



United States Department of the Interior
BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240
<http://www.blm.gov>



AUG 14 2014

The Honorable Edward J. Markey
United States Senate
Washington, DC 20510

Dear Senator Markey:

Thank you for your letter of February 4, 2014, to Secretary of the Interior Sally Jewell regarding findings of the Government Accountability Office (GAO) about the Bureau of Land Management (BLM) Federal coal leasing program. Secretary Jewell has asked me to respond to your letter.

In the BLM's responses to both the Office of Inspector General (OIG) and GAO reports, BLM has acknowledged that improvements can and should be made and has initiated work to implement reforms that will improve and standardize the performance of the program.

Our responses to your specific questions related to the GAO report on the Federal coal leasing program are enclosed. Additionally, you urged the Secretary "...to take immediate action to reform the Department's coal lease program to ensure that the true value of these natural resources is obtained on behalf of the taxpayers..." We agree with these goals and are working on tools that will improve the Federal coal leasing program.

You further asked that BLM "... temporarily suspend new coal lease sales until these reforms are completed." While the Department intends to make necessary changes to improve the coal leasing program, we do not agree that our coal program should be suspended until these reforms are completed. I assure you, however, that while BLM updates existing guidance and develops new guidance to help improve the coal leasing program, BLM will be thoroughly reviewing each new potential sale before approval to ensure compliance with the recommendations of the GAO and OIG reports.

You also suggested that BLM's presale estimate of value, and any post sale analysis, should be transparent to the public. We agree fundamentally with the need for transparency in Government actions. However, publicly releasing presale estimates of value is likely to compromise the competitive process the BLM undertakes on behalf of the American taxpayer. Release of BLM's presale estimate of value, or significant parts of the data considered in development of the presale estimate of value, could be used to reverse engineer the BLM's analysis. This would be similar to competing coal companies sharing the basis for their bids with each other prior to a lease sale—and it logically follows that the release of such information would lead to lower bonus bids over time. Further, information included in these analyses is

from third parties that require assurances of confidentiality as a condition precedent to obtaining the information. Releasing such information may jeopardize BLM's ability to obtain similar information in the future. The BLM is making transparent as much information as possible, including keeping current the recently developed webpages that provide the public with data for each sale since 1990.

We look forward to working with you as we reform BLM's coal leasing program for the benefit of all American taxpayers. If you have any questions, please contact me or Patrick Wilkinson, Chief of BLM's Legislative Affairs Division, at 202-912-7421.

Sincerely,

A handwritten signature in black ink, appearing to read "Neil Kornze". The signature is fluid and cursive, with a long horizontal stroke at the end.

Neil Kornze
Director

Enclosure

Response to questions from Senator Markey's letter dated February 4, 2014

1) In examining more than 100 recent coal lease sales, the GAO found "a similar lack of competition for federal coal leases" as existed in the 1982 coal lease sales in the Powder River Basin (PRB) that the GAO examined at my request. Specifically the GAO found in the public report I am releasing today, that roughly 90 percent of federal coal lease tracts received a bid from only a single coal company. The GAO further found that the Department accepted that first coal company bid more than 80 percent of the time. According to the GAO, in the 18 instances where the initial bid was rejected by the Department, coal companies always bid again for the tract and did so at higher levels. This raises the question of whether taxpayers are receiving a proper return on the majority of coal lease sales conducted by the Department.

1a) Do you believe that the overwhelming lack of industry competition for federal coal tracts and the acceptance of initial coal company bids by the Department is leading to a loss of revenue for the American people? If not, why not? If so, what steps is the Department taking to address this lack of competition and when will those steps be completed?

For each coal lease sale, BLM determines a presale estimate of value based on comparable sales, the income approach, or both. The presale estimate of value is, therefore, based on similar transactions between willing buyers and willing sellers, or based upon a complete analysis of the tract and market trends using methods similar to those used by the bidder. All information is considered in establishing the confidential presale estimate of value. Regardless of the number of bids received, a bid will only be accepted if it meets or exceeds the presale estimated value. This requirement helps ensure that the American taxpayer is receiving the benefits of a competitive process.

1b) Bureau of Land Management (BLM) officials told the GAO that the BLM uses the tract modification process to encourage competition. However, the GAO found that Interior modified the lease tract boundaries to enhance competition in 23 percent of the lease sales examined yet none of these modified leases received multiple bids. It therefore appears that the BLM's attempts to modify coal tracts to increase industry competition is not working successfully. What steps is the Department taking to improve the tract modification process to increase competition and when will those steps be completed?

The BLM is examining all coal lease sale procedures to determine where changes are needed, including those used in the tract modification process. Some corrective actions regarding the lease sale modification process may require regulatory changes. The BLM is working closely with the Department's Office of Valuation Services (OVS) to identify required changes and then proceed to develop efficient strategies to implement changes. We cannot predict an exact time for completion of this action, but work is underway.

2) BLM's guidance lays out two approaches for developing an estimate of Fair Market Value – one that looks at past sales and one that takes into account revenue from mining – but found that not all states use both evaluations, as recommended by the appraisal organizations GAO interviewed. GAO concluded that states that only use past sales "may not be fully considering current or new trends in coal markets when estimating Fair Market Value."

2a) Do you agree with GAO's conclusion that states that only use past sales to determine an estimate of FMV may not be considering current or new trends in coal markets and therefore may be generating a deficient estimate of Fair Market Value? If not, why not?

Based on the facts of a particular lease sale, the best estimate of value may be realized by the prudent use of the comparable sales method or the income approach method, or both. While retaining discretion to complete an appraisal using the most appropriate method, BLM will strive to require complete documentation and description of the methodologies utilized for appraisal of each sale to ensure FMV estimates take into account current and emerging trends in coal markets.

2b) Do you intend to require that all state offices use both of these types of evaluations as recommended by appraisal organizations interviewed by the GAO and, if so, when will such a requirement be put in place? If not, why not?

We are currently considering this issue. We need to ensure that the policy accounts for known variances in coal, geology, and development alternatives. The BLM is working closely with OVS to identify required changes and then proceed to develop efficient strategies to implement changes.

3) The GAO found that DOI is using coal lease sales that are outdated in setting an estimate of Fair Market Value, that some states did not even update these outdated sales to account for inflation and one state that did not prepare a formal appraisal report to justify setting the FMV at the lowest possible level.

3a) The GAO found that several comparable sales being used were more than five years old and that an appraisal organization interviewed by the GAO suggested such a sale might not reflect current market conditions. Do you believe that DOI should not use comparable sales that are five or more years old in generating an estimate of FMV? If not, why not? If so, what actions is the Department taking to ensure that states do not use outdated lease sale information and when will those actions be implemented?

The BLM believes that comparable sales continue to be the best indicator of value because they indicate what a willing buyer, who is not obligated to buy, and a willing seller, who is not obligated to sell, have agreed is the value of similar property. In many parts of the western United States where BLM leases coal the Federal resource tends to be in greater abundance, and there are proportionately fewer comparable non-Federal transactions. Some comparable non-Federal transactions include other assets, such as building and mining equipment and sales contracts, which complicates the determination of the comparable value. Other non-Federal transactions may have significantly different terms and conditions and may not be comparable measures of value. Therefore, prior comparable sales of Federal resources can be a great aid to determining value.

There is no question that comparability of a transaction will decrease as its age increases. The viability of older comparable sales is currently under discussion within BLM and with

OVS. There are several alternatives being actively discussed to deal with this issue. We are committed to improving this aspect of the FMV analysis and disclosing the rationale for all adjustments.

3b) The GAO found that some states did not even adjust outdated sales information to account for inflation. Do you believe that lease sale information should always be adjusted for inflation in calculating the FMV estimate? If not, why not? If so, what steps are you taking to ensure that all BLM offices adjust this information to account for inflation?

Regardless of the appraisal method used, if results or analysis produced from prior sales are utilized in a current appraisal analysis, those historic values should be appropriately adjusted for inflation, and all such adjustments completely described and documented in the appraisal report. The BLM is evaluating policies to ensure consistency across all BLM offices in the calculation of the FMV estimate.

3c) The GAO found three related lease sales in Oklahoma where a formal appraisal report was not prepared at all to justify setting the Fair Market Value at the lowest level allowed in law. Do you believe that the procedures in place in Oklahoma and all state offices should be reviewed to ensure that proper justification for the Fair Market Value estimate is completed for every lease sale? If not, why not? If so, when will such a review be completed?

We are exploring methods and opportunities that will enable us to assure that future presale FMV estimates are reviewed prior to the sale date. We are working with OVS to ensure consistent coal valuation processes throughout BLM.

4) In response to the problems uncovered with the 1982 PRB sales, it was recommended that Interior conduct periodic independent reviews of coal leasing.

4a) The GAO found that Interior is not using an independent third party office within Interior with appraisal expertise. Do you believe that all federal coal lease sales should be reviewed by Interior's Office of Valuation Services or another independent entity? If not, why not? If so, when will such a requirement be implemented?

We agree that appraisals should be reviewed prior to the lease sale. We are currently working with OVS to develop a protocol for review of presale FMV estimates. We plan to have the protocol developed before the end of the year.

4b) The GAO found that BLM headquarters currently only reviews a tiny percentage – between five and ten percent – of appraisal reports prior to lease sales. As a result, the GAO concluded that appraisal reports “may not be receiving the scrutiny they deserve.” Do you believe that BLM headquarters officials should review every appraisal report prior to lease sales? If not, why not? If so, what actions will the Department take to ensure that this review by top BLM officials occurs prior to lease sales?

At this time, we do not believe that BLM headquarters officials should review every appraisal completed for a prospective coal lease sale for the following reasons:

- In response to the OIG and GAO recommendations, the BLM headquarters staff is revising Agency guidance for coal evaluations and sales, and may in the future conduct a review of a random sample of completed presale FMV estimates to ensure compliance with the modified guidance.
- The OIG and GAO determined that an independent entity should conduct any review of the presale estimate of value to assure that there is no collusion or institutional bias in such a review. As noted in the response to 4a, BLM is working to determine the best approach for review of FMV estimates and the role of OVS or other entities in the valuation review process.

5) BLM's guidance states that appraisal reports determining Fair Market Value should consider specific markets for the coal being leased, including export potential. But the GAO found that some offices, such as Wyoming, typically contained only "generic boilerplate statements about the possibility of coal exports in the future and the uncertainty surrounding them." Further, many other states did not consider coal exports at all when valuing federal coal, according to the GAO. What steps are you taking to protect taxpayers by ensuring that the BLM follows its guidance to conduct a meaningful consideration of the possibility of coal exports in determining the Fair Market Value of public coal resources, given that coal leases are issued for a period of at least 20 years?

Federal coal leases are issued with an initial term of 20 years, but leases may be adjusted at the end of the initial 20-year term, and at the end of each subsequent 10-year readjustment period.

We agree that the presale estimate of value should appropriately and proportionately consider the value of coal exports where such exports are likely. Given that when presale appraisals are completed we may not know who the successful lessee will be or whether the prospective lessee has any desire to export the coal from a particular tract, the inclusion of coal exports in a quantitative analysis must also include the possibility of such exports not occurring.

6) The GAO also found that the Interior Department is providing limited information to the public about federal coal leasing activities. It is vital that there is transparency in the federal coal program so that the American people can be assured that they are receiving a proper return.

6a) Although BLM guidance states that Interior should prepare and release a public version of the Fair Market Value appraisal reports that removes all proprietary or confidential information, the GAO found that the BLM is not following this guidance. Do you disagree with the agency guidance that states that public versions of appraisal reports should be disseminated? If so, why? If not, what steps are you taking to ensure that such documents are prepared and released by BLM?

Agency guidance appropriately states, consistent with the requirements of the Freedom of Information Act, that public versions of the appraisal reports, which appropriately safeguard proprietary information, should be made available to the public. As we work to revise and update internal guidance, this effort will be re-emphasized.

6b) The GAO found that the main BLM webpage does not post consolidated information on federal coal lease sales and that most BLM state offices do not maintain information on past lease sales on their state webpages. Do you believe that this information should be posted in an easily accessible and searchable fashion on BLM websites for the public? If not, why not? If so, what actions are you taking to ensure that this information is posted on government websites and when will those actions be completed?

We have updated our public webpage to include information on past Federal coal lease sales, including consolidated information by state about the total number of leases in effect, acres under lease, and lease sales since 1990. In addition, detailed state specific information is available on each individual coal lease issued since 1990, including the lessee's name, acres leased, tons offered, bid information, and other documentation. This information can be found at: http://www.blm.gov/wo/st/en/prog/energy/coal_and_non-energy/coal_lease_table.html.

7) The GAO report highlights the outdated fees coal companies are paying on public lands.

7a) Rental rates were set decades ago at \$3 per acre. The GAO found that in fiscal year 2012, we generated \$1.4 million in rent revenue from federal coal leases, comprising 0.1 percent of the annual revenue related to coal. Do you believe the rental rates should be updated to account for current market conditions or inflation? If not, why not? If so, what actions does the Department plan to take to update these rates?

We are currently in the process of analyzing the feasibility of making adjustments to the annual rental rate. The current rental rate was established by regulation and any change will require new regulations.

7b) The minimum bid that Interior can accept for a coal lease is \$100 per acre. Do you believe that this minimum bid amount should be updated to reflect current market conditions or inflation? If not, why not?

We are currently analyzing the feasibility of making adjustments to the minimum bid requirement. The current minimum bid amount was established by regulation and any change will require new regulations.

8) Are there any other recommendations made by the GAO in its report with which you disagree? If so, why? If not, what steps will you take to implement those additional reforms and when will those actions occur?

We are on record as agreeing with all of the GAO recommendations and are currently taking steps to implement them.