done some work in this area, but some updating is needed. Once updated, Interior could be ready to publish proposed regulatory minimums for public comment.

--Revised fair market value determination procedures that include specific quantitative tests (1) applicable whether or not adequate bidding competition is present and (2) placing greater reliance on prior comparable sales and recent arm's length sales in the absence of bidding competition at the actual sale.

Interior's interim procedures used after the October follow-up sale are overly dependent on the presence of genuine bidding competition at the sale itself and are so flexible that they permit inconsistent postsale analyses. These procedures require substantial revision. On pages 54 and 55 of our report, we discuss how Interior analyzed the bids for the Fortin Draw and Rocky Butte tracts sold at the October sale. Because Interior officials were unable to explain inconsistencies in the analyses of these two tracts, it was not clear to us whether the Department's efforts were directed more to supporting preconceived notions of value than at fairly determining it.

These concerns and unfinished tasks lead us to recommend a postponement in leasing. Interior needs time to strengthen its leasing, valuation, and fair market value determination procedures. Some of these weaknesses can only be addressed by detailed analyses, building upon existing knowledge already in the Department, including some of the work of the regional economic evaluation team and Office of Policy Analysis. Even with an all-out effort to bring about needed improvements, however, several months or more may be required to satisfy administrative requirements, including the possible need for public comments. This obviously has implications for the planned Fort Union sale in July and possibly for the December sale in San Juan.

At the same time, while Interior prepares for future lease sales, Congress too should take steps to make the Department's task more practicable. Legislative amendments are needed to authorize Interior to negotiate the essentially noncompetitive production maintenance leases. In addition, to ensure public

and industry awareness of the lease negotiation process, and to provide ample opportunity for affected parties to influence the process, the amending legislation should require that Interior publish its (1) intent to negotiate a proposed maintenance lease, (2) decision to negotiate the lease as proposed and its evaluation of public comments, (3) intent to sell the lease and the proposed sale terms, and (4) decision to sell the lease as proposed, or under modified terms, and its evaluation of public comments. Further, to facilitate future evaluations of the negotiation process, we recommend that the amending legislation require that detailed records be kept of the negotiations, including evidence presented by Government and industry representatives, and of its disposition.

Mr. Chairman that concludes my statement; I welcome any questions the committee may have.