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Report to the Chairman, Subcommittee on Environment, Energy, and Natural Resources, Committee on Government Operations, House of Representatives

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MINERAL REVENUES

Coal Lease Readjustment Problems Remedied but Not All Revenue Is Collected

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Resources, Community, and
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The Honorable Mike Synar
Chairman, Subcommittee on Environment,
Energy, and Natural Resources
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

On August 20, 1986, you requested that we provide information on the Department of the Interior's progress in carrying out its responsibilities under Section 6 of the Federal Coal Leasing Amendments Act (FCLAA). FCLAA requires that Interior readjust federal coal leases at the end of their initial 20-year term and at the end of each 10-year period thereafter, to reflect increased royalty rates and change other lease terms and conditions as provided for in the act. Interior's Bureau of Land Management (BLM) issues and manages federal coal leases under the authority of the Mineral Lands Leasing Act of 1920 and is responsible for readjusting lease terms and conditions. Interior's Minerals Management Service (MMS) is responsible for collecting the higher royalty and rent once a lease has been readjusted.

This report discusses Interior's progress in readjusting federal coal leases scheduled for readjustment through September 30, 1986. It also discusses the adequacy of Interior's collection of royalties and rent, resulting from the required readjustments, and the adequacy of the bonds it requires from lessees to protect the government against the loss of revenue that is accruing while the lessee appeals the readjustment.

In summary, during the period 1976 to 1984, BLM did not readjust 149 federal coal leases by their lease anniversary dates, and as a result it lost an estimated $187 million in royalty and rent payments.[1] The problem in lease readjustments appears to have been corrected, since from 1985 through the end of fiscal year 1986, BLM readjusted on time all but one federal coal lease that were scheduled to be readjusted. In addition, in the five states that we reviewed MMS had not collected over $12.6 million in royalties and rent, as of September 30, 1986, because of inadequate controls over royalty and rent collection.

[1]Under a 1986 ruling by an Interior Appeals Board, this amount will be less (See app. III.)

BLM also frequently did not protect the government's financial interest in the five states we reviewed, by not requiring bond amounts from lessees adequate to cover revenue that accrued during the period that lease readjustments were being appealed. As of September 30, 1986, there was $11.9 million in unprotected revenue.

We conducted our review at the BLM headquarters in Washington, D.C., and its state offices in Colorado, Wyoming, Utah, and New Mexico. We also collected information on federal coal leases in Oklahoma, which are administered by the New Mexico state office. In addition, we performed audit work at the MMS Royalty Management Service in Denver, Colorado. (See app. I for a detailed discussion of our objectives, scope, and methodology.)

Background

Before 1976, federal coal leases were issued for an indeterminate period and were subject to a royalty rate of no less than $0.05 per ton and an annual rent starting at no less than $0.25 and increasing to no less than $1.00 an acre at the end of the fifth year. However, at the end of each 20-year period, BLM could readjust lease terms and conditions.

In 1976 the Congress passed the FCLAA, which revised the royalty provisions of federal coal leases. Specifically, FCLAA required that the Secretary of the Interior (1) set a higher minimum royalty rate, of 12.5 percent of the coal's value, for surface mines and authorize the setting of a lesser rate for underground mines,[2] (2) change the basis for royalties from a cents-per-ton rate to a percentage of value, (3) reduce the time period between readjustments after the initial 20-year term, from 20 years to 10 years, and (4) authorize the setting of an annual rental rate.[3] These revisions have caused about a 10-fold increase in the royalties paid on coal mined on federal lands.

According to a memorandum of understanding between BLM and MMS, BLM has the sole decision-making authority on lease readjustments, while MMS has the final authority for revenue collection. BLM lease readjustment procedures require that it notify a lessee at least 2 years before the lease anniversary date of its intent to readjust the lease. In addition, 6 months before the anniversary, BLM forwards the lessee the new FCLAA

[2]Although the Secretary set a uniform royalty rate for underground coal at a minimum of 8 percent of value, a 1987 U.S. Court of Appeals decision ruled that underground coal lease rates should be determined on a lease-by-lease basis, but no less than 5 percent of value.

[3]The Secretary set an annual rental rate of no less than $3 00 an acre

lease terms and conditions. At this point the lessee can either (1) accept the new terms and conditions, (2) relinquish the lease, or (3) protest the new terms and conditions to the BLM state office within 60 days.

If BLM's state office dismisses the protest, the lessee has 30 days to appeal the decision to the Interior Board of Land Appeals (IBLA).[4] While the lease is under appeal to IBLA, the lessee is not required to pay the higher royalty and rent. The difference between what a lessee had been paying (for example, royalty of $0.15 a ton and rent of $1.00 an acre) and what would be paid under FCLAA (12.5 and/or 8 percent of sales and $3.00 an acre) accrues but remains unpaid until IBLA renders a decision. After IBLA makes its determination, the lessee can further appeal to the federal courts.

After BLM readjusts federal coal leases to reflect new terms and conditions, MMS collects rents, royalties, and other payments and maintains accounting records relating to royalty management on federal leases. (See app. II for a detailed flow chart of BLM's current readjustment process.)

Pre-1976 Federal Coal Leases Currently on Schedule for Readjustments

Between 1976, when FCLAA was enacted, and 1984, BLM did not timely readjust 149 of the 241 federal coal leases whose lease anniversary dates fell within this period, because of processing delays. As a result, BLM lost an estimated $187 million in royalties and rent.[5] However, BLM has acted on the 88 federal coal leases scheduled for readjustment from January 1, 1985, through September 30, 1986, and all but one of the federal coal leases had been readjusted on their lease anniversary dates. The one Utah lease that was not readjusted on its anniversary date was 2 months late at a cost of $1,038, which cannot be recovered. Additional details on the status of leases are provided in appendix III.

Collection of Readjusted Lease Revenue Needs Improvement

In our 5 review states, MMS did not collect over $12.6 million in royalty and rental payments, plus an additional amount for late charges, on 53 federal coal leases that BLM had readjusted, as of September 30, 1986, because of 3 factors. First, MMS is unsure as to when to collect accrued revenue, that is, rent and royalty increases not paid while they are being appealed. BLM regulations require the collection of accrued revenue after

[4]IBLA is responsible for deciding mineral resource issues under dispute.

[5]However, under a 1986 IBLA ruling, this amount will be less. For more details see app. III

BLM's decision is upheld through appeal, although the regulations do not specify and BLM staff differed on whether the term "appeal" refers to IBLA appeals or subsequent court appeals. However, Interior's Assistant Solicitor for Onshore Minerals and GAO agree that BLM's regulation required lessees to pay the accrued revenue once IBLA renders a judgment in favor of BLM.

Second, MMS does not have an adequate system to identify nonpayment and/or underpayment of rent. MMS' Auditing and Financial System, the primary system used to ensure accurate royalty reporting and payment, does not identify underpayment and nonpayment of rent; therefore, MMS relies on the lessee to report and pay the correct rent.

Lastly, BLM formally agreed to supply MMS with documents to support all major changes to lease terms and conditions that would occur as a result of lease readjustments. However, we found that BLM's state offices did not send the specific documents needed by MMS because they were not listed in BLM regulations or procedures. Therefore, MMS was often unaware of the lease terms and conditions of readjusted leases, and the lessees continued, undetected, to pay at the lower rate. Additional details on the collection of revenue are provided in appendix IV.

The Government's Financial Interest Is Not Fully Protected When Readjustments Are Appealed

BLM has not fully protected the government's rights to revenues that accrue while readjusted coal leases are being appealed. As of September 30, 1986, bond amounts for 30 of the 94 leases in the 5 review states being appealed to IBLA and the courts did not fully cover the accrued royalties and rent (i.e., the royalty and rent increases). Because of BLM district offices' noncompliance with BLM bonding instructions, BLM state offices' lack of oversight, and incomplete bonding instructions, $11.9 million of the $56.9 million in accrued revenue was not covered by bonds. Thus, these unprotected funds could be lost if the lessees go out of business.

All leases are required to have a lease bond, a security given Interior to ensure payment of all obligations under a lease. Standard bond provisions for leases not under appeal include 3 months of estimated royalty at the readjusted rate and 1 year of rent. Beginning in December 1985, if a lessee appealed a lease readjustment, BLM instructed its state offices to increase the bond to reflect not only the readjusted rate but also the amount equivalent to the difference between the unreadjusted and readjusted rates for an additional period until the next 6-month bond review.

Thus, if the lessee went out of business during the appeal process, the government had assurance that it would receive the accrued revenue.

However, in January 1987 IBLA ruled that because BLM had not incorporated into its regulations the requirement for an increased bond to cover accrued revenue, appropriate authority did not exist for BLM to increase the bond for a lease under appeal with IBLA. Thus, BLM cannot currently protect revenue that accrues during the appeal process from lessee default unless it changes its regulations. According to BLM headquarters officials, BLM has drafted regulations that would require the lessee to pay the higher readjusted royalty and rent rates on the lease anniversary date, even if the lessee appeals. We agree that such a regulation would decrease the potential loss of revenue because it would eliminate the need to periodically increase bond amounts to cover accruals for leases under appeal. As of August 1987, the draft regulations were being held, pending a briefing of the Secretary of the Interior. Additional details related to bond issues are provided in appendix V.

Conclusions

While BLM lost revenues by not readjusting coal leases between 1976 and 1984, that problem has been corrected, and all but one lease was adjusted properly during 1985 and 1986.

In our 5 review states, MMS did not collect over $12.6 million in royalty and rental payments, plus an additional amount for late charges, on 53 federal coal leases that BLM had readjusted, as of September 30, 1986, because (1) MMS has not collected royalty and rent increases after IBLA ruled that they were proper, (2) MMS had not implemented a financial management system to identify nonpayments of rent, and (3) BLM did not provide MMS with adequate notification of the leases' readjustment status.

In addition, because of BLM district offices' noncompliance with bonding instructions, limited oversight by the state office over its district office, and incomplete bonding instructions, bond amounts did not cover $11.9 million of royalty and rent that accrued while leases were under appeal. Thus, the government was not assured of receiving all the revenue owed it should the lessees default. Furthermore, because of an IBLA ruling, BLM can no longer require increased bond amounts to cover accrued revenue during an appeal to IBLA until it amends its regulations. Therefore, accrued revenues owed to the government are not entirely protected, and these unprotected revenues are increasing as accruals increase. BLM is drafting regulations that, if implemented, will solve this problem.

Recommendations

We recommend that the Secretary of Interior instruct the Director of BLM to (1) incorporate in BLM's coal lease readjustment procedures a list of specific lease readjustment documents that state offices should provide to MMS, (2) establish a system to consistently provide those and other lease documents to MMS, and (3) ensure that BLM continues to develop and issue a regulation requiring lessees to pay the readjusted rates while a lease is under appeal with IBLA. In the interim, pending the issuance of the regulation under recommendation 3, the Director should notify BLM state and district office staff and MMS officials that the term "appeal," in BLM's current regulations, refers to the IBLA appeal.

We further recommend that the Secretary of the Interior instruct the Director of MMS to ensure that the MMS financial management system identifies the nonpayment or underpayment of rent.

We discussed our findings with BLM and MMS officials and included their comments where appropriate. However, at your request, we did not obtain agency comments on a draft of this report. Unless this report is publicly announced by you, we plan no further distribution until 30 days from the date of the letter. At that time, copies will be sent to the Director, Office of Management and Budget; the Secretary of the Interior; other House and Senate committees and subcommittees having oversight and appropriation responsibilities for the federal minerals leasing and development program; and other interested parties.

This review was performed under the direction of James Duffus III, Associate Director. Major contributors are listed in appendix VI.

Sincerely yours,

J. Dexter Peach

J. Dexter Peach
Assistant Comptroller General

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Abbreviations

BLM	Bureau of Land Management
FCLAA	Federal Coal Leasing Amendments Act
GAO	General Accounting Office
IBLA	Interior Board of Land Appeals
MMS	Minerals Management Service
RCED	Resources, Community, and Economic Development Division
SLMS	Solid Leasable Minerals System

Objectives, Scope, and Methodology

On August 20, 1986, the Chairman, Subcommittee on Environment, Energy, and Natural Resources, House Committee on Government Operations, requested that we assess the Department of the Interior's progress in carrying out its responsibilities under Section 6 of the Federal Coal Leasing Amendments Act. Our objectives were to determine (1) the status of each federal coal lease scheduled for readjustment by the end of fiscal year 1986, (2) if MMS has adjusted the royalty and rental rates of readjusted leases in conformance with the adjustments made by BLM and collected unpaid revenue that accrued during an appeal, and (3) if BLM required an appropriate bond amount to protect the government during the period that some leases were being appealed.

The scope of our review covered a total of 329 federal coal leases, nationwide, scheduled to be readjusted by the end of fiscal year 1986. We obtained data for the review from BLM's Solid Leasable Minerals System (SLMS), located in Washington, D.C. We performed various assessments of the information in this data system to assure its accuracy and completeness. Specifically, we tested the data's reliability by tracing the data of the leases in our survey to the source documents—coal lease files. We also reviewed coal lease files and interviewed BLM state office personnel responsible for updating the system. Because we found numerous errors in these data, we verified all information that would be used in our report. This verification was conducted by either a review of lease files or interviews with BLM personnel.

We conducted our review at the BLM headquarters in Washington, D.C., its state offices in Denver, Colorado; Cheyenne, Wyoming; Salt Lake City, Utah; and Santa Fe, New Mexico. We also collected information on federal coal leases in Oklahoma—which are administered by the New Mexico state office. The 5 states were chosen because they represent 492 of the 538, or 91 percent, of the pre-1976 leases managed by BLM. In addition, we performed audit work at the MMS Royalty Management Service in Denver, Colorado. We interviewed officials at BLM headquarters and state offices, as well as MMS' Royalty Management Service to determine procedures and internal controls for readjusting federal coal leases. We reviewed Interior's guidelines and procedures, examined BLM's annual coal lease publications, and reviewed studies and audits conducted by BLM personnel, state auditors, and Interior's Inspector General to obtain an overview of Interior's coal lease readjustment program. Our review was conducted between November 1986 and April 1987.

To determine the status of federal coal leases scheduled for readjustment by the end of fiscal year 1986, we reviewed a BLM printout, generated by SLMS, of all federal coal leases issued before 1976. From this list of leases, we identified those leases that had been issued on, or before, September 30, 1966. These leases would have had their 20-year anniversary by September 30, 1986, and should have been readjusted. We verified lease information through a review of coal lease files for the five states in our review. For the leases not in our five review states, we verified the lease status information through interviews with the BLM state coal coordinators.

To determine if MMS had adjusted the royalty and rental rates of readjusted leases and collected outstanding royalties and rentals, we analyzed lessee payer files to determine if the lessee had paid the higher royalty and rental rate to MMS from the date of the readjustment. For those companies that had not paid at the higher readjusted rate, we identified the amount of revenue not collected by subtracting the actual revenue paid at the old rate from the revenue that should have been paid at the new FCLAA rate. In some cases we could not determine the amount not paid because information such as the sales price of the coal had not been reported to MMS. For those cases, we obtained the outstanding balance cited in this report from BLM. We also reviewed MMS company files, which contained miscellaneous data on the company, to determine the rationale for nonpayment or to provide additional information. We reviewed billing records to ensure that those lessees who had not paid the appropriate royalty and/or rental amounts or who were late in paying had been billed the balance plus a late charge.

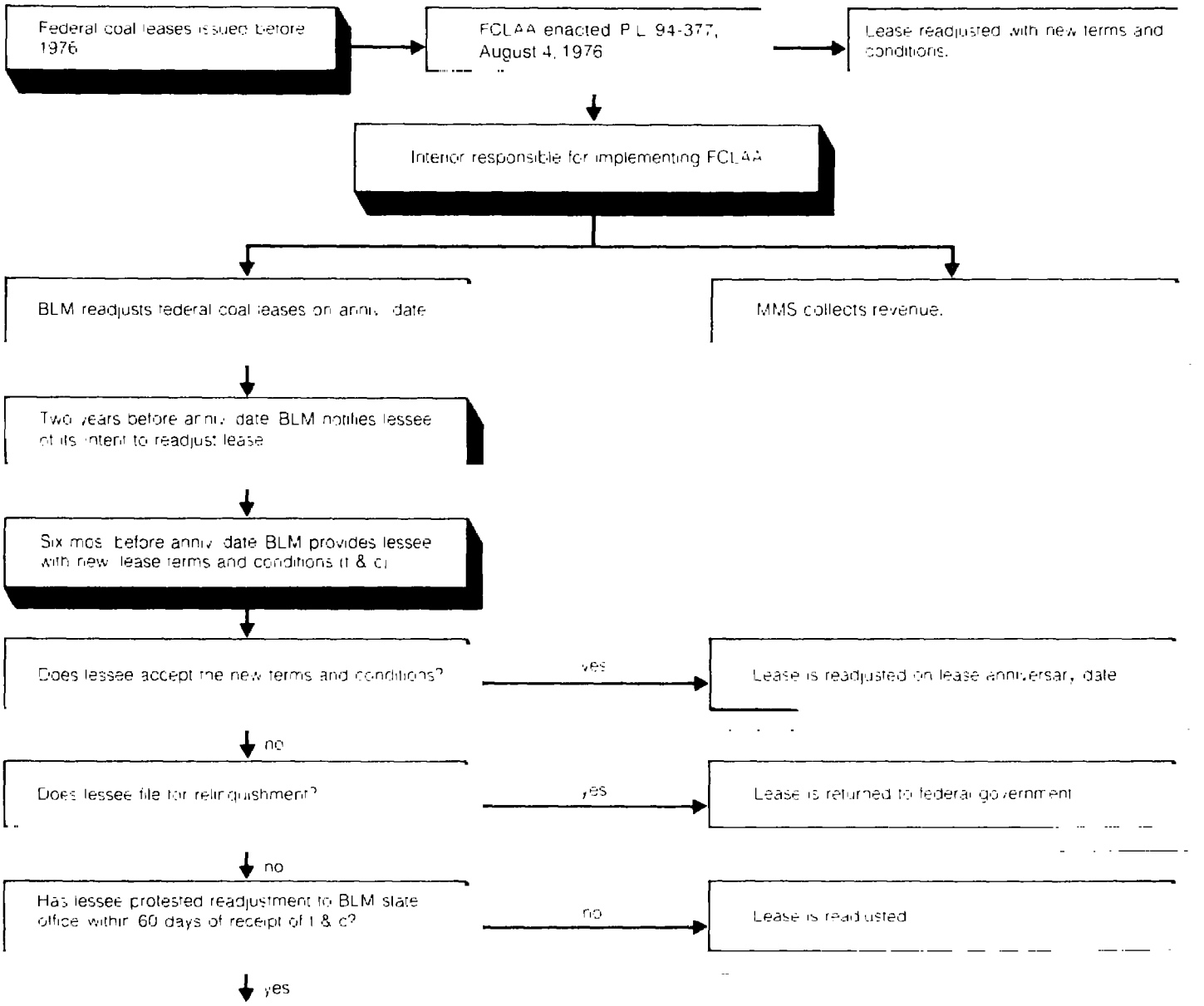
To determine if BLM required an appropriate bond amount for those leases under appeal, we identified those leases in our five review states that were in an appeal status as of September 30, 1986. We reviewed BLM state office files for each lease to determine how often the bond had been reviewed and if it had been increased or decreased during the period the lease was in appeal. We also reviewed BLM quarterly reports for September 30, 1986, to obtain information on total royalty and rental amounts that had been accruing from the date the leases were readjusted up to the date of the quarterly report. To determine if the BLM bonds covered the amounts accruing for leases under appeal, we compared each lease's total accrual amount to the bond amount in effect on or before September 30, 1986.

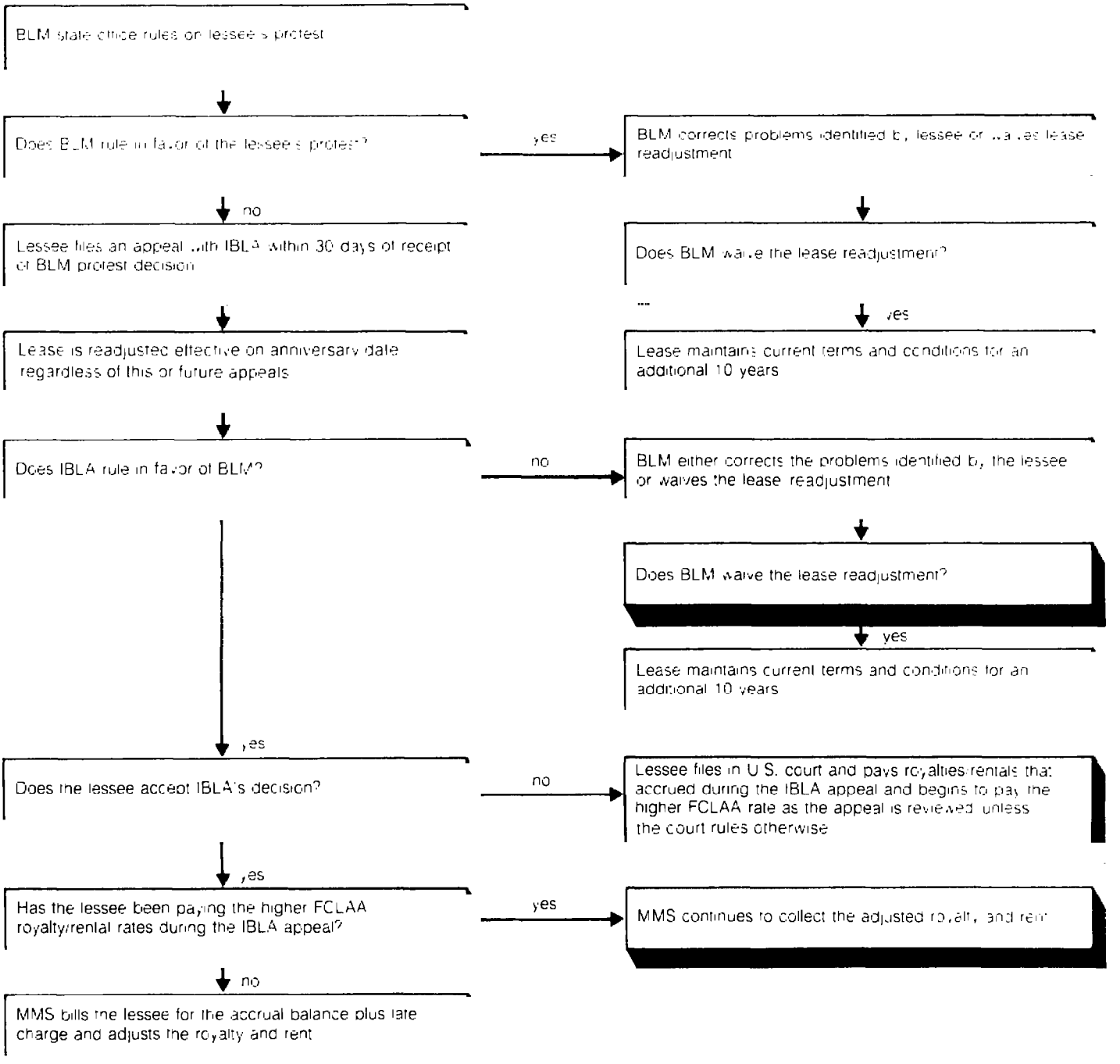
We interviewed BLM headquarters and state officials to obtain reasons for any noncompliance with the instruction memorandums. We also used

the information we found in the files, on the frequency of bond reviews and the basis for bond amounts, to determine why BLM had not required appropriate bond amounts for some leases under appeal. During the course of our review, IBLA ruled on January 28, 1987, that BLM could not increase bond amounts to cover the accrual (the difference between the readjusted and unreadjusted royalty and rental rates) for leases under appeal with IBLA.

We conducted our review in accordance with generally accepted government auditing standards. In accordance with the requester's wishes, we did not request official agency comments on a draft of this report. However, we discussed our findings with BLM and MMS officials and included their comments where appropriate.

BLM's Coal Lease Royalty Readjustment Process





Source: BLM readjustment precedures and interviews

Pre-1976 Federal Coal Leases Currently on Schedule for Readjustments

Between 1976 and 1984 BLM did not readjust, by their lease anniversary dates, 149 of the 241 federal coal leases due for readjustment. According to an Interior 1984 study,[1] untimely readjustments resulted in a loss to the federal government estimated at $186,656,379 in royalty and rental revenue. BLM figures showed that 119 readjustments resulted in royalty and rental underpayment because the readjustment occurred 1 to 4 years after the lease anniversary date. Thirty additional attempted readjustments were denied by the IBLA or the BLM state office until the next 20-year lease anniversary date, because the BLM state office had not notified the lessee of its intent to readjust the lease before the lease anniversary date. However, IBLA concluded, on August 29, 1986, that regardless of whether BLM provided the lessee with timely notice, a lease issued before the enactment of FCLAA can be readjusted after 10 years. Therefore, under IBLA's new determination, the amount of unrecoverable royalties and rent originally estimated for the 30 leases denied readjustment for 20 years would be less.

According to BLM the causes for untimely notification have been corrected by its introduction of procedures in 1984. (See app. II for a detailed flow chart of the readjustment process.) One cause was that BLM did not start the readjustment process soon enough. BLM's 1976 regulations required it to notify the lessee before the lease anniversary date but did not specify when to start the process. The 1979 regulations specified that the lessee be notified of the intent to readjust the lease before the anniversary date but allowed BLM up to 2 years after that notification to complete the readjustment. During the time between this notification and the readjustment effective date, the lessee paid the old royalty and rental rate, resulting in underpayments. However, in 1984 BLM initiated instructions under which the readjustment process begins at least 2 years in advance of the lease anniversary date.

Since revenue losses between 1976 and 1984, BLM has developed readjustment procedures that were to ensure that all federal coal leases were readjusted on their lease anniversary date. Between 1985 and the end of fiscal year 1986, BLM had acted on the 88 federal coal leases scheduled for readjustment. We found that all but one federal coal lease, between

[1] Information Memorandum to the Secretary of the Interior, from the Assistant Secretary, Land and Minerals Management Subject: Bureau of Land Management Revisions of Federal Coal Lease Readjustment Procedures, July 23 1984 Our count of 149 leases readjusted late or not at all includes 12 federal coal leases scheduled for readjustment between 1976 and 1984 that were not included in the 1984 study. Four readjustments resulted in rental underpayment because readjustment occurred 5 days to 1 year after the lease anniversary date and eight were denied readjustment by IBLA or the BLM state official until their next anniversary date. These 12 leases, which were identified after the completion of the study, resulted in a revenue loss to the government of $163,884.

1985 and 1986, had been readjusted on their lease anniversary date. The one Utah coal lease that was readjusted late had an anniversary date of January 1985 but the readjustment became effective 2 months later, March 1985. The untimely readjustment of this nonproducing lease resulted in a loss of $1,038 in rental payments to the federal government, which cannot be recovered.

BLM is currently managing 538 federal coal leases issued before 1976; 329 of these leases were scheduled to be readjusted by September 30, 1986. As shown in table III.1, 167, or about half, of the leases had been readjusted while the remaining 162 leases were in various stages of processing.

Table III.1: Status of Pre-1976 Federal Coal Leases as of September 30, 1986

Lease status	Number of leases	Percentage
Readjusted	167	50.76
In appeal	98	29.79
IBLA	78	23.71
COURT	20	6.08
Waived[a]	30	9.12
Relinquished[b]	33	10.03
Other[c]	1	.30
Total	**329**	**100.00**

[a]Waived—Interior surrenders its right to take any readjustment action on the lease anniversary date for failure to comply with its own regulations

[b]Relinquished—the lessee surrenders the entire lease, or any subdivision of the lease, to the federal government

[c]Lease not readjusted. The lessee was notified of BLM's intent to readjust the lease on its anniversary date, July 27, 1984. On July 25, 1984, the lessee filed a request with BLM's state office for relinquishment and the readjustment process was stopped. As of the date of our review, the relinquishment had not been approved.

Collection of Readjusted Lease Revenue Needs Improvement

In our 5 review states, MMS did not collect over $12.6 million in royalty and rental payments, plus late charges, on 53 federal coal leases that BLM had readjusted, as of September 30, 1986, because (1) MMS has not collected royalty and rent increases that accrued after IBLA ruled that they were proper, (2) MMS had not implemented a financial management system to identify nonpayments of rent, and (3) BLM did not provide MMS with adequate notification of the leases' readjustment status.

Because of uncertainty among BLM and MMS officials as to when in the readjustment process payment of accrued royalties and rents should be collected, MMS did not collect over $12.5 million in accrued royalty and rent after IBLA rendered its decision on 15 lease readjustments. Both MMS and most of the BLM state office officials, in our five review states, were unsure as to when lessees must pay accrued royalties and rent. For example, according to a former MMS Chief of Solid Minerals, the BLM Solicitor's office had informed him that a lessee can continue to pay at the old rate until the appeal process is exhausted. However, an MMS Solids Team Leader told us that once BLM forwards MMS a copy of its final decision letter—a final readjustment document that notifies the lessee of the readjustment effective date and the results of IBLA's decision—MMS is to issue a demand letter to the company and the company is responsible for making payment within 30 days. In addition to the uncertainty among the MMS officials, three of the four BLM state office officials visited in our review told us that the lessee could pay the lower royalty and rental rate and accrue the revenue difference during the court appeal.

IBLA's determination is the final agency decision, according to Interior's Assistant Solicitor for Onshore Minerals; therefore after IBLA makes its determination, all outstanding royalties and rent are to be collected regardless of whether the lessee appeals in court.[1] In addition, BLM's own regulations state that if the appeal upholds BLM's decision, the accrued royalties and rent, plus a late charge, shall be payable. Although BLM regulations require the collection of accrued revenue after the upholding of BLM's decision through appeal, these regulations do not specify whether the appeal refers to IBLA appeals or subsequent court appeals. However, Interior's Assistant Solicitor and a January 1987 IBLA order agreed that the term "appeal" refers to IBLA. GAO agrees with this interpretation of BLM's regulations. Although, BLM will presumably attempt to collect the accrued royalty and rent when final appeals are resolved in

[1]According to Interior's Assistant Solicitor, the only exception is if the lessee obtains a court order relieving him of payment.

its favor, the postponement of collection can jeopardize the possibility of recovery since the appeal process can continue for years.

In addition to the $12.5 million in accrued royalties and rent not collected because of misinterpretation of BLM's unclear regulations, MMS did not collect $114,574 in additional rental payments on 38 readjusted leases. MMS was not aware that on 29 leases the rent had either been underpaid or had not been paid for 1 to 6 years because its financial management system's rent monitoring function has not been implemented. As a result $91,355 was not collected. MMS' Auditing and Financial System is the primary system used to ensure accurate royalty reporting and payment. However, this system does not identify underpayment and nonpayment of rent and is not expected to gain this capability in the near future.[2] Until then, MMS will rely on the lessees to report and pay the correct royalties and rent.

Third, during our review we compared BLM lease information to the information MMS had on the lease and identified nine leases that BLM had readjusted but that MMS was unaware of because of incomplete readjustment information. Thus, the lessees continued to pay at the lower rate, and MMS did not collect $23,219 in rental payments. MMS and BLM's memorandum of understanding states that BLM is to supply MMS with the appropriate documents to support changes on lease readjustments. However, during our review the specific documents needed by MMS were not identified in BLM regulations, readjustment procedures, or the memorandum of understanding. Therefore, no consistent understanding existed between BLM state offices as to what documents were to be sent to MMS. In response to a 1987 Interior Inspector General report,[3] BLM headquarters officials identified six documents that they claim to routinely send to MMS. In addition, the one document that MMS officials said is required to initiate MMS' rate adjustment and revenue collection, the final decision letter, was not included in the list of documents BLM states that they routinely send. However, our review showed that none of the MMS files reviewed contained all seven of the documents needed to support changes in lease terms.

[2]Interior noted, in response to our report Mineral Revenues: Opportunities to Increase Onshore Oil and Gas Minimum Royalty Revenues (GAO/RCED-86-110, June 24, 1986) that MMS was conducting a pilot project that, among other things, would include identifying and researching individual cases that may show rent underpayment.

[3]U.S. Department of the Interior, Office of Inspector General Audit Report, Coal Lease Readjustments, Bureau of Land Management, Minerals Management Service and Office of Hearings and Appeals (Feb. 1987) C-LM-BLM-10-86.

The Government's Financial Interest Is Not Fully Protected When Readjustments Are Appealed

Background

BLM is responsible for setting, accepting, and terminating bonds for federal coal leases that ensure payment of all lease obligations by lessees. BLM district offices are usually responsible for reviewing the leases to recommend appropriate bond amounts to the state offices, which in turn notify the lessee of the bond amount and due date. BLM state offices are to oversee the bond process. BLM state and district offices also track accrual amounts (the difference between the readjusted and unreadjusted royalty and rental rates) for lessees appealing their readjustments to IBLA and/or the courts. State offices then document these amounts in quarterly reports that are submitted to BLM's Division of Solid Mineral Operations in Washington, D.C.

Beginning in December 1985, BLM required its state offices to increase bonds for leases under appeal to protect accruing revenues. According to BLM Instruction Memorandum 86-145, bonds for producing leases under appeal were to be calculated differently than for those leases not under appeal. Standard bond provisions for leases not under appeal include 3 months of estimated royalty at the readjusted rate and 1 year of rental rounded up to the next even $1,000; but in no case less than $5,000. If a lessee appealed a lease readjustment, the bond was increased to reflect not only the existing bond but also the amount equivalent to the difference between the unreadjusted and readjusted rates that accrued while the lease was in appeal.

The BLM instruction memorandum also required state offices to ensure that the new bonding procedures were implemented for all leases no later than March 3, 1986. BLM staff were instructed to review the bonds for all leases annually and those for producing leases under appeal semiannually.

Revenues Are Not Entirely Protected When Lease Readjustments Are Appealed

BLM has not fully protected the government's rights to revenues that accrue while readjusted coal leases are being appealed. As of September 30, 1986, in the 5 review states, bond amounts for 30 of the 94 leases being appealed to IBLA and the courts did not fully cover the accrued royalties and rent, because of noncompliance with BLM readjustment regulations and bond instructions. As a result $11.9 million of the $56.9 million in accrued revenue was not covered by bonds, as shown in table V.1, leaving it unprotected and potentially lost if the lessees go out of business. In addition, incomplete bonding instructions and limited oversight also contributed to the problem.

Table V.1: Total Unprotected Revenue for Leases Under Appeal as of September 30, 1986

State	Leases under appeal	Total accrual	Leases with inadequate bond amounts	Unprotected revenue
Colorado	19	$13,638,952	4	$274,622
New Mexico	2	[a]	[a]	[a]
Oklahoma	5	348,400	2	333,400
Utah	53	29,266,351	16	3,267,284
Wyoming	15	13,599,876	8	8,072,576
Total	**94**	**$56,853,579**	**30**	**$11,947,882**

[a]These leases had no accrual because the lessees had been paying the readjusted rates while the leases were under appeal.

In addition, IBLA ruled on January 28, 1987, that because BLM's regulations do not provide for an increased bond to cover accrued revenue, BLM can no longer increase the bond amount to cover leases under appeal with IBLA. Thus, BLM can no longer protect revenue that accrues during the appeal process if the lessees default, but BLM is currently drafting amended regulations to cover this void.

BLM Did Not Require Adequate Bond Amounts for Some Leases Under Appeal

As of September 30, 1986, BLM had not required adequate bond amounts for 30 of the 94 federal coal leases under appeal, resulting in $11.9 million in unprotected accrued revenue. In the 5 review states, 94 leases were in appeal with IBLA or the courts, which resulted in a total accrued revenue of almost $57 million. Although 93 of the 94 leases under appeal had bonds, nearly one third had bond amounts that did not fully cover the accrued rental and royalty revenue.

Noncompliance with BLM procedures and regulations was the major reason for bond amounts being insufficient. For example, bonds on 10 of the 30 leases in Utah and Wyoming had not been adjusted to cover accruals by September 30, 1986, even though BLM's instructions stated that all leases should have been reviewed by March 3, 1986. Unprotected accruals amounted to $7.3 million on the 10 leases.[1] Although BLM made bond adjustments for accruals on 18 of the 30 leases, the adjustment increases were insufficient by $4.3 million. For one Utah lease, the bond calculation did not include the additional royalty and rental revenue that had accrued during 1986. As a result $716,062 of revenue was unprotected. According to a Utah BLM official, calculations on this and

[1]BLM subsequently increased 5 of the 10 lease bonds before accrual bonding was suspended in January 1987.

other leases were not done correctly because the district staff responsible for calculating bonds were unsure of how to calculate bonds for leases under appeal. They did not take into consideration the lease readjustment and did not understand the accrual process or that the accrued revenue should be included in the bond calculation.

Noncompliance with readjustment regulations by the BLM New Mexico state office caused insufficient bond amounts for two Oklahoma leases. The lessees appealed the readjustments for these leases to IBLA, which agreed with BLM's decision to readjust. The lessees next appealed the readjustments to a U.S. district court and the court of appeals. According to BLM officials in the New Mexico state office and the Tulsa district office, the state office decided not to increase the bond amounts, contrary to BLM bonding procedures, because the leases were under appeal in court and currently not producing. As a result $333,400 of accrued royalty and rent was unprotected.

Incomplete Bond Procedures

BLM Instruction Memorandum 86-145 did not contain any guidance on how to calculate bonds for nonproducing leases under appeal. This lack of guidance, for example, contributed to $2,272 of unprotected revenue from one nonproducing Utah lease. The lease had accrued $7,272 in unpaid rent while under appeal for 4 years. However, the bond amount was $5,000, the minimum required for nonproducing leases not under appeal.

In addition, procedures for producing leases under appeal did not specify that accrued rent had to be included in the calculation of bond amounts. For a producing Colorado lease under appeal for 2 years, the bond calculation included accrued royalty for both years but included rent at the readjusted rate for 1 year. Because the total accrued rent was not included in the calculation, $1,244 in revenue was unprotected.

Lack of Oversight

Although BLM district offices were primarily responsible for reviewing and calculating accrual bonds, its state offices were responsible for overseeing this process. However, according to BLM officials, virtually no oversight of the bond process existed, and state offices relied on whatever information the districts gave them. For example, according to BLM state officials in Utah and New Mexico, their state offices provided virtually no oversight over the accrual bond process. After a district mining engineer calculated a bond, no one verified the bond amount's

accuracy. Therefore, when the BLM state offices received bond recommendations from their district offices, they relied on whatever information the districts gave them and were not necessarily aware that bonds did not cover accruals. In addition, a Wyoming state official who had oversight responsibility of the district bond process had to refer us to the district office for an explanation of how to calculate the bonds.

The calculations for the bond amounts were also not always documented in the lease files, making oversight even more difficult. Only one of four BLM state offices we visited was able to provide documentation on bond calculations for leases under appeal. According to a BLM state official in Utah, the bonds were often calculated on a piece of paper that was then thrown away after the bond recommendation was made to the state office.

IBLA Ruling

Although BLM Instruction Memorandum 86-145 required BLM state offices to increase bonds for leases under appeal to protect accruing revenues, BLM regulations (43 CFR 3451.2(e)) do not provide for this protection. They refer instead to a suspension and accrual of readjusted royalties and rent, pending the appeal's outcome, payable with interest if the decision is upheld.

On June 30, 1986, a lessee appealed to IBLA, taking issue with BLM's increasing bond amounts to cover revenues that were accruing while the lease readjustment itself was under appeal to IBLA. IBLA ruled on January 28, 1987, that because the increased royalty had been suspended, the requirement for an increased bond, which was based on the increased royalty, should also be suspended. In the absence of a regulatory provision requiring payment of increased royalty or submission of a bond guaranteeing payment while a lease was under appeal, IBLA did not believe that an increased bond based on that royalty rate was proper while the lease was under appeal to IBLA.

As a result, BLM could no longer increase bonds to cover the accrual for leases under appeal. Thus in our 5 review states, as of September 30, 1986, $11.9 million of the total accrued revenue for the 94 leases under appeal was not protected. Although $44.9 million was protected by bonds, the accrued revenue continues to increase and with it the amount of unprotected revenue.

BLM Plans to Develop New Regulations

In response to IBLA's ruling, BLM has issued a change to the bonding procedures that directs its state offices not to increase bonds to cover accruals for leases under appeal. However, for those leases currently under appeal, BLM will not reduce the already increased bond amounts unless requested to do so by the lessee. According to BLM headquarters officials, BLM is also drafting regulations that would require the lessee to pay the higher readjusted royalty and rent rates on the lease anniversary date, even if the lessee appeals. Thus there would no longer be a need to increase the bond amounts to cover accruals for leases under appeal. As of August 1987, the draft regulations were being held, pending a briefing of the Secretary of the Interior.

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