GAO

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

September 1987

MINERAL RESOURCES

Interior's Actions on Three Coal Leases

GAO/RCED-87-193

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-228945

September 30, 1987

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

Dear Mr. Chairman:

This report responds to your request that we review the circumstances surrounding an October 23, 1986, memorandum by the Department of the Interior's Bureau of Land Management (BLM). The memorandum discussed an informal proposal to suspend portions of three coal leases in western Colorado owned by West Elk Coal Company, a subsidiary of the Atlantic Richfield Company. The proposal was designed to improve the likelihood that Atlantic Richfield would comply with a provision of the 1976 amendments to the Mineral Leasing Act of 1920 (MLA). The provision prohibits a company and its affiliates from obtaining additional onshore federal mineral leases covered by the act, including oil and gas, if the company is not producing commercial quantities of coal from a federal lease within a certain time frame. According to an Interior legal opinion, leaseholders do not lose their right to obtain other onshore federal mineral leases during suspension periods.

BLM and West Elk were in disagreement over the amount of recoverable coal reserves in the three leases that should be counted to establish the leases' commercial coal production requirements. Atlantic Richfield and West Elk had appealed BLM's determination of the amount of West Elk's recoverable coal reserves seeking to reduce it to a level that would ensure compliance with the 1976 amendments. BLM's October 23, 1986, memorandum contained an alternative designed to improve the likelihood of compliance with the 1976 amendments, thereby making the appeal unnecessary.

In summary, we found that although BLM was prepared to act on the proposal discussed in the memorandum had the companies asked BLM to do so, the companies have not asked and BLM has taken no action on the proposal. However, Atlantic Richfield and West Elk are pursuing their appeal of BLM's determination of recoverable reserves.

The following sections of this report summarize our findings. Appendix I includes a detailed chronology of events associated with the October 23, 1986, memorandum.

Coal Lease Production Requirements

Concerned over the large number of nonproducing federal coal leases, the Congress in 1976 amended MLA, in part, to discourage speculation and to encourage diligent development and continued operation of coal leases. The antispeculation provision [section 2(a)(2)(A)], effective December 31, 1986, prohibits issuance of any new coal or other onshore federal mineral lease covered by the act, including oil and gas, to a company or its affiliates that holds, and has held for 10 years since passage of the 1976 amendments, a federal coal lease that is not producing in commercial quantities (later defined by BLM as 1 percent of recoverable coal reserves). The legislation did not specify a time frame for complying with the commercial quantities production requirement in section 2(a)(2)(A). However, BLM issued guidelines in August 1985 establishing an appropriate time frame for each federal lease of no more than 10 years beginning with the date coal is first produced on the lease on or after the 1976 amendments were passed.

As the December 31, 1986, effective date of the section 2(a)(2)(A) provision neared, BLM issued a final rulemaking on December 5, 1986, officially establishing the time frame for producing in commercial quantities—a fixed 10-year period from the date coal is first produced on or after passage of the 1976 amendments for leases not yet subject to the act's diligence provisions (see below). The 10-year commercial production period identified in the BLM rule is independent of the 10-year section 2(a)(2)(A) holding period contained in the 1976 amendments.

Section 7 of MLA, also revised as part of the 1976 amendments, seeks to assure the diligent development and continued operation of coal leases. For leases issued prior to the 1976 MLA amendments, the diligent development provision requires a company to produce coal in commercial quantities within 10 years of its lease being readjusted.[1] A coal lease is terminated if diligent development is not achieved. The continued operation provision of section 7 specifies that, once commercial quantities are achieved, the company must annually either produce in commercial

[1]Readjustment refers to changes in the terms and conditions of a company's lease. All leases issued prior to August 4, 1976, are subject to readjustment at the end of their current 20-year lease period, and at the end of each 10-year period thereafter. The three West Elk leases were issued prior to August 4, 1976. Two of West Elk's leases were readjusted on May 1, 1983, and June 1, 1985, respectively. The third lease was readjusted on September 1 1987.

quantities or pay advance royalties. The 10-year diligent development time period of section 7 is independent of the 10-year production time period of section 2(a)(2)(A).

Section 39 of MLA (the suspension authority cited in the BLM memorandum) authorizes the Secretary of the Interior, in the interest of conservation, to suspend the operation and production of a coal lease. When a lease is in suspension, compliance with section 2(a)(2)(A) requirements is suspended, but section 7 diligent development requirements continue to apply.

Problems Facing Atlantic Richfield/ West Elk in Complying With Coal Lease Production Requirements

The December 31, 1986, compliance deadline for section 2(a)(2)(A) and the compliance requirements for section 7 led BLM to initiate steps in January 1986 to verify recoverable reserves for all federal coal leaseholders. During the verification process, BLM and West Elk agreed on the amount of reserves that could be extracted from the three West Elk leases but disagreed on the amount of recoverable coal reserves that should be counted to determine compliance with provisions of the MLA. BLM said that coal resources on the upper and lower seams should be included as recoverable reserves but West Elk wanted to exclude resources from the lower seams and some resources from the upper seam.[2] These exclusions would decrease the recoverable reserves nearly 90 percent from BLM's recoverable reserve estimate and would likely assure West Elk's compliance with section 2(a)(2)(A) for all three leases and with section 7 diligent development requirements for the two leases already readjusted.

At various times between April and June 1986, West Elk and/or Atlantic Richfield presented documents to BLM and Interior's Assistant Secretary for Land and Minerals Management's office citing economic, permitting, legal and technical reasons for excluding the lower seam resources and some resources from the upper seam. However, on August 22, 1986, BLM's Montrose District Office notified Atlantic Richfield and West Elk that BLM's computation of West Elk's recoverable coal reserves was determined using BLM's regulatory definitions and standard industry operating criteria, and would include both lower and upper seams and the reserves would be used to determine compliance with sections 2(a)(2)(A) and 7 of MLA.

[2]West Elk's discussions did not always address excluding portions of the upper seam.

In its notification, BLM also said that West Elk was in compliance with section 2(a)(2)(A) and would remain in compliance as long as there continued to be any production from each of the three leases. Since the BLM district office's decision on section 2(a)(2)(A) compliance was made before BLM issued its December 5, 1986, final rules, Atlantic Richfield was concerned that the decision could be overturned resulting in Atlantic Richfield's loss of the right to obtain other onshore federal leases. The BLM letter did not address compliance with section 7. We were told by agency and company officials, however, that West Elk would probably be able to satisfy the section 7 diligent development requirement in the 10-year time frame but would probably have insufficient production to satisfy section 7's requirement for continued annual production in commercial quantities. On September 22, 1986, West Elk and Atlantic Richfield filed a notice of appeal to reduce the amount of recoverable reserves determined by BLM's district office.

BLM's Colorado State Director sent the October 23, 1986, memorandum to the Director, BLM, explaining that Atlantic Richfield and West Elk officials had proposed (1) segregating the three West Elk leases into separate leases by seam to create two to four new lower seam leases and (2) immediately suspending the lower seam leases.[3] The memorandum did not mention suspending any portion of the upper seam leases. The memorandum stated, however, that Atlantic Richfield and West Elk intended to submit an application to segregate and suspend the lower seam leases in the near future. The staff assistant to Interior's Assistant Secretary for Land and Minerals Management told us that BLM was prepared to approve the application. However, BLM officials and the attorneys for Atlantic Richfield told us that no such application was submitted and the proposal has been dropped.

Atlantic Richfield said that it did not submit the application because final rules for section 2(a)(2)(A) had been issued, thus assuring Atlantic Richfield that it was in compliance with section 2(a)(2)(A). Atlantic Richfield and West Elk are pursuing their appeal of the amount of recoverable reserves identified in BLM's August 22, 1986, letter. BLM has not changed its position on its determination of the amount of West Elk's recoverable reserves.

[3]The memorandum stated that the proposal came from Atlantic Richfield and West Elk. However, the proposal was not in writing. The attorneys representing the companies could not recall who originated the idea. The staff assistant to Interior's Assistant Secretary for Land and Minerals Management told us during our review that the idea for the proposal originated within his office.

We obtained our information from BLM officials in Washington, D.C.; the Colorado State Office in Lakewood, Colorado; and the Montrose District Office in Montrose, Colorado. We also interviewed the staff assistant to Interior's Assistant Secretary for Land and Minerals Management and officials at Interior's Regional Solicitor's Office for the Rocky Mountain Region in Lakewood, Colorado. We met with attorneys in Denver, Colorado, representing the Atlantic Richfield Company and the West Elk Coal Company. In addition, we reviewed documents prepared by BLM and the companies relating to the appeal of the BLM decision. Our audit work was conducted between February and June 1987.

We discussed the contents of this report with BLM officials and an Atlantic Richfield attorney, and they generally agreed with the facts presented. We incorporated their comments where appropriate. As requested by your office, we did not obtain official agency comments on a draft of this report.

Major contributors to this report are listed in appendix II.

Sincerely yours,

James Duffus III
Associate Director

Contents

Abbreviations

BLM	Bureau of Land Management
FCLAA	Federal Coal Leasing Amendments Act
MLA	Mineral Leasing Act
RCED	Resources, Community, and Economic Development Division

Chronology of Events Associated With October 23, 1986, BLM Memorandum

08/04/76	Federal Coal Leasing Amendments Act (FCLAA) of 1976 amended parts of Mineral Leasing Act of 1920 (MLA). Section 3 of FCLAA added section 2(a)(2)(A) of MLA and provided that, effective December 31, 1986, no onshore federal mineral lease, including oil and gas, may be issued under MLA to any entity or its affiliates that holds, and has held for 10 years since passage of FCLAA, a federal coal lease that is not producing in commercial quantities.[1] Section 6 of FCLAA amended section 7 of MLA. According to section 7, each coal lease shall be subject to the conditions of diligent development and continued operation. Diligent development is achieved when coal is produced in commercial quantities within 10 years of the lease being readjusted or otherwise made subject to MLA (e.g., issued after August 4, 1976, or modified through the addition of acreage or recoverable reserves).[2] If diligent development is not satisfied, the lease is terminated. Upon achieving diligent development, regardless of when achieved during the 10-year period, the lease becomes subject to the condition of continued operation, which requires a minimum annual production of commercial quantities. The Secretary of the Interior, upon determining that the public interest will be served, may suspend the condition of continued operation upon the payment of advance royalties. The 10-year time frame for achieving diligent development is independent of the 10-year holding period associated with section 2(a)(2)(A) compliance.
07/30/82	BLM defined commercial quantities to mean 1 percent of recoverable coal reserves.
02/12/85	Department of the Interior's Office of the Solicitor issued an opinion on section 2(a)(2)(A) stating that (1) the holder of a coal lease whose production is suspended for conservation reasons under section 39 of MLA does not lose the right to obtain other onshore federal leases during the suspension period, and (2) BLM can define the time frame for satisfying

[1]The effective date of section 2(a)(2)(A) was originally August 4, 1986, but was changed to December 31, 1986, by P.L. 99-190 (Dec. 19, 1985).

[2]Readjustment refers to changes in the terms and conditions of a company's lease. All leases issued prior to August 4, 1976, are subject to readjustment at the end of their current 20-year lease period, and at the end of each 10-year period thereafter.

	the "producing in commercial quantities" requirement of section 2(a)(2)(A).
08/29/85	BLM issued guidelines on section 2(a)(2)(A) to clarify the time frame for satisfying the producing in commercial quantities requirement. Consistent with the Solicitor's opinion, BLM's guidelines established a commercial production time frame for each leaseholder—a maximum of 10 years from the start of production on or after August 4, 1976. The guidelines stated that the 10-year period for holding a federal coal lease, as mentioned in section 2(a)(2)(A) legislation, is independent of the 10-year period over which production in commercial quantities is measured for section 2(a)(2)(A) compliance. These two 10-year periods are also independent of the 10-year section 7 diligent development period.
12/19/85	BLM issued guidelines for implementing section 7 of MLA.
01/14/86	Memorandum from Director, BLM, to BLM's State Directors noted BLM's effort to verify recoverable coal reserve data in light of compliance deadlines for sections 2(a)(2)(A) and 7 of MLA.
04/08/86	Letter from West Elk to BLM's Grand Junction District Office expressed the opinion that only the upper seam of the three leases was mineable and identified the amount of recoverable tons on the upper seam. On the same day, a letter from the president of West Elk to BLM's Montrose District Manager explained that only upper seam coal resources should be included in West Elk's recoverable reserve base since it was uneconomical to mine the lower seams.[3] The letter also stated that West Elk and its parent, the Atlantic Richfield Company, could not fully assess West Elk's position relative to sections 2(a)(2)(A) and 7 of MLA, and take action accordingly, until BLM determined the amount of recoverable reserves. (Although discussions had occurred between BLM and the company about the amount of recoverable reserves, BLM did not officially notify West Elk of the amount of its recoverable reserves until August 22, 1986.)

[3]Two BLM district offices in Colorado were involved in determining West Elk's recoverable coal reserves. BLM's Grand Junction District Office was initially responsible for calculating West Elk's reserves since BLM's Montrose District Office did not have a mining engineer. BLM's Montrose District Office later obtained a mining engineer.

04/21/86	Letter from the president of West Elk to BLM's Grand Junction Assistant District Manager explained that BLM should include only upper seam coal. The letter stated that (1) FCLAA was intended to eliminate speculation in federal coal leases and to encourage their development and (2) the Congress did not intend to penalize good faith operators, yet that is what would happen if uneconomic resources were included in West Elk's recoverable reserve base. The letter also mentioned that West Elk, in order to avoid the section 2(a)(2)(A) sanction and meet the section 7 diligence requirement, would be forced to return to BLM some of these seams or leases if all seams were included in recoverable reserves.
05/16/86	In preparation for a meeting on 5/22/86, Atlantic Richfield submitted a briefing document to Interior headquarters officials (Director, BLM; Assistant Secretary, Land and Minerals Management; and Deputy Assistant Secretary, Land and Minerals Management). The document presented the position that recoverable reserves should exclude coal that is uneconomical to mine and technically unrecoverable. Atlantic Richfield stated that the purpose of the 5/22/86 meeting was to agree on the amount of West Elk's recoverable coal reserves so that Atlantic Richfield and West Elk would not become subject to the sanction imposed by section 2(a)(2)(A).
05/22/86	Atlantic Richfield met with Interior headquarters officials, including the Assistant Secretary, Land and Minerals Management.
05/30/86	Director, BLM, issued an Instruction Memorandum to BLM's State Directors that clarified the original intent of the recoverable coal reserve verification process. The memorandum stressed that recoverability was to be based on the physical characteristics of the coal in the identified areas and ". . . should not be affected to an appreciable degree . . ." by a leaseholder's internal economics.
06/11/86	Atlantic Richfield submitted a briefing document to Interior headquarters officials (Director, BLM; Assistant Secretary, Land and Minerals Management; and Deputy Assistant Secretary, Land and Minerals Management) for a final determination of the amount of recoverable reserves and compliance with section 2(a)(2)(A). Atlantic Richfield's submission excluded reserves for the lower seams, and some reserves for the upper seam where the company did not have state permits to

	mine. (This was the first time Atlantic Richfield suggested in writing that a portion of the upper seam reserves be excluded.) Atlantic Richfield cited state permitting requirements and legal and technical considerations as reasons for the exclusions but pointed out that no reserve exclusions were being made on an economic basis.
06/26/86	BLM headquarters staff completed an internal evaluation of Atlantic Richfield's 6/11/86 submission. The evaluation stated "Based on an in-depth evaluation of [West Elk's] proposal, none of the arguments put forth therein may be construed to alter the existing determination. In the opinion of BLM, [West Elk] has failed to provide any technical or legal reasons why any of the existing recoverable coal reserves should be excluded."
06/30/86	Memorandum from BLM's Colorado State Director to Director, BLM, analyzed Atlantic Richfield's 6/11/86 submission and disagreed with the company's reasons for reducing the amount of recoverable reserves.
07/15/86	Memorandum from BLM's Montrose District Manager to BLM's Colorado State Director identified West Elk's recoverable reserves which included coal from the upper and lower seams.
07/22/86	Memorandum from BLM's Colorado State Director to Director, BLM, suggested the following clarification of BLM's recoverable coal reserves policy: "Where a producing operation exists on a lease with multiple underground coal seams which require sequential mining, and where the mining operation has been permitted by [Office of Surface Mining] and/or the State, and BLM has approved the Resource Recovery and Protection Plan, only those beds covered by the permitted/approved mine plan shall be counted as recoverable reserves for the purposes of Section 2(a)(2)(A) and Section 7 of the Mineral Leasing Act." The memorandum stated ". . . a clarification of our current guidelines might be desirable in the case of multiple-seam underground mining such as that involving the West Elk Coal Company." BLM's Colorado State Office received a verbal response from BLM headquarters rejecting the suggestion.

07/30/86	A BLM headquarters staff was assigned to prepare an options paper on the West Elk recoverable reserves situation.
08/11/86	The president of West Elk sent a letter to BLM's Colorado Deputy State Director and enclosed a draft letter for signature by the Assistant Secretary, Land and Minerals Management. The draft letter, which apparently was never finalized, specified that West Elk was in compliance with section 2(a)(2)(A).
08/22/86	BLM's Montrose District Office issued a letter to Atlantic Richfield and West Elk that identified the amount of recoverable reserves for West Elk (same number as in the 7/15/86 memorandum) and stated that West Elk was in compliance with section 2(a)(2)(A) and would remain in compliance as long as there was production from each of the three leases.
08/27/86	Letter, hand-delivered, from an Atlantic Richfield lawyer to BLM's Colorado Deputy State Director acknowledged receipt of the 8/22/86 letter from BLM's Montrose District Office and stated Atlantic Richfield's "... understanding that the BLM Colorado State office had recommended to BLM officials in Washington that for operating mines located within Colorado, recoverable coal reserves would be based only upon those reserves within a seam or seams included within the operating mine's permit area." Atlantic Richfield further pointed out that it understood that BLM headquarters reviewed and approved this position but, for some reason, this policy was not integrated into BLM's Montrose District Office's determination of recoverable coal reserves for the West Elk leases.
09/03/86	BLM completed an unsigned options paper examining potential solutions for West Elk's recoverable reserves situation. Three options were presented: (1) West Elk return to BLM one or both of the two lower seams on each lease, thus reducing the amount of recoverable reserves, (2) BLM modify existing recoverable coal reserves determination to mean only that portion of the lease covered by an approved permit, or (3) segregate leases by seam and process lease suspensions for the lower leases. The options paper stated that West Elk's current production levels would satisfy section 2(a)(2)(A) requirements, but West Elk would have

insufficient production to comply with the continued operation requirement of section 7.

The options paper also stated that West Elk was still attempting to reduce its recoverable coal reserves ". . . presumably due to a lack of faith in the Department's guidelines ability to withstand judicial review." The options paper stated that, in summary, West Elk appeared to be making every effort to satisfy the production requirements of MLA but was constrained by the state of the coal market. The paper also stated that failure to satisfy section 2(a)(2)(A) would result in Atlantic Richfield selling or closing the mine which would effect the local communities already affected by the soft coal market. The options paper continued "Therefore, it is in the best interest of all involved parties to find a reasonable solution to this problem."

09/22/86

Atlantic Richfield and West Elk filed a notice of appeal of BLM's Montrose District Office's 8/22/86 decision, but the statement of reasons for the appeal was not submitted until 2/26/87.

10/23/86

Memorandum from BLM's Colorado State Director to Director, BLM, stated that on 10/22/86, Atlantic Richfield/West Elk officials met with Interior officials to discuss the companies' appeal and to propose that their appeal be resolved by segregating each of the three existing leases into new leases by seam and immediately suspending the lower seam leases under section 39 of MLA.[4] The memorandum also stated that Atlantic Richfield and West Elk intended to submit an application for suspension of these lower seam leases in the near future. BLM headquarters did not provide a written response to the memorandum but the staff assistant to Interior's Assistant Secretary for Land and Minerals Management told us that BLM was prepared to approve the application if it was submitted. Atlantic Richfield/West Elk did not submit a suspension application.

10/31/86

Memorandum from BLM's Wyoming State Director (responding to a copy of the Colorado State Director's 10/23/86 memorandum) stated "It appears that the action being advocated is allowable. . . ." However, the Wyoming State Director raised questions such as (1) Is suspending for

[4]Although the memorandum indicated that the proposal came from Atlantic Richfield/West Elk, it was not in writing. The companies' lawyers could not recall who originated the idea. We were informed by the staff assistant to Interior's Assistant Secretary for Land and Minerals Management that the idea for the proposal originated within his office.

	the purpose of conservation of the resources a valid argument? (2) Is the proposal an attempt to sidestep the intent of section 2(a)(2)(A)? (3) Would BLM be obligated to take similar action for other leaseholders if asked?
11/07/86	Memorandum from Interior's Regional Solicitor, Rocky Mountain Region (also responding to the Colorado State Director's 10/23/86 memorandum) stated that the terms of section 39 of MLA do not authorize suspensions for economic reasons and the language of section 2(a)(2)(A) ". . . renders your proposed solution problematical."
11/15/86	The Washington Post published an article that was critical of the suspension idea.
11/19/86	The Director of BLM's Office of External Affairs responded to the author of The Washington Post article in a letter that stated that the section 39 suspension provisions may be appropriate to this individual situation. The letter pointed out that Atlantic Richfield was in a unique situation as a result of conflicts between federal laws mandating production levels and environmental permitting processes of federal and state agencies that prevent the company from meeting the statutory mandates.
12/05/86	BLM issued a final rulemaking on section 2(a)(2)(A) establishing a fixed time period of 10 years for coal leaseholders to achieve production in commercial quantities. The 10-year period starts with the date coal is first produced on or after August 4, 1976. In simple terms, the rulemaking said that a pre-FCLAA lease must be in production by December 31, 1986, and must be producing in commercial quantities within 10 years from the start of production to avoid disqualification from obtaining other federal leases.
02/26/87	Atlantic Richfield and West Elk submitted their statement of reasons for appeal to the Interior Board of Land Appeals (original notice of appeal was 9/22/86) and requested that the Board ". . . reverse that portion of the August 22, 1986, Bureau of Land Management decision purporting to establish recoverable coal reserves . . ." for the West Elk coal leases.

04/27/87	BLM submitted its response to Atlantic Richfield/West Elk's statement of reasons to the Interior Board of Land Appeals. The response, prepared by BLM's Montrose District Office, disagreed with the position submitted by Atlantic Richfield/West Elk and reiterated its belief that reserves should be as stated in the 8/22/86 letter.
06/01/87	Atlantic Richfield/West Elk filed a reply to the Interior Board of Land Appeals, disagreeing with BLM's position.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

James Duffus III, Associate Director, (202) 275-7756
Robert W. Wilson, Group Director
Rosellen McCarthy, Evaluator-in-Charge

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

Address Correction Requested

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100