EVALUATION

OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

Coal Management Program, U.S. Department of the Interior

Report No.: CR-EV-BLM-0001-2012

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OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

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Memorandum

To: Tommy P. Beaudreau
Acting Assistant Secretary, Land and Minerals Management

Rhea Suh
Assistant Secretary, Policy Management and Budget

From: Mary L. Kendall
Deputy Inspector General

Subject: Final Evaluation Report – Coal Management Program, U.S. Department of the Interior
Report No. CR-EV-BLM-0001-2012

This memorandum transmits the results of our evaluation of the U.S. Department of the Interior's (Department) coal program. The evaluation focused on the coal lease sale process, the coal lease inspection and enforcement program, and the venting of methane gas from coal mines.

We found weaknesses in the sale process that put the Government at risk of not receiving full value for coal leases. In addition, deficiencies in the inspection and enforcement program could prevent the program from ensuring that mine operators comply with laws, regulations, and lease terms. We did not find, however, any issues with the venting of methane gas.

Our report contains 13 recommendations to improve the coal management program. In response to the draft report, the Bureau of Land Management (BLM) concurred with 12 recommendations and partially concurred with 1. The details of the response, however, were sufficient for us to consider all 13 recommendations resolved. Because full implementation of the recommendations will not be accomplished until 2014, we will refer all recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all reports issued, actions taken to implement our recommendations, and recommendations that have not been implemented.

We appreciate the cooperation and assistance of the BLM staff during our review. If you have any questions about this report, please contact me at 202-208-5745.

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Results in Brief

The Bureau of Land Management (BLM) in the U.S. Department of the Interior (Department) oversees coal mining activities on Federal (public) and Indian lands. The Department collects more than $1 billion in bonus and royalty revenues from coal mining companies each year, a figure that has been steadily rising. In fiscal year 2012, bonuses and royalties exceeded $2.4 billion, the highest amount recorded in the last decade. The program also meets the coal industry's continuing demand for additional leases, and helps satisfy the Nation's energy needs.

Coal-burning power plants generate about half of the Nation's electrical power. About 40 percent of the Nation's coal comes from public lands. As a result, coal mining on public lands is a significant source of revenue to the U.S. Government, and significantly contributes to the Nation's power supply.

We focused on the program's goal of obtaining a fair return for coal on public lands, its mine inspection and enforcement activities, and venting of methane gas from mines. We found weaknesses in the current coal sale process that could put the Government at risk of not receiving the full, fair market value for the leases. For instance, we identified lost bonus revenues of $2 million in recent lease sales and $60 million in potentially undervalued lease modifications. In addition, flaws in the inspection and enforcement program could prevent BLM personnel from detecting noncompliance with laws, regulations, and lease terms. We did not find evidence that mines improperly vented methane gas.

We make 13 recommendations to enhance BLM's coal sales and inspections. Since even a 1-cent-per-ton undervaluation in the fair market value calculation for a sale can result in millions of dollars in lost revenues, correcting the identified weaknesses could produce significant returns to the Government.

Introduction

Objective

Our objective was to assess the U.S. Department of the Interior's (Department) effectiveness in managing its coal program. Our focus was to—

- determine if the Department's coal leasing process obtains a fair return for the public's coal;
- assess the effectiveness of the Department's coal lease inspection and enforcement program; and
- assess whether the Department is sufficiently addressing financial concerns about venting methane gas from coal mines.

Appendix 1 contains the details of the scope and methodology for this report.

Background

Coal management is a high-dollar program for the Department (see Figure 1). In fiscal year (FY) 2012, the Department collected $876 million in royalties (the amount paid by companies for producing the coal) and over $1.5 billion in bonuses (the amount paid by companies to obtain a lease) from six sales. The Bureau of Land Management's (BLM) budget for coal management is about $9.5 million. The program has 76 full-time employees.

Coal Revenues ($ in millions)

Revenue Type	FY2010	FY2011	FY2012
Royalties	$810.0	$ 848.6	$ 876.0
Bonus Bids		701.1	1,551.7
Total	$810.0	$1,549.7	$2,427.7

Figure 1. Coal revenues from FYs 2010 through 2012.

Coal is one of the Nation's primary sources of energy. The Nation uses coal to generate about half of its electrical power. More than 90 percent of coal mined in the Nation is for generating electricity. Other sources of electrical energy include natural gas, nuclear, wind, solar, geothermal, and hydroelectric plants.

Multiple bureaus within the Department have roles in the coal management program, including the Office of Natural Resources Revenue (ONRR), Office of Surface Mining Reclamation and Enforcement, U.S. Geological Survey, and Bureau of Indian Affairs. BLM, however, is responsible for most of the daily management and regulatory oversight of the public and Indian coal resources;

including exploration, lease administration, and production verification; and was the focus of this evaluation.

Coal from lands controlled by the Department comprises about 40 percent of the Nation's total coal production. The Department manages 314 leases—306 leases on public lands and 8 leases on Indian lands. Ten States produce public and Indian coal: Alabama, Arizona, Colorado, Kentucky, Montana, New Mexico, North Dakota, Oklahoma, Utah, and Wyoming. Three tribes lease their coal reserves: the Navajo Nation in Arizona, the Hopi Tribe in Arizona, and the Crow Tribe in Montana. The combined tribal production is about 5 percent of the Department's total.

In FY 2011, mining operations on public and Indian lands produced 473 million tons of coal, which was mostly shipped to power plants across the Nation (see Figure 2). The largest coal producing State is Wyoming. In FY 2011, Wyoming accounted for 83 percent of the Department's total coal production and 86 percent of its coal revenues.

Figure 2. Load-out facility in Utah where coal from several mines is gathered and shipped to end users such as power plants. Source: Office of Inspector General.

Seventy-one companies operate about 80 mines (surface and underground) on public and Indian lands, mostly in the Western United States. Four companies

(Alpha Natural Resources, Arch Coal Inc., Cloud Peak Energy Inc., and Peabody Energy) account for over 90 percent of the Department's sales volume.

In general, the process for a coal lease sale begins with a company applying for and receiving a license to explore an area for possible coal production. If the exploration has been successful, the company submits a "lease by application" request to BLM to initiate planning for the sale. The lease by application contains a variety of information such as the geographic coordinates and size of the proposed lease, expected production volumes, quality of the coal, and a mine plan detailing such information as the coal extraction methods, disposition and use of the coal, and the reclamation plan for restoring the land. BLM reviews the application and may recommend changes such as altering the acreage and adjusting the location of the lease. BLM also computes the fair market value (FMV) for the lease, which is kept secret, and publicly announces the sale. At various times in the process, BLM invites the public to comment.

Eventually, the applicable BLM State Office arranges and convenes the lease sale, using a competitive sealed bid procedure. BLM then awards the lease to the highest qualified company whose bid meets or exceeds the FMV. The awarded company must pay the first installment of the bonus, with the remainder paid over the next 4 years. During the life of a lease, BLM monitors and inspects the mine to ensure compliance with the lease's terms as well as the mine's plan.

A number of laws, rules, policies, and procedures govern leasing and managing coal on public lands, including the following:

- The Mineral Leasing Act (MLA) of 1920 (30 U.S.C. § 181, et seq.) and the Mineral Leasing Act for Acquired Lands of 1947 (30 U.S.C. § 351, et seq.) grant BLM the responsibility to lease mineral resources on public lands.
- The Federal Coal Leasing Amendments Act of 1976 (Pub. L. No. 94-377) amended the MLA to require a royalty rate of not less than 12.5 percent of the sale value of coal for surface mines, but allowed a lower rate for underground mines. The Department has set the royalty rate for underground mines at 8 percent. In addition, the MLA generally requires BLM's coal leases to be competitive lease sales and requires the Federal Government to receive the FMV for coal leases. The MLA does not define the FMV, but BLM follows a standard real estate definition.[1] Regulations for the coal leasing program are in the Code of Federal Regulations (43 C.F.R. §§ 3000, 3400-3480).
- The handbook titled "H-3070-1- Economic Evaluation of Coal Properties" contains BLM's policies for estimating FMV for coal lease sales.

[1] The "Uniform Appraisal Standards for Federal Land Acquisitions," published in 1992, defines FMV as "the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would be sold by a knowledgeable owner willing but not obligated to sell to a knowledgeable purchaser who desired but is not obligated to buy."

- The handbook titled “H-3486-1- Inspection and Enforcement” contains BLM’s inspection policies for ensuring that coal operators comply with lease terms and conditions, approved mine plans, and leasing regulations.
- The Energy Policy Act of 2005 (Pub. L. No. 109-58) increased the amount of land that can be added to an existing lease, through lease modification, from 160 acres to 960 acres.

Findings

We found several areas for BLM to improve the coal leasing process and strengthen the inspection and enforcement program. We did not find, however, financial-related issues with venting methane gas from mines. Underground mines must dispose of this hazardous gas for safety reasons.

Correcting the deficiencies identified in this report will be a challenge because the BLM Washington Office does not have direct lines of authority for the coal program. Specifically, although the Washington Office manages the coal program, it does not directly control the program in the many State and field offices that oversee coal leases. Without strong, centralized management, State and field office personnel may interpret official standards, processes, and procedures inconsistently.

Coal Leasing

BLM has a responsibility to obtain a fair return for coal on public lands. We found weaknesses in the current sale process that could put the Government at risk of not receiving the full value for the leases. For instance, we identified lost bonuses of $2 million from recent lease sales and $60 million in potentially undervalued lease modifications (see Appendix 2).

Valuation

A critical aspect of a competitive coal lease sale is determining the value of the property. BLM estimates FMV prior to each sale and by statute cannot accept a bid that is less than this amount. The FMV determination is based on the Government's assessment of projected income to the coal mining company and an analysis of comparable, prior lease sales as well as economic, geologic, and engineering variables unique to each proposed mining operation. These variables include the price of coal; current and future demand for coal; market conditions; shipping costs; proximity of the mine to available transportation and the end market; quality of the coal, which includes energy content and impurities such as ash and sulfur; depth of coal seams; equipment and labor required to operate the mine; and whether the coal will be extracted by surface or underground mining methods.

FMV Determination

BLM does not use the Department's Office of Valuation Services (OVS) to prepare the FMV appraisals. Instead, BLM has continued to prepare the appraisals using its own appraisers, which does not comply with Secretarial Order No. 3300, issued in May 2010. The order intended to foster independence by taking responsibility for the valuation process from the bureaus and placing it with OVS. The order was converted in June 2011 into Part 112, Chapter 33 in the Departmental Manual. The Departmental Manual notes: "The mission of the Office of Valuation Services is to provide independent real property valuation

services." As the following discussion in this report shows, we believe BLM's coal lease sales would be greatly enhanced if OVS assumed the appraisal function.

Mineral valuation expertise is essential for setting the FMV. In that regard, OVS is responsible for serving as the Department's authority on valuation for all minerals extracted from public lands. Mineral valuation is a complex and unique field of appraisal, requiring special training to be properly qualified. In contrast, real estate appraisers primarily deal with a land's surface. For the Department's coal regions, which contain vast quantities of coal worth hundreds of millions of dollars, an accurate valuation of the mineral is essential for ensuring the Government receives the proper amount for each lease.

To illustrate the significance of computing an accurate FMV, the average sale price was $320 million in seven coal lease sales conducted in Wyoming's Powder River Basin since 2011. Given the magnitude of these sales, even a 1-cent-per-ton undervaluation in the FMV calculation could result in a $3 million revenue loss.

Comparable sales are a key component of determining the FMV. In two recent sales in one State, however, BLM developed its comparable sales analyses using a lower bid amount instead of the higher, actual sale price. Although these sales may not have resulted in lost revenue, the risk of accepting a lower bid is increased with an inappropriately low FMV.

Although OVS must determine the FMV according to the Departmental Manual, BLM would retain a major role in coal lease sales. Specifically, BLM would continue to develop the critical data components, such as the geologic, engineering, and aspects of the economic analyses, leading up to a sale. Further, BLM would still conduct the lease sales.

Exports

BLM does not fully account for export potential in developing the FMVs. The export of public coal has been growing in recent years (see Figure 3 next page), especially to Asian markets. The U.S. Energy Information Administration reported 125 million tons of coal exports for calendar year 2012, over twice the export levels of 2007. Likewise, the price of exported coal has more than doubled from 2007 through 2011. Coal companies are reported to be exploring the expansion of ports in the Northwest United States to enable coal to be shipped overseas. Accordingly, BLM should reflect the export potential in its FMV calculations to ensure the Government receives proper value for lease sales. Based upon our analysis of appraisals, however, it appears that several state offices overlook the export potential, thus possibly undervaluing the public's coal. In contrast, the Utah State Office used a contractor to help develop the FMV for a sale and did consider the export value.

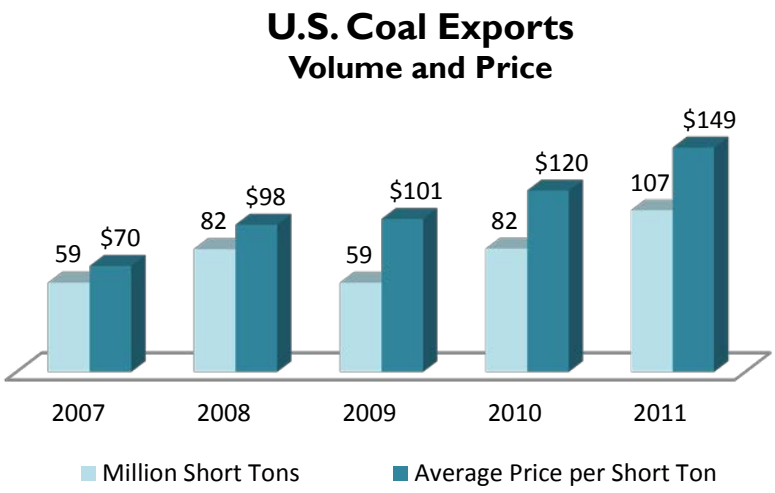

Figure 3. Coal export volumes and prices from calendar years 2007 through 2011. †Short ton equals 2,000 pounds. Source: U.S. Energy Information Administration.

Competition

The FMV determination is critical in coal leasing because a competitive market generally does not exist for coal leases, therefore, the FMV serves as a substitute for competition. For example, we found that over 80 percent of the sales for coal leases in the Powder River Basin received only one bid in the past 20 years. No coal lease has had more than two bidders on a sale. Further, with mergers and consolidations during this period, the number of operating mines and companies has been declining even though coal production has increased (see Figure 4 next page). This lack of competition also applies to the coal producing regions in other States. Since FY 2002, BLM has held 47 successful coal lease sales nationwide, averaging about 4 per year, with as many as 9 and as little as 1 in a single year. The Powder River Basin has been the most active region for leasing, with 18 sales during this period.

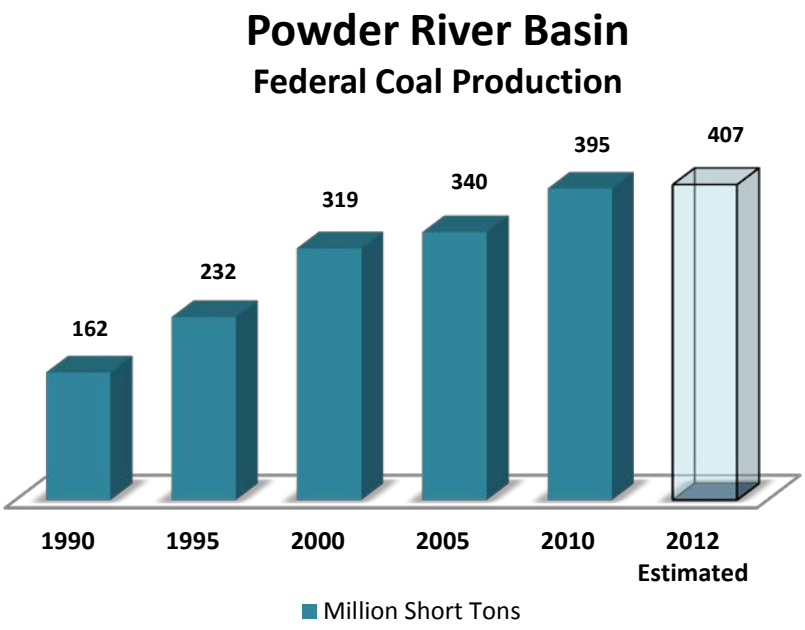

Figure 4. The volume of coal mined from Wyoming's Powder River Basin since 1990 has grown about 150 percent, while the number of mining companies has declined from 12 to 7. Source: BLM.

In our "Notice of Potential Findings and Recommendations" (NPFR) issued during our review, we recommended BLM have its methodology for coal lease valuation and the FMV determination peer reviewed independently, such as by the Office of Minerals Evaluation, a division under OVS that handles minerals evaluation matters. BLM responded that it would ask the Office of Minerals Evaluation to review, for possible revision, the Bureau's handbook, "H-3070-1-Economic Evaluation of Coal Properties," which contains its existing policies and procedures for coal property valuation.

Also, in response to our NPFR's recommendation to "achieve consistency in administering coal sales by assigning this function to one State Office or to a central group of specialists," BLM wrote that it will train new or existing coal specialists by establishing "mentoring or peer groups." BLM also said it would use external consultants when appropriate.

Recommendations

1. BLM should work with OVS when establishing FMV policies and methods, and when identifying FMV for coal leases.

2. BLM and OVS should take action to fully account for export potential in developing coal FMVs.

3. BLM should ensure a consistent and efficient coal lease sale process by designing a system that prevents individual BLM State Office discretion.

Bid Acceptance

To protect the public's interest in obtaining a fair return for coal sales, BLM computes the FMV and is required by the MLA to reject bids that fail to meet or exceed the calculated FMV. The process for accepting the winning bid at a lease sale is not consistent among BLM state offices. For example, two state offices normally reject a bid that does not meet or exceed the FMV. In such cases, BLM holds a new sale or "reoffer." At least three other state offices, however, have allowed companies to provide information to justify their original bid, and approved the sale if BLM considered the information satisfactory. In four sales in two of these States, BLM did not comply with the MLA because they accepted bids that were below the established FMV, resulting in over $2 million in lost revenues from the bonuses (see Appendix 2).

We believe that any sale below the FMV should be rejected. Mining companies could exploit this inconsistency between state offices by adjusting their bidding strategy for state offices they perceive as lenient in enforcing the FMV.

When a bid is rejected, however, lease reoffers are inefficient because the sales process starts over. Many administrative actions, such as reassessing the FMV and publishing Federal Register notices, must then be repeated. Since a company does not know the FMV, the sales process may repeat multiple times over many months as the company adjusts its bid until BLM finally accepts it. Until then, the company does not obtain the lease and the Federal Government does not receive any bonus income.

To address these inefficiencies, an alternative method involving direct negotiations immediately following an unsuccessful sale between BLM and the bidder could provide a quicker resolution. This would likely require legislative change to the MLA and revision of applicable regulations. This may be worth the effort, however, as about 25 percent of lease sales in the Powder River Basin go through the inefficient and time-consuming reoffer process.

Recommendations

4. BLM should reject bids less than the established FMV in compliance with the MLA.

5. BLM should explore options for a more efficient lease reoffer process, such as initiating direct negotiations with the coal company, or otherwise revising current procedures to execute a timely sale.

Internal Controls

BLM considers the FMV determinations and related files as highly confidential. Acquiring this sensitive information could give a company an unfair competitive advantage. Unintended disclosure would have significant ramifications considering that a single coal lease can sell for hundreds of millions of dollars. We found insufficient internal controls over securing the FMV data.

FMV Data Security

Some state offices do not adequately safeguard the FMV records. We found an instance where one employee locked an appraisal in a standard file cabinet in a cubicle that other employees could access. In another instance, an electronic copy of the appraisal was stored on an unencrypted compact disk at an employee's home.

Procedures for securing the FMV data are not consistent throughout BLM's offices, and there is no standard information security protocol. We notified BLM of these information security issues in our NPFR. In its response, BLM said it had taken corrective steps to secure the FMV documentation.

Review and Approval of FMV Determinations

At one State Office, various personnel contribute to the specialized geologic, engineering, and economic analyses that form the basis for the FMV, but only one person computes the actual value. This process was established decades ago to eliminate potential leaks of information to mining companies, which could then adjust their bids. If information is now leaked, only a single individual is accountable.

Our concerns over this process include the possibility of undetected errors in the FMV methodology and calculations, a higher risk of fraud, and the inability to complete sales during periods of key-employee turnover. Others involved in making the FMV could verify the data and subsequent approval. In addition, mining companies may be aware of the BLM employees computing the FMV, and could attempt to influence those individuals. A basic principle of internal control includes separation of duties, which involves additional personnel to alleviate the risk of undetected errors or fraud. Having additional people involved

in the FMV appraisal process would also help ensure continuity when the lead appraiser is unavailable.

Third-Party Access to Proprietary Information

Where the Department does not have the people to work on a coal lease sale, using an external consultant—as was previously done by the BLM Utah State Office—could prove useful. We caution, however, that confidential data must be safeguarded. This would likely necessitate a nondisclosure agreement for the consulting company, and procedures that grant information access to the consultant only on a "need-to-know" basis. In response to a recommendation in our NPFR, BLM agreed to evaluate protocols to safeguard confidential and proprietary information when it uses private consultants in developing appraisals.

Recommendation

6. BLM should strengthen its internal controls and safeguards over the FMV records. This should include a thorough assessment of the data's information security protocol at all BLM state offices, the data's physical security, and security when allowing access to an outside party.

Exploration Integrity

Before a lease sale takes place, a mining company explores the site for the existence and extent of coal seams, including the energy content and quality of the coal. The mining company is required to furnish the information to BLM, which helps form the basis of BLM's FMV determination. BLM, however, does not independently verify the data, relying instead on test results supplied by the mining company. Further, an independent laboratory does not furnish exploration data directly to BLM. This constitutes a risk in that BLM might not receive accurate data. Although "H-3486-1- Inspection and Enforcement" handbook recommends that BLM staff witness exploration activities, at least one State Office does not conduct such field inspections.

Our evaluation did not uncover specific indicators of data misrepresentation, however, there are risks in current exploration-data management. Without verification, a company could provide incorrect data to BLM, resulting in BLM's undervaluing the FMV and unknowingly accepting a low bid. Further, a company could use unverified data to justify a request for a reduced royalty rate (see the "Royalty Rate Reduction" section below).

Recommendations

7. BLM should require that all State and field offices conduct and document inspections of exploration operations.

8. BLM should protect the integrity of exploration data by requiring coal companies to certify the accuracy of the data under penalty of the applicable false statement statute, and it should periodically verify data through an independent laboratory.

Modifications

A coal company may increase the size of an existing lease by up to 960 acres through a noncompetitive procedure, a lease modification. BLM uses a modification primarily for mining one or more coal seams deemed less desirable, typically due to the quality of the coal and its location. This is in contrast to the coal from the primary seam. Modifications serve BLM's goal of achieving "maximum economic recovery" of the natural resource by developing coal that would otherwise go unmined. BLM has approved 45 lease modifications since 2000.

We found, however, that BLM might not be obtaining a fair return for lease modifications. Some BLM state offices did not prepare a full FMV appraisal as required by 43 C.F.R. § 3432.2. Our sample of 11 modifications for 4 state offices disclosed inconsistencies in the supporting documentation, often making it difficult to assess whether the FMV determination was properly justified. Further, more than half of the FMVs were for $100 per acre (the lowest price allowed by regulation) without adequate supporting documentation for this minimal price. In addition, as previously stated in the "Valuation" report section, OVS is the Department's office that is authorized to perform appraisals.

We analyzed all 45 lease modifications since 2000 and found that BLM typically approved a substantially lower price—averaging more than 80 percent lower—than the price used in the regular lease sales during the same period. The cumulative price difference indicated a potential $60 million in lost revenues (see Appendix 2). While the reduced quality and accessibility of these coal seams could justify a lower price, the overall lack of documentation made it difficult to validate BLM's decisionmaking process.

Recommendation

9. BLM should work with OVS in preparing the FMV appraisals for lease modifications. This should include establishing recordkeeping standards.

Royalty Rate Reduction

If a mine becomes unprofitable because of adverse geologic conditions (for example, difficult access to the coal seam or a decrease in coal quality) or financial hardship, a company may formally request that BLM reduce the royalty rate. The company submits an application, and if BLM considers the request justified, the rate may be reduced to as low as 2 percent of sales value. Approval is granted on a temporary basis and may expire after a designated period, when a specified volume of coal has been mined, or when mining operations cease. Similar to lease modifications, the goal of royalty rate reduction is to promote maximum recovery of the natural resource.

A judgmental sample of six rate reduction requests for four state offices showed that BLM appropriately evaluated and managed royalty rate reductions. Occasionally, however, the mining company and the state offices criticized the review process for being too slow as final approval comes from the Bureau's Washington Office. In two cases, State Governors intervened in the review process, thus bypassing the BLM Washington Office. Although BLM's policy does allow for the State Governor's input, the policy reserves decision authority to BLM. We believe the process is better served when BLM maintains full control over the application review.

In addition, when a royalty rate reduction is based on financial hardship, BLM coal program officials, who are mostly trained in geology and mine engineering, generally do not have the expertise to evaluate a company's financial statements and other supporting documentation. In these cases, officials from ONRR, who have accounting expertise in financial record analysis, could provide assistance. To date, however, ONRR has not been requested to do so.

Recommendation

10. BLM should process applications for royalty rate reductions timely and request ONRR to assist when requests are based on financial hardship.

Coal Inspection and Enforcement Program

BLM has an active inspection and enforcement program in place. The program has 27 personnel who conduct more than 2,500 inspections annually. Mines are inspected to ensure that there is no wasted coal, that coal operations conform to mine plans, and that the actual coal production matches a mine's reported production. In addition, to verify royalty payments, inspectors ensure that the amount of coal shipped in a given month matches the volume of coal sold, as reported to ONRR. Active mines are inspected at least quarterly, while inactive mines are inspected annually for such reasons as unauthorized mining, physical hazards, and environmental degradation.

We found vulnerabilities, however, that could prevent the program from ensuring that mining companies comply with laws, regulations, and lease terms.

Inspections

We found that the inspection and enforcement program operates without the benefit of strong oversight from the BLM Washington Office, due in part to BLM's decentralized organizational structure. This leaves the individual State and field offices to administer inspections without consistent guidance. Moreover, BLM has not implemented an effective quality assurance process, such as regular peer or external reviews, to ensure uniformity and quality of work.

BLM developed the handbook "H-3486-1- Inspection and Enforcement" in the 1980s to guide the inspection process, but we found the following issues with the handbook:

- Since the handbook is still in draft, the inspection staff does not follow the policies and guidelines consistently.
- It contains outdated material such as references to old Code of Federal Regulations' citations and an obsolete database.
- It provides insufficient guidance for conducting and documenting inspections.
- Inspectors do not always follow the handbook. For example, one State Office did not prepare a report of its inspection results.
- The handbook allows for unannounced inspections, but in actual practice, these are rarely performed. Unannounced inspections would strengthen BLM's inspection process.

As a result, the quality of inspections is unknown. Our review of 21 inspection reports in 6 States showed that the narratives in these reports were inconsistent among BLM offices and inspectors. Some state offices did not have sufficient documentation, making it difficult to determine what they had inspected. In contrast, BLM's inspection program for oil and gas operations achieves uniformity via structured training, updated guidance, and checklists that provide evidence of work performed.

BLM's handbook states that all inspections should be recorded in a central database. We found, however, that BLM presently has no effective central database to track inspections or production verification reviews. BLM is piloting a new system, but funding constraints have prevented its full development.

In response to our NPFR recommending that BLM establish inspection and enforcement policies and procedures, BLM stated that in 2009 it began developing a new inspection and enforcement manual and handbook, and a handbook for production verification. It noted that many issues we address above should be corrected with the addition of these guides. The target dates for issuing the new guides are FY 2013 for the inspection and enforcement manual and FY

2014 for the production verification handbook. In addition, BLM said it began a pilot program in 2010 that will standardize inspection reports, but full implementation is contingent on funding availability.

Recommendation

11. BLM should update its policies and procedures to ensure consistent and effective inspections and enforcement. Documentation and reporting standards should be included.

Enforcement

Coal inspectors do not presently have effective enforcement tools. Unlike the wide variety of penalties available to oil and gas inspectors, which vary based on the severity of the infraction, Notices of Noncompliance used by coal inspectors do not have a financial penalty to deter noncompliance with Federal leases. Inspectors said they prefer to work informally with mining companies to resolve noncompliances. This may explain why only 6 instances of noncompliance have been reported in 8,118 inspections conducted from FYs 2009 through 2011. Although the informal approach may have merit, this approach essentially conceals a company's record of noncompliance. It also complicates BLM's assessment of its inspections' effectiveness. In contrast, for Indian leases we noted that a financial penalty up to $1,000 per day may be enforced as an incentive to deter noncompliance.

In response to our NPFR, BLM stated that current statutory authority limits its available enforcement options. BLM could, however, partner with ONRR if the infraction concerns unpaid royalties. ONRR has a greater enforcement ability that includes substantial monetary fines. BLM said that it will team with ONRR to achieve the desired compliance in such instances.

While we support this approach, a company's noncompliance may concern non-royalty-related violations. For example, a company may attempt to bypass lower-quality coal, use inefficient mining techniques, or mine coal outside the lease boundary. In these instances, ONRR would not be involved. Accordingly, BLM still needs its own set of enforcement tools.

Recommendation

12. BLM should evaluate its enforcement policies and, where necessary, augment its enforcement capability.

Inspector Rotation and Training

There is no formal rotation policy for inspectors. BLM has assigned some inspectors to the same mines for many years. One inspector said that he had

worked one mine since the 1980s. Another inspector said that rotations do not occur until a person retires, thereby forcing a redistribution of the workload. This could result in overfamiliarity with mine operators. It could also lead to complacency and the potential failure to detect noncompliance. In response to our NPFR, BLM stated it would consider evaluating the cost-effectiveness of instituting a rotation policy.

In addition, BLM has no policy for cross-training inspectors. A substitute inspector may not be as effective when standing in for the regular inspector. The substitute may be unfamiliar with a particular mine's operations, or may look for different things based upon personal experiences at other mines. Cross-training would also allow BLM to better plan for succession. More than one-half of BLM's solid minerals staff will be eligible for retirement by 2015.

BLM has an inspector certification initiative underway that covers all personnel who inspect solid mineral operations, which includes coal. As is done for inspectors in the oil and gas program, this should enhance inspectors' professionalism. We believe this initiative will substantially improve the quality and consistency of inspections.

Recommendation

13. BLM should enhance the effectiveness of its inspectors by developing and implementing a rotation policy, cross-training program, succession plan, and finalization of the inspector certification program.

Promising Practices

During our evaluation, we noted the following practices at BLM's offices that could be considered at other locations. We are not making recommendations, but are providing this information for BLM's consideration:

- The Price Field Office in Utah meets annually with each mining company within its jurisdiction. ONRR representatives have also recently attended these meetings. In the meetings, the company explains its mining strategy so the bureaus can better design their oversight and management plans. The parties also discuss the company's production and royalty payment history to resolve any concerns. The Government and industry benefit from this communication and coordination.
- The Utah State Office developed an in-house database known as the Solid Minerals Program Tracking System, which contains extensive details about each mine in Utah. ONRR will eventually have access to the database, enabling both BLM and ONRR to use the same data. Personnel involved in this pilot program stated that this database is more useful for lease management than the LR 2000 database used by the rest of BLM.

We believe the new system would also be useful for managers at the Washington Office as they oversee the coal management program.

Conclusion and Recommendations

Conclusion

The Department's coal management program generates billions of dollars in revenue from public and Indian leases and helps meet the Nation's continuing demand for energy generated from coal. As noted in this report, however, BLM faces significant challenges in the areas of coal leasing and mine inspection and enforcement. Most importantly, a stronger management emphasis from the Washington Office is needed to bring program consistency and guidance over the individual State and field offices. Fortunately, most of the identified issues can be resolved with little or no additional funding or personnel. By implementing our recommendations, BLM can enhance its coal management program significantly.

Throughout our review, we were impressed with the commitment and professionalism of the Department's employees who work in the coal program. BLM's people, in particular, carry out many complicated tasks, sometimes using innovative ideas. Ongoing activities such as the new mine tracking database and the inspector certification initiative bode well as the program heads into the future.

Recommendations Summary

1. BLM should work with OVS when establishing FMV policies and methods, and when identifying FMV for coal leases.

   BLM's Response: BLM concurred with the recommendation, stating that it will evaluate all existing coal program guidance and update them if necessary. BLM will also work with OVS to explore options for obtaining OVS' input into coal lease sales, and potential revision to existing BLM guidance.

   Office of Inspector General's (OIG) Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

2. BLM and OVS should take action to fully account for export potential in developing coal FMVs.

   BLM's Response: BLM concurred with the recommendation, stating that it will evaluate and consult with OVS whether existing valuation guidance should be updated to properly account for export potential.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant

Secretary for Policy, Management and Budget for tracking its implementation.

3. BLM should ensure a consistent and efficient coal lease sale process by designing a system that prevents individual BLM State Office discretion.

   BLM's Response: BLM concurred with the recommendation, stating that it will issue supplemental coal lease sale guidance reiterating requirements, and will provide additional Washington Office oversight through new internal control reviews.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

4. BLM should reject bids less than the established FMV in compliance with the MLA.

   BLM's Response: BLM concurred with the recommendation, stating that it will issue supplemental guidance reiterating existing requirements, and will integrate additional Washington Office review to include a minerals specialist as a member of the post-sale panel.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

5. BLM should explore options for a more efficient lease reoffer process, such as initiating direct negotiations with the coal company, or otherwise revising current procedures to execute a timely sale.

   BLM's Response: BLM partially concurred with the recommendation, stating that it will evaluate options for a more efficient lease reoffer process and evaluate available alternatives. BLM, however, disagreed that direct negotiations would be permitted under existing law and guidance.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The matter concerning direct negotiations was only intended as an example of a possible method for resolving lease reoffers. Therefore, BLM's nonacceptance of direct negotiations does not prevent us from considering the response as a concurrence. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

6. BLM should strengthen its internal controls and safeguards over the FMV records. This should include a thorough assessment of the data's information security protocol at all BLM state offices, the data's physical security, and security when allowing access to an outside party.

   BLM's Response: BLM concurred with the recommendation, stating that it will issue supplemental guidance reiterating existing internal controls and safeguards for FMV records. BLM will also conduct internal control reviews every 2 years.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

7. BLM should require that all State and field offices conduct and document inspections of exploration operations.

   BLM's Response: BLM concurred with the recommendation, stating that it will issue supplemental guidance emphasizing the need to oversee exploration activity. BLM will also stress the importance of exploration inspections in its inspection and enforcement handbook and mine inspector training.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

8. BLM should protect the integrity of exploration data by requiring coal companies to certify the accuracy of the data under penalty of the applicable false statement statute, and it should periodically verify data through an independent laboratory.

   BLM's Response: BLM concurred with the recommendation, stating that it will work with the Office of the Solicitor to develop an exploration authorization form and to determine allowable penalties when operators provide misleading exploration data. BLM will also consider having an independent laboratory certify exploration data. BLM suggested that such certification might be implemented through existing cost recovery regulations.

   OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

9. BLM should work with OVS in preparing the FMV appraisals for lease modifications. This should include establishing recordkeeping standards.

   BLM's Response: BLM concurred with the recommendation, stating that it will work with OVS to explore options for obtaining OVS' input into appraisals for select coal lease modifications. BLM will also evaluate its recordkeeping standards and guidance for modifications, and make changes as necessary.

   OIG's Reply: We consider this recommendation resolved, but not implemented, as long as BLM works with OVS for all lease modifications, not just "select" modifications. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

10. BLM should process applications for royalty rate reductions timely and request ONRR to assist when requests are based on financial hardship.

    BLM's Response: BLM concurred with the recommendation, stating that it is developing supplemental guidance for royalty rate reductions and that ONRR may be able to provide assistance for financial hardship cases.

    OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

11. BLM should update its policies and procedures to ensure consistent and effective inspections and enforcement. Documentation and reporting standards should be included.

    BLM's Response: BLM concurred with the recommendation, stating that it anticipates issuing a new manual in FY 2013 covering inspection, enforcement, and production verification; an inspection and enforcement handbook in FY 2013; and a new production verification handbook in FY 2014.

    OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

12. BLM should evaluate its enforcement policies and, where necessary, augment its enforcement capability.

BLM's Response: BLM concurred with the recommendation, stating that it will review its license and lease forms to ensure appropriate enforcement authorities are included, and issue supplemental guidance memoranda. Further, BLM will coordinate with the Office of the Solicitor to identify other potential enforcement authorities.

OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation.

13. BLM should enhance the effectiveness of its inspectors by developing and implementing a rotation policy, cross-training program, succession plan, and finalization of the inspector certification program.

    BLM's Response: BLM concurred with the recommendation, stating that it will evaluate policies and budget implications for the feasibility of rotating mine inspectors. Also, the inspector certification program was finalized in the second quarter of FY 2013, and this included cross-training of inspectors.

    OIG's Reply: We consider this recommendation resolved, but not implemented. The recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking its implementation. Concerning cross-training of inspectors, please see our additional comments in the next section.

OIG's Analysis of General and Technical Comments

BLM's response to the draft report contained comments and requests for clarification, which are addressed below.

The response provided additional general information about bureau responsibilities, coal leasing, lease modifications, OVS assistance, coal exports, royalty rate reductions, inspection, enforcement, and production verification. We did not include this information in the draft report for reasons of brevity, because it was not needed to describe the identified weakness, or because it was outside the scope of our evaluation. The report is not intended to explain all functions of the coal program, nor is it a compilation of coal program facts. Instead, the report discloses the results of our evaluation, which focused on a defined objective and scope. Nevertheless, we considered BLM's comments and revised the report where deemed helpful to the reader.

Bid Acceptance

BLM requested more detail on the $2 million in lost bonus revenues. We intentionally left this information out of the draft and final reports to avoid compromising BLM's FMV methodology. During the evaluation, we agreed to

protect the confidentiality of the valuation process. As a result, valuation data relating to specific sales have been excluded from the report. We have since provided this information to BLM.

Modifications

BLM stated that OIG used a flawed methodology to compute lost revenues, explaining that coal in the modification area would likely have less value than the coal seams in the original sale. We recognize that the lost revenue cannot be computed with precision, and that the issue of lease modification is complex. Modifications are granted noncompetitively, and are therefore not the optimal method to establish value. As we note in the report: "While the reduced quality and accessibility of these coal seams could justify a lower price, the overall lack of documentation made it difficult to validate BLM's decisionmaking process." Moreover, this condition prevents us from identifying a specific value on which to base a more precise estimate of potential revenue shortfalls. Therefore, we believe it reasonable to simply calculate the gap between the original bid prices and the prices associated with each approved modification. This illustrates the range that BLM exercised its discretionary pricing authority without adequately documenting its valuation decisions.

FMV Determination

BLM disagreed with the report's assertion that the Bureau did not comply with Secretarial Order No. 3300 and the applicable Departmental Manual's section. BLM stated that OVS may provide valuation services only upon request, but BLM acknowledged some uncertainty about this matter. We believe, however, that the Secretarial Order and Departmental Manual clearly transferred real estate valuation responsibilities from the bureaus to OVS. This position was reinforced during discussions with the Office of the Solicitor. We therefore maintain our position that BLM should work with OVS concerning FMV valuations.

Exports

BLM stated that the report may give a "misleading impression" about the significance of exported Federal coal, as no more than 1.6 percent of coal from Wyoming's Powder River Basin is exported. BLM added, however, that it will work with OVS to determine whether improvements in the FMV methodology are needed to account for the export potential. We believe that FMV determinations need to fully account for current and future export potential even if export volumes are relatively low at the present time. A coal mine is a long-term, commercial project, and operations may extend over decades. Exports from the Powder River Basin are expected to increase substantially in the coming years. Accordingly, all coal lease sales should fully recognize this factor in the valuation of the commodity.

Enforcement

BLM agreed to evaluate its enforcement policies and augment them if necessary. BLM also provided several examples of non-royalty-related violations where it

maintains that existing enforcement tools are sufficient. Most of the examples, however, show that BLM may only recover lost revenues after noncompliance has been discovered. In our opinion, assessing a penalty after the fact is inefficient. Deterrence is a better option. We believe that BLM needs additional enforcement tools backed by penalties that actually deter noncompliance.

Inspection Rotation and Training

BLM stated that its inspector certification program sufficiently provides cross-training of mine inspectors through a mentoring process. We believe this is a good start, but does not fully address the needs of the inspection program. A more complete cross-training program would have the inspectors stationed at a field, district, or State office to learn the unique operations of each mine. This would enable all inspectors to inspect any mine, ensuring continuity of operations.

Appendix 1: Scope and Methodology

Scope

Our evaluation covered the U.S. Department of the Interior's (Department) coal leasing activities on public and Indian lands, specifically relating to the lease sale process, mine inspection and enforcement program, and venting of methane gas from coal seams.

Methodology

We conducted this review from December 2011 through September 2012. We reviewed laws, regulations, policies, and procedures related to the coal management program; examined prior reviews; analyzed program data; interviewed many Department and bureau officials having coal program responsibilities; interviewed State Government officials and other organizations knowledgeable about the Department's coal program; evaluated program processes relating to coal exploration, leasing, and inspections; examined internal controls; obtained input from the coal industry; evaluated inspector training; reviewed coal leasing practices used by selected international governments; and observed conditions at a surface mine, an underground mine, coal gathering facilities, and a power plant.

We visited or contacted the—

- BLM Washington Office, Washington, DC;
- BLM State Offices in Arizona, Colorado, Montana, New Mexico, Utah, and Wyoming;
- BLM district and field offices in Craig, CO; Farmington, NM; Price, UT; and Casper, WY;
- Office of Natural Resources Revenue, Lakewood, CO;
- Office of Surface Mining Reclamation and Enforcement, Washington, DC;
- Bureau of Indian Affairs, Washington, DC;
- Office of Indian Energy and Economic Development, Lakewood, CO;
- Office of the Solicitor, Washington, DC;
- Office of Valuation Services and the Office of Minerals Evaluation, Lakewood, CO, and Washington, DC;
- U.S. Geological Survey, Washington, DC;
- Navajo Nation, Window Rock, AZ;
- State government offices of Wyoming, Cheyenne, WY;
- State and Tribal Royalty Audit Committee;
- National Mining Association, Washington, DC;
- Peabody Energy, St. Louis, MO;
- Colorado School of Mines, Golden, CO;
- University of Colorado – Boulder; Boulder, CO;

- Black Thunder Mine, WY; and the
- coal mining region near Price, UT.

We conducted our evaluation in accordance with the Quality Standards for Inspection and Evaluation as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

Appendix 2: Schedule of Monetary Impact

Issue	Monetary Impact
Potential lost revenue from lease modifications	$60,000,000
Lost bonus revenues from accepting lease bids lower than full market value	$2,042,675

Appendix 3: The Bureau of Land Management Response to the Draft Report

The Bureau of Land Management's response to our draft report follows on page 30.

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240
http://www.blm.gov

In Reply Refer To:
1245 (320/830)

MAY - 6 2013

Memorandum

To: Assistant Inspector General for Audits, Inspections, and Evaluations

Through: Tommy P. Beaudreau
Acting Assistant Secretary, Land and Minerals Management

From: for Neil Kornze
Principal Deputy Director, Bureau of Land Management

Subject: Office of the Inspector General Evaluation Draft Report, Department of the Interior's Coal Management Program (Report No. CR-EV-BLM-001-2012)

Thank you for the opportunity to review and comment on the Office of Inspector General (OIG) draft report, "Department of the Interior's Coal Management Program" (Report No. CR-EV-BLM-001-2012). The Department of the Interior (DOI) appreciates the continued interest of the OIG in the administration of the Federal coal program.

There were 13 recommendations identified in the report. The Bureau of Land Management (BLM) concurs with 12 of the recommendations, and concurs in part with one of the recommendations. The BLM agrees with the majority of findings included in the report; however, a few points require additional context or clarification, which BLM has included in the attachments.

Attachment 1 provides general comments and requests clarification regarding those aspects of the BLM's coal management program discussed in the draft report. Attachment 2 provides specific responses to each of the recommendations, including a summary of the actions taken or planned by the BLM, Office of Natural Resources Revenue, and the Office of Valuation Services to implement the recommendations. Attachment 3 provides technical comments and recommended edits to the report.

If you have any questions about this response, please contact LaVanna Stevenson, BLM Audit Liaison Officer, at 202-912-7077, or Mitchell Leverette, BLM Chief, Division of Solid Minerals, at 202-912-7113.

Attachments

Department of the Interior
General Comments and Requests for Clarification

The draft report discusses Federal coal leasing, export market considerations in pricing coal for pre-sale evaluations, royalty rate reduction processing, and the inspection and enforcement of coal mining operations. The Bureau of Land Management (BLM) is one of several agencies that have responsibilities for Federal coal. The BLM is responsible for:

- The issuance of exploration licenses for unleased Federal coal;
- The issuance of licenses to mine for Federal coal;
- The issuance, readjustment, modification, termination, cancellation, and/or approval of transfers of Federal coal leases;
- Inspection and enforcement of Federal coal leases and licenses to verify production for royalty determination purposes; and
- General responsibilities for the development of coal resources on Indian lands as provided at 25 CFR 211.4, 212.4, and 225.4.

The Bureau of Indian Affairs has specific responsibilities associated with the issuance of permits, leases or contracts on Indian lands. The Office of Surface Mining Reclamation and Enforcement (OSM) has responsibility for preparation and submission to the Secretary a decision document recommending approval, disapproval or conditional approval of the mining plan on Federal and Indian leases and oversees the State regulatory program that issue coal mining permits. The OSM, or the applicable State regulatory authority, also monitors coal mining operations for surface reclamation compliance and has direct regulatory authority for mining permits on Indian leases. The Office of Natural Resources Revenue (ONRR) is responsible for collecting the revenue from Federal and Indian leases, determining whether the value reported by the lessee is a fair representation of mineral value for determination of royalty obligations, and disbursing mineral revenues to the American Indian Tribes and allottees, states, Federal agencies, and the United States Treasury.

Over the past year, the BLM has been working to provide more effective guidance and oversight to help strengthen the coal program. The BLM recently developed new training programs for BLM coal specialists, and is in the final stages of updating several handbooks and manuals that will aid specialists in performing their duties. Additionally, the BLM has completed phase one of a pilot project to develop an inspection tracking system that would be used across all states to monitor and consistently document all coal inspections.

The report highlights some of the same concerns that the BLM has been working to address. The BLM's on-going efforts, combined with addressing the recommendations in the draft report, will help to improve the agency's management of the coal program. To help resolve several of the recommendations, the BLM will develop a taskforce that will include representatives from the Office of Valuation Services (OVS) and ONRR.

Attachment 1

While BLM agrees with the majority of findings and conclusions in the report, there are some cases where the BLM believes that additional information is necessary for clarification or context, or where the BLM requires additional information before it can respond appropriately to certain pieces of information within the draft report. The BLM's general comments are included below.

Leasing

BLM Handbook H-3070-1, Economic Evaluation of Coal Properties, provides the procedures for developing the presale estimate of minimum acceptable bids based on fair market value concepts, and post-lease-sale evaluation of the bids. The BLM plans to provide supplemental guidance and will make any necessary changes to the existing guidance. The supplemental guidance will also reiterate the importance of following the guidance.

To clarify a definitional point that occurs often in the draft report, the BLM does not directly calculate the fair market value (FMV) for a coal lease sale. Rather, the BLM estimates the minimum acceptable bid for the lease using the guidance provided in Handbook H-3070-1. If the highest qualified bid comes in higher than the estimated pre-sale minimum, that bid becomes, by definition, the FMV.

The Office of Inspector General (OIG) asserts a loss of $2 million in sales revenue as the result of acceptance of bids that were less than the BLM pre-sale estimate. The BLM would like to address this assertion. However, the report does not provide additional details regarding how the OIG calculated this figure.

Lease Modifications

The BLM has authority to issue a lease modification to avoid bypassing Federal coal for unleased lands contiguous to an existing lease. Under the Mineral Leasing Act (MLA), as amended by the Energy Policy Act of 2005, each lease modification must comply with three basic requirements:

- The modification serves the interests of the United States;
- There is no other competitive interest in the lands or deposits; and
- The additional lands or deposits within the lease modification cannot be developed as part of another potential or existing independent mining operation.

The report concludes that the BLM did not properly document the pre-sale estimate of FMV for lease modification bonuses and estimated that there was up to $60 million in lost revenue from potentially undervalued lease modifications. The BLM disagrees with this estimate. The OIG's estimate requires the coal in the modification area to have the same value as the coal in the original lease area; however, coal within a lease modification will likely have a lesser competitive value than coal in the original lease.

Attachment 1

As part of the lease by application (LBA) process, the BLM does not simply accept an applicant's proposed tract configuration to be issued as a lease. The BLM uses a wide variety of information, including geologic data that delineates the location, quality, and quantity of coal within a given area, to determine the most appropriate tract configuration that would encourage competition and help achieve maximum economic recovery of the resource. If the coal were indistinguishable from the coal in the original LBA, then under the BLM's policies, the tract boundaries would have included that coal in the lease sale.

Office of Valuation Services (OVS) Assistance

The BLM agrees with the OIG's recommendations to work with OVS to explore potential appraisal improvements. The BLM has had some preliminary discussion with OVS as to how they might be able to assist the BLM in the pre-sale estimate determination process. We have discussed the possibility of OVS having a role in reviewing select pre-sale estimates completed by the BLM. The BLM disagrees with the OIG's conclusion that BLM has not been in compliance with Secretarial Order (SO) 3300 or Part 112, Chapter 33 of the Departmental Manual (DM). Under the SO, OVS may provide real estate (including mineral estate) valuation services to the bureaus if it is requested by the bureau. Therefore, the OIG's interpretation of the SO and the DM is not accurate. The OVS, however, may be able to offer their skillsets at the request of the BLM recognizing the limited resources currently available to the agency.

It is not clear to the BLM that the SO or the DM transferred responsibility for coal pre-lease-sale FMV determinations to the OVS. The main role of OVS is to appraise real estate for purposes of property purchase, sale or exchange, not for purposes of issuing a lease to be used as part of a commercial endeavor. At its inception, the staff of OVS included real estate appraisers that had formerly worked for a number of Interior agencies. However, engineers, geologists and other staff who are necessary to perform pre-lease-sale tract evaluation were not transferred at that time.

Exports

The BLM agrees with the importance of considering the possibility of future coal exports in developing presale estimates. However, little Federal coal is currently exported. According to the Energy Information Administration, no more than 1.6 percent of Powder River Basin coal is exported. However, and the general discussion of exports in the text of the report, as well as Figure 3, may create the misleading impression that the opposite is the case. The BLM's Handbook 3070-1 provides some direction as far as considering the potential for exports when making the pre-sale FMV determination, if such information is available. However, the BLM, in coordination with OVS, will evaluate whether improvements can be made to the methods and procedures the BLM currently uses to establish the pre-sale FMV estimate so as to better account for coal export potential. The BLM intends to monitor changes in the export market in the future years that may result from changes in the North American market for natural gas.

Attachment 1

Royalty Rate Reduction (RRR)

The BLM acknowledges the RRR issues raised by the OIG. Based on an internal review of the RRR process, the BLM has begun developing guidance to help make the process for reviewing RRR applications more timely. However, there are a few misconceptions included in this draft report:

- The State Governor cannot approve an RRR. Additional information is needed from OIG on this subject.
- The report incorrectly states that the temporary RRR ends on a designated date or when a specified volume has been mined. The RRR ends when the conditions no longer exist upon which the RRR was approved, regardless of the time or the tonnage allowed for the RRR in the decision letter, or any exploration data submitted in the application request.

Inspections, Enforcement, and Production Verification

The OIG is correct in stating that the BLM is working diligently to improve its inspection, enforcement, and production verification capabilities. With the cooperation of the Utah State Office and Wyoming State Office, the BLM has initiated a pilot program to develop an automated system to standardize and monitor reporting of lease inspection, enforcement, and production verification actions. The first phase of the pilot, known as the Mineral Tracking System, has been completed. However, further development and deployment of this pilot has been delayed due to budget constraints.

The BLM Washington Office has also recently established a national mine inspector certification policy that establishes minimum education and experience levels and requires:

- Initial safety training consistent with Mine Safety and Health Administration (MSHA) requirements for new miners;
- Successful completion of an online training course on inspections, production verification, and evaluating exploration and mining plans;
- Annual safety refresher training consistent with MSHA requirements; and
- Continued professional development training.

The BLM is finalizing new manual sections and handbooks for inspections, enforcement, and production verification to update to current policy and procedures.

Attachment 1

U.S. Department of the Interior
Response to the Recommendations included in the Office of the Inspector General Draft Report Evaluation of U.S. Department of Interior's Coal Management Program (Assignment No. CR-EV-BLM-001-2012)

Recommendation 1: BLM should work with OVS when establishing FMV policies and methods, and when identifying FMV for coal leases.

Response: The BLM concurs with this recommendation. The BLM will evaluate all of the existing coal program guidance and, if necessary, update guidance to bring it into conformance with current regulations and practices. The BLM will work with OVS to explore options for obtaining OVS input into coal lease sale analyses and potential revisions to existing BLM guidance.

Target Date: August 31, 2014.

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 2: BLM and OVS should take action to fully account for export potential in developing coal FMVs.

Response: The BLM concurs with this recommendation. The BLM will evaluate, in consultation with OVS, whether the methods and procedures provided in existing valuation guidance—such as the appropriate use of the comparable sales approach versus the income approach—properly account for export potential, and will implement any necessary changes.

Target Date: August 31, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 3: BLM should ensure a consistent and efficient coal lease sale process by designing a system that prevents individual BLM State office discretion.

Response: The BLM concurs with this recommendation. The BLM will issue supplemental coal lease sale guidance reiterating the sale process requirements and will provide additional Washington Office (WO) oversight through the initiation of new internal control reviews every 2 years.

Attachment 2

Target Date: December 31, 2014, for completion of the first control review

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 4: BLM should reject bids less than the established FMV in compliance with MLA.

Response: The BLM concurs with this recommendation. The BLM will issue supplemental guidance reiterating the existing coal lease sale guidance requirement as outlined in H-3070-1 Economic Evaluation of Coal Properties. The BLM will also integrate an additional WO review of FMV estimates and will ensure that in most cases a WO minerals specialist is a member of the post-sale panel.

Target Date: May 31, 2014,

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 5: BLM should explore options for a more efficient lease reoffer process, such as initiating direct negotiations with the coal company, or otherwise revising current procedures to execute a timely sale.

Response: The BLM partially concurs with this recommendation. The BLM will evaluate other options for a more efficient lease reoffer process and evaluate all alternatives that are within current statutory authorities. The BLM does not agree, however, that direct negotiations are appropriate. Such negotiations are inconsistent with existing law and guidance, and could potentially lead to inconsistencies between States.

Target Date: December 31, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 6: BLM should strengthen its internal controls and safeguards over the FMV records. This should include a thorough assessment of the data's information security protocol at all BLM State offices, the data's physical security, and security when allowing access to an outside party.

Response: The BLM concurs with this recommendation. The BLM will issue supplemental guidance that reiterates existing internal controls and safeguards required for pre-sale estimated

FMV records. Additionally, the BLM will complete internal control reviews on this issue every 2 years to monitor for compliance and will issue supplemental guidance if necessary.

Target Date: December 31, 2014, for completion of the first internal control review

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 7: BLM should require that all State and field offices conduct and document inspections of exploration operations.

Response: The BLM concurs with this recommendation. The BLM will issue supplemental inspection and enforcement guidance to emphasize the need to oversee exploration activity. Additionally, the BLM will edit the draft Inspection and Enforcement (I&E) handbook, and augment the new Mine Inspector training courses, to emphasize the importance of inspecting exploration operations.

Target Date: May 31, 2014. The recommendation will be closed when the supplemental guidance is issued, the handbook edits are finalized, and the training course is updated.

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 8: BLM should protect the integrity of exploration data by requiring coal companies to certify the accuracy of the data under penalty of the applicable false statement statute, and it should periodically verify data through an independent laboratory.

Response: The BLM concurs with this recommendation. The BLM will work with the Solicitor's Office to explore the potential development of an exploration authorization form, and determine the allowable penalties if operators provide misleading exploration data.

The BLM will also explore the potential for independently certifying exploration data at a laboratory selected by the BLM. The BLM will also consult with the Solicitor's Office to determine if such certification could be implemented through existing cost recovery regulation for the coal program.

Target Date: August 31, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Attachment 2

Recommendation 9: BLM should work with OVS in preparing the FMV appraisals for lease modifications. This should include establishing recordkeeping standards.

Response: The BLM concurs with this recommendation. The BLM will work with OVS to explore options for obtaining OVS input into appraisals for select coal lease modifications. The BLM will also evaluate existing recordkeeping standards and other program guidance for lease modifications, and make such changes as necessary in order to bring them into conformance with current regulations and practices.

Target Date: December 31, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 10: BLM should process applications for royalty rate reductions timely, and request ONRR to assist when requests are based on financial hardship.

Response: The BLM concurs with this recommendation. The BLM is developing supplemental guidance to clearly explain all necessary processing steps and requirements for royalty rate reduction applications. The guidance will reiterate the importance and necessity for field office staff to follow the current guidance when processing royalty rate reductions applications. The ONRR already assists the BLM in this process by reviewing the lessee history of payments in making a determination of good standing. ONRR may also be able to assist the BLM when reviewing hardship cases that fall under the RRR categories that are based on financials.

Target Date: December 31, 2013

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 11: BLM should update its policies and procedures to ensure consistent and effective inspections and enforcement. Documentation and reporting standards should be included.

Response: The BLM concurs with this recommendation. The BLM anticipates issuing a new manual for inspection, enforcement, and production verification, and an inspection and enforcement handbook, in fiscal year (FY) 2013. The BLM anticipates issuing a new production verification handbook in FY 2014.

Target Date: September 30, 2014

Attachment 2

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 12: BLM should evaluate its enforcement policies and, where necessary, augment its enforcement capability.

Response: The BLM concurs with this recommendation. The BLM will review its existing license and lease forms to ensure that the appropriate enforcement authorities are included and issue supplemental guidance memoranda regarding enforcement procedures. The BLM will coordinate with the Solicitor's Office to identify other potential enforcement authorities.

Target Date: November 30, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

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Recommendation 13: BLM should enhance the effectiveness of its inspectors by developing and implementing a rotation policy, cross-training program, succession plan, and finalization of the inspector certification program.

Response: The BLM concurs with this recommendation. The BLM will evaluate policies and budgetary implications for rotating certified mine inspectors when such rotation does not impose a significant fiscal burden. The inspector certification program already provides for cross-training of mine inspectors. The mine inspector certification courses were finalized and distributed during the second quarter of FY 2013.

Target Date: August 31, 2014

Responsible Official: Michael D. Nedd, Assistant Director, Minerals and Realty Management

Attachment 2

Technical Comments

Page 2, fourth paragraph: The second sentence in this paragraph says "BLM, however, is responsible for most of the daily management and regulatory oversight of the public and Indian coal resources, and was the focus of this evaluation." As previously mentioned in Attachment 1, within the DOI, OSM also has regulatory oversight responsibilities over coal mining operations. Consistent with the general discussion provided in Attachment 1, the BLM recommends that this paragraph clarify the bureau's responsibility over coal mining operations. The referenced sentence should be replaced with the following:

"BLM, however, is responsible for the exploration, leasing administration, and production verification of Federal coal resources. The BLM also has responsibilities over exploration and mining operations on Indian lands. Therefore, the bureau is the focus of this evaluation."

Page 4, second and third paragraph: Lease sales create a significant workload, including public coordination, meetings, hearings, environmental analyses, consultation, inter-agency cooperation, decisions and appeal resolution. These important steps in the leasing process were omitted in the description of processing a lease application.

Page 5, bullets: The bullet on H-3070-1 would be more accurate if described in the following manner:

- The handbook titled "H-3070-1- Economic Evaluation of Coal Properties" contains BLM's policies for determining the pre-sale FMV bonus estimate that establishes the minimum acceptable lease bid and lease sale bid evaluation process.

In addition, the following additional information should be referenced:

- The handbook titled "3420-1 – Competitive Coal Leasing" contains the BLM's policies for processing coal lease applications.
- The manual titled "3486-1- Inspection and Enforcement, Production Verification, and Appeals" contains BLM's inspection policies for ensuring that coal operators comply with approved lease terms conditions and BLM approved mine plans and leasing regulations.
- Code of Federal Regulations at 30 C.F.R. §§ 1201-1290 delineating ONRR responsibilities regarding coal production gross sales value determinations, collecting and distributing revenue, and other financial obligations.
- Code of Federal Regulations at 30 C.F.R. §§ 700-955 delineating OSM responsibilities regarding mining reclamation permits, plans and revisions on Federal and Indian lands.

Page 6, third paragraph, Page 10, first paragraph, and page 13, third paragraph: The referenced paragraphs identify lost bonuses of $2 million from recent lease sales and $60 million in potentially undervalued lease modifications. As previously mentioned in Attachment 1, the BLM would like to address the assertion about $2 million in lost bonuses. However, the report

does not provide additional details regarding how the OIG calculated this figure. The BLM recommends that the OIG include a discussion in the report (either in Appendix II or as a new paragraph after the first paragraph on page 10) as to how the $2 million dollars was determined or whether the BLM State Office processing the lease sale had followed current guidance outlined in H-3070-1.

As for the $60 million in potentially undervalued lease modifications, the BLM explained in Attachment 1 that lease modification areas are considered less desirable for mining from a geologic and economic perspective by both the applicant and the BLM at the time the original lease application was processed. Therefore, the value of the coal in the lease modification area is of lesser value than the coal in the area that was originally leased. We recommend that all mention of $60 million in undervalued lease modification sales be removed from the report.

Page 6, fifth paragraph and Page 7, second and fifth paragraph: As explained in under the sections titled Office of Valuation Services (OVS) Assistance and Fair Market Value in Attachment 1, the OIG has a different interpretation of Secretarial Order 3300 and 112 DM 33 as compared to the BLM. The OIG implies that OVS must determine the minimum acceptable commercial coal lease pre-sale FMV and that BLM is out of compliance with those directives (?) by not using OVS for coal valuations. The BLM believes the OIG has misinterpreted 112 DM 33 and the Secretarial Order. As explained in Attachment 1, OVS may provide real estate (including mineral estate) valuation services to the bureaus if it is requested by the bureau. The BLM does not view the referenced directives as requiring the bureau to use OVS. The BLM recommends that this difference of interpretation be recognized in the report.

Page 8, Figure 3: The export volumes and average price per ton provided in Figure 3 reflects total coal exports from the United States. The BLM recommends that the OIG point out that exports of coal from Federal lands are a small and unknown fraction of the total exports shown. According to the Energy Information Administration, no more than 1.6 percent of Powder River Basin coal is exported. See Attachment 1 for additional information.

Page 8, paragraph 1: The OIG should use the terms "estimated pre-sale FMV" when referring to the process the BLM uses in establishing an estimate of the minimum acceptable fair market value that will be considered.

Page 9, Figure 4 narrative: The chart only depicts coal production from the Wyoming Powder River Basin production and not the number of mining companies. The title under the chart should be consistent with what the chart illustrates.

Page 12, last paragraph: Royalty rate reductions cannot be approved and maintained based upon incorrect exploration data. The BLM inspects coal mines to verify the existence of adverse geologic conditions in order to confirm that royalty rate reductions are necessary. After the royalty rate reduction is approved, the lessee and the BLM must periodically inspect, evaluate, and verify that the adverse geologic condition that justified the reduction remains pertinent. The

Attachment 3

BLM recommends deleting the last sentence of the paragraph, which suggests a correlation between the use of exploration data used to help form the basis of the BLM's FMV determination and the approval and maintenance of royalty rate deductions.

Page 13, paragraph 1 and 2: The statement that, "BLM uses a modification primarily for mining one or more coal seams deemed less desirable, typically due to the quality of the coal and its location" is an over-simplification and does not fully explain the purpose or legal requirements for considering modifications. As discussed in Attachment 1, the BLM issues a lease modification to avoid bypass of Federal coal that is contiguous to the existing lease, (1) when it is in the interest of the U.S., (2) when there is no competitive interest, and (3) where the coal included in the lease modification cannot be mined as part of another independent operation. If the coal is bypassed, the public's interest would not be served because recovery of the resource and resulting revenue from production would not be realized. The bypassed tract becomes an isolated coal deposit that cannot be mined economically and in an environmentally sound manner if it remains separate from the existing lease. The BLM recommends that the OIG point out the bureau's responsibility for executing lease modifications in order to avoid bypassed Federal coal.

Page 16, paragraph 5: The paragraph states, "a company may attempt to bypass lower-quality coal, use inefficient mining techniques, or mine coal outside the lease boundary" as examples of potential non-compliance that might not be identified or enforced against by the BLM. While the BLM concurs with the recommendation regarding reviewing and potentially augmenting its enforcement policies, the BLM believes that OIG would benefit from understanding that there are existing tools that would allow the BLM to take action against non-royalty-related violations. We ask that you consider adding the following examples to the report:

- When a coal company attempts to bypass lower-quality coal that had previously been approved for mining as part of its BLM-approved resource recovery and protection plan, the BLM would discover the bypass during an inspection or the production verification process. The BLM, by lease stipulation, requires that the lessee mine the recoverable reserves approved in their resource recovery plan to obtain maximum economic recovery. The measure of damages in this case would be the royalty that would have been paid had the coal been mined.
- Similarly, using inefficient mining techniques would not be approved by the BLM in the resource recovery and protection plan for the lease or mine. Discovery of such methods would be a violation of the resource recovery and protection plan, and could also be a potential violation of safety or environmental regulations. BLM's inspector would advise other State or Federal regulatory entities of the potential violation so that appropriate enforcement actions could be pursued.
- The BLM requires a bond to secure payment of financial obligations. The BLM has been in consultation with the Solicitor's Office regarding the appropriateness of resolving criminal violations under Title 18 of the U.S. Code, or civil penalties as provided under the False Claims Act at 31 U.S.C. 3729(a)(1)(g).

Attachment 3

- If a company mines outside of a lease boundary, the BLM would determine the quantity and qualities of coal removed, and recommend the amount of trespass damages for the coal removal as provided in the trespass regulations found at 43 CFR 9239.

Page 17, paragraph 3: The OIG states that the BLM has no policy for cross-training inspectors. However, the BLM has an inspector certification program that provides for cross-training through a mentoring process in which a new inspector works with certified mine inspectors until the new inspector can demonstrate the ability to perform the work independently. A mine inspector can only be certified once he or she has demonstrated the ability to perform mine inspector duties for certain mine types or commodities. We recommend that the referenced paragraph be deleted.

Attachment 3

Appendix 4: Status of Recommendations

In its response to our draft report (see Appendix 3), the Department concurred with 12 of the recommendations and partially concurred with 1 recommendation. Although partial concurrence was expressed for Recommendation 5, the response was sufficient for us to consider it resolved. The table below summarizes the status of the recommendations.

Recommendations	Status	Action Required
1 – 13	Resolved; not implemented.	Recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking their implementation.

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