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"MINING IN AMERICA: POWDER RIVER BASIN COAL MINING, THE BENEFITS AND CHALLENGES."
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Mr. Chairman and members of the Committee, thank you for the opportunity to testify today about the Office of Inspector General's evaluation of the U.S. Department of the Interior's management of its coal program.

Coal management is a high-dollar program for the Department. In fiscal year 2012, the Department collected $876 million in coal royalties, and over $1.5 billion in bonuses from six lease sales. The budget for coal management is approximately $9.5 million.

The Bureau of Land Management (BLM) is responsible for managing the coal program for the Department. Coal from lands controlled by BLM makes up roughly 40 percent of the total coal production in the United States. BLM manages a total of 314 leases—306 leases on public lands and 8 on Indian lands. In fiscal year 2011, 473 tons of coal were produced from these mining operations. Seventy-one companies operate about 80 mines on public and Indian lands. Four companies account for over 90 percent of BLM's sales volume. The largest coal producing State is Wyoming, primarily from the Powder River Basin. In fiscal year 2011, Wyoming accounted for 83 percent of the Department's total coal production and 86 percent of its coal revenues.

We conducted our evaluation to determine if the Department's coal leasing process obtains a fair return on coal produced from public and Indian lands. We also assessed the effectiveness of the Department's coal lease inspection and enforcement program.

We found several areas in which BLM could improve the coal leasing process—in valuation, bid acceptance, internal controls, exploration integrity, modifications, and royalty rate reduction—and strengthen the inspection and enforcement program.

Fair Market Value

BLM is responsible for obtaining fair market value (FMV) for coal produced on public and Indian lands. FMV is calculated by considering a number of variables. Mineral valuation expertise is critical for setting FMV, but BLM does not use the Department's Office of Valuation Services (OVS), which is the Department's authority on valuation for all minerals extracted from public lands. We believe that BLM's coal lease sales would be greatly enhanced if OVS assumed the appraisal function.

In addition, BLM does not fully account for export potential in developing FMV. The U.S. Energy Information Administration reported that 125 million tons of coal were exported in 2012, an amount that has more than doubled in 5 years. The price of exported coal has also more than doubled in only 4 years. This trend suggests that export potential should be considered in calculating FMV. Exported coal volumes from the Powder River Basin represent about 1.6 percent of production (6 million tons), but mining companies are actively exploring methods to transport the coal to western ports to export the coal overseas. Export volumes have stabilized in 2013 but are expected to rise in the long term.

Accurately calculating FMV is particularly important in coal leasing because a competitive market does not generally exist for coal leases, making FMV a substitute for competition. Over 80 percent of the sales for coal leases in Wyoming's Powder River Basin had only one bid in the past 20 years. None had more than two bidders on a sale. The lack of competition is attributed to BLM's decision in 1990 to discontinue large-scale regional lease sales and use smaller scale lease sales to continue or extend the life of existing mines.

The Mineral Leasing Act requires BLM to reject bids that fail to meet or exceed FMV. We found four instances, however, in which BLM accepted bids below FMV, resulting in over $2 million in lost revenue from the bonuses. We believe that any bid below FMV should be rejected. When a bid is rejected by BLM, however, the sales process starts all over. We recommended that BLM explore options to stop this inefficient practice. Entering into direct negotiations with the unsuccessful bidder is one possible solution. This may require a change to legislation and applicable regulations but may be worth the effort, as about 25 percent of lease sales in the Powder River Basin, which is among the highest producing coal areas on public lands, are rejected and go through the time-consuming process of lease reoffer.

Internal Controls

We also found that BLM has internal control weaknesses regarding FMV data security and review and approval of FMV determinations. Procedures for safeguarding FMV data are inconsistent among BLM offices, and in one State office, a single individual computes FMV, increasing the possibility of undetected errors, a higher risk of fraud, and an inability to move sales forward if that person is absent.

Exploration Integrity

Prior to a lease sale, a mining company explores the site for the existence and extent of coal seams and considers the energy content (BTU) and quality (sulfur, ash, water content) of the coal. The company is required to furnish this information to BLM, which uses the information to form the basis of the FMV determination. BLM does not, however, independently verify this information. While a BLM handbook recommends that staff witness exploration activities, at least one State office (Montana) does not conduct such oversight. We did not find specific indicators of data misrepresentation but, without verification, BLM places itself at risk of receiving, and relying upon, incorrect data from mining companies.

Modifications

We found that BLM may not be getting a fair return for lease modifications. In the lease modifications we reviewed, 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. We estimated a potential $60 million in lost revenues. While the modifications may have been justified, we could not validate BLM's decisionmaking process with the documentation available to us.

Royalty Rate Reduction

Mining companies may apply for a royalty rate reduction for a number of reasons. Our review showed that BLM appropriately evaluated and managed royalty rate reductions. When a royalty rate reduction is based on financial hardship, however, BLM program officials generally do not have the expertise to evaluate a company's financial statements and other supporting documentation. We recommended that in such cases, BLM seek the assistance of the Office of Natural Resources Revenue (ONRR), which has accounting expertise in financial records analysis.

Inspection and Enforcement

BLM has an active inspection and enforcement program. The Bureau runs the risk of inconsistencies among its State offices, however, due to its decentralized organizational structure and outdated and never-finalized guidance. The practice of BLM coal inspectors is to work informally with mining companies to resolve noncompliance. This is due, in part, to the ineffective tools they have for enforcement. The Notices of Noncompliance that BLM uses to cite companies for infractions do not have a financial penalty associated with them. BLM told us that it is limited by current statutory authority.

Inspector Rotation and Training

BLM has assigned inspectors to the same mines for many years, sometimes decades. This may result in over familiarity with mine operators and complacency in inspections and enforcement. BLM has no policy or practice for cross-training inspectors. One inspector may see things differently than another, and cross-training would assist BLM in succession planning.

BLM does have an inspector certification initiative underway that covers all personnel who inspect solid minerals, which includes coal. This initiative should improve the quality and consistency of inspections and enforcement.

The Office of Natural Resources Revenue's Powder River Basin Project

Outside of our Coal Program Evaluation, we have been monitoring the Office of Natural Resources Revenue's coal audits focusing on export coal sales from the Powder River Basin. In December 2012, ONRR formed a Task Force Team, consisting of auditors from ONRR and the States of Montana and Wyoming, to review potential export sales involving Federal coal mined from the Powder River Basin to ensure that the royalty calculations and payments complied with lease terms. ONRR developed a comprehensive Project Action Plan to be completed by December 2015, with additional reviews beyond 2015 if warranted.

This concludes my formal testimony today. I would be happy to answer any questions members of the Committee may have.