TESTIMONY OF THE HONORABLE EARL E. DEVANEY
INSPECTOR GENERAL FOR THE DEPARTMENT OF THE INTERIOR
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE
JUNE 8, 2005

Mr. Chairman, I want to thank you and the members of the Committee for inviting me here today to talk about the results of our recent investigation into the "Agreement for the Acquisition and Donation of the Mineral Estate between the United States of America and the Collier Family."

The Office of Inspector General (OIG) initiated its investigation in September 2003, after receiving allegations from a confidential source that the Collier Resources Company (CRC) took advantage of the politically charged situation surrounding drilling in the Florida Everglades and "bluffed" the Department into executing an agreement to purchase CRC's mineral interests in the Big Cypress National Preserve (BCNP) in Florida for $120 million.

The attempted acquisition by the Department of the Interior of CRC's mineral rights in the BCNP has been years in the offing. This was an acquisition supported by the Clinton Administration as well as by the present Bush Administration. It was heralded by environmentalists and enjoyed the enthusiastic backing of the citizens and leaders of the State of Florida. The intentions behind the attempted acquisition have always appeared to be firmly grounded in the Department's righteous desire to protect the environmentally sensitive Everglades from potential harm. The means by which these intentions were advanced, however, were very troubling.

The statutory backdrop for Big Cypress National Preserve is both complex and complicated. The statute, however, is simplistically clear on one thing: an appraisal is required for acquisition by the government of property interests in BCNP. Yet, prior to the Agreement between Interior and the Colliers, no appraisal was ever done, or even undertaken. The reason, I believe, is because from the genesis of negotiations, while the Colliers made known that they viewed the value of their subsurface mineral interests in the hundreds of millions of dollars, the negotiators for the Department knew a traditional appraisal would not get them to a dollar amount that would be agreeable to the Collier family.

The Colliers have been the driving force behind DOI's acquisition of their BCNP mineral rights from the start. Representatives of Collier Resource Company (CRC) initiated the discussions with the Department in the mid-1990s; they renewed them in January 2000 and, yet again, with the present administration in 2001. By the time CRC approached the Department in 2001, it had positioned itself nicely for another round of negotiations, having embarked on a public outreach effort to signal that it was about to exercise its rights to explore for subsurface oil and gas in the BCNP. Between 1997 and 2001, CRC had submitted 27 plans of operation to explore within the BCNP. Not unexpectedly, this caused an uproar in the environmental community, which naturally captured the attention of the new Secretary for the Department.

In the clamor, however, the following facts were lost: 1) none of the plans of operation were complete; 2) the plans were designed to suggest the most extreme impact possible on the Preserve's environment, 3) approval of the plans – once complete – would be subject to regulations governing activity on the Preserve which strictly limit

exploration; and, as such, 4) several decades would likely pass before CRC could incrementally actualize the 27 plans that it had filed with the Department.

Thus, the stage was set with two critical assumptions: first, the Collier's had a specific dollar goal for the Department to acquire their subsurface mineral rights; second, if the Colliers could not achieve their dollar goal, they would assault the Preserve with oil and gas exploration.

Because Department negotiators believed that a traditional appraisal could not reach the Colliers dollar goal, they used an alternative approach to evaluating the mineral interests. Ignoring career appraisers in the National Park Service (NPS) and over the objection of the Minerals Management Service (MMS), senior officials and attorneys for the Department pushed the MMS Resource Evaluation Division to evaluate the mineral interests in BCNP. Unable to determine what percentage of those interests belonged to the Colliers, MMS evaluated **all** the mineral resources in BCNP.

Beginning in 1996, and relying almost exclusively on data provided by CRC, MMS developed a mean value of approximately $155 million for 100% of the mineral rights in BCNP. CRC thought that MMS had significantly undervalued the resources, while NPS appraisers questioned the validity of the MMS evaluation.

When no exchange resulted from the 1996 evaluation, MMS was asked to update its earlier evaluation for a newly proposed deal. A different MMS geologist re-evaluated the same data from the 1996 evaluation, and in 2000 adjusted the evaluation **downward** to a mean value of $68 million for 100% of the subsurface mineral rights in BCNP. CRC again objected.

In late 2001, yet another re-evaluation was being considered for yet another round of negotiations. Despite its continuing objection, MMS eventually produced a spreadsheet containing numbers that valued 100% of the mineral rights in BCNP at $68 million.

Unable to reach CRC's absolute minimum of $130 million with these diminishing values, an attorney from the Office of Solicitor sought the assistance of an outside contractor, to conduct a review of the methodology used by MMS. Subsequently, the contractor was also asked by the attorney to develop a "range of value" around the MMS mean of $68 million. Using an approach that had no specific provision in microeconomic theory, the contractor determined that a "range of value" around the $68 million mean was $31 million to $140 million for 100% of the BCNP mineral rights.

Using this range, the Department's negotiators justified the final offer contained in the agreement of $120 million.

During our review of this information, we readily recognized that the OIG did not have the substantive expertise to compare the way in which this valuation was derived against the intricacies and complexities of a formal appraisal process and its attendant rules and standards. Therefore, we contracted with The Appraisal Foundation, an independent, not for profit educational organization, authorized by the Congress as the source of appraisal standards and appraiser qualifications, to review and comment on these valuation reports, as well as the report and conclusions produced by the contractor.

In addition to its conclusion that there are no provisions for "alternative valuation means" where market value determinations [an appraisal] are an element of land acquisitions or exchanges involving private sector entities, the Foundation observed that

the 2000 MMS report, in particular, was misleading in that, without complying with the requirements for federal appraisals, and without appropriate data reasoning, analysis, and conclusions, it was reported in a format that was apparently used as though it were prepared in accordance with federal appraisal standards.

Despite the difficulty with and lengths to which the Department had to go to reach the $120 million price tag, CRC continued to insist that its subsurface mineral rights in BCNP were considerably more valuable. In keeping with this position, CRC also insisted that the Agreement include language that would allow it to do two things: First, to claim credit for a donation for any amount it could sustain with the IRS over the $120 million that the Department was willing to pay, and second, to reap the tax benefits associated with a sale of the property "in lieu of condemnation," which, in summary, equates to the ability to defer or avoid taxation on capital gains.

With few questions and little analysis, the Department's negotiators agreed to these terms.

Since my office has no more expertise in tax issues than it does in appraisals, we sought the assistance of the Senate Joint Committee on Taxation. We met with Committee staff members with expertise in these areas to discuss the matter. After being provided a summary of the facts, Committee staff said the circumstances in this case "sound weird." They explained that it seemed like CRC wanted it both ways. Specifically, CRC not only wanted to secure the benefits of donating a portion of its mineral rights under IRS Code Section 170, which applies to charitable donations and requires "donative intent," but also wanted to claim the tax benefits associated with IRS Code Section 1033, which contemplates "involuntary conversion" and requires that

property be taken away under threat or use of force. Committee staff opined that tax treatment under these two code sections is, essentially, mutually exclusive.

Committee staff further explained that the intent to involuntary convert property should be formed by the Department and not the property owner. Thus, the government would form the intent to initiate or contemplate an involuntary conversion and notify the property owner in writing. They concluded that involuntary conversion did not appear applicable in this case.

On the other hand, they noted that for the charitable donation, the IRS would ask the donor for information such as the history of the deal/negotiations, the values that were asserted, and other information salient to the transaction. They explained that a donee could incur potential criminal or civil liability if its representative signed IRS Form 8283 (acknowledging the donation) knowing the donated property was overvalued.

For the record, Mr. Chairman and members of the Committee, as we noted in our Special Report, we found no evidence that anyone representing the Department signed an IRS Form 8283 in this matter.

One of the attorneys who drafted the Agreement justified inclusion of these terms because the Department had used similar language in a prior exchange. Another attorney who helped draft the Agreement said that while he was aware of the donation aspect of the agreement, he did not understand it. The Secretary's representative handling the negotiations said she was told by one of the two attorneys that similar language had been used in other deals, but that the IRS usually does not grant the donation.

Like the failed Agreement itself, this tax treatment, today, might be dismissed as "no harm, no foul." We felt compelled, however, to comment in the following regards:

- It represents a careless practice to conclude that something is appropriate simply because the Department has done it before. Without factual basis and analysis, it is reckless to draw such a conclusion and advise decision-makers without more. In fact, the OIG has uncovered numerous, serious programmatic failings when one program relies on the precedent of another for justification to act.
- It represents a compartmentalized view of responsibility that has haunted and thwarted other transactions investigated by the OIG. This compartmentalization results in a wholesale lack of accountability, with the various participants pointing to one another as being responsible for whichever aspect of a transaction breaks bad.
- Taking the compartmentalization one step further, it represents a view that the Department acts only in its own self-interest and not the interest of the federal government and the American public – here the IRS and the taxpayers.
- It represents yet another aspect of the deal that was being driven and controlled by CRC, with the acquiescence and assistance of the Department.
- By including "in lieu of condemnation" language, the Department was acceding to a statement that was factually false.
- Including both aspects of tax treatment that CRC insisted upon, aspects that are mutually exclusive in the view of subject-matter experts, causes the Department to look, at best, foolish and, at worst, complicit.

Simply stated, Mr. Chairman and members of the Committee, this is not the substance of which a sound Agreement in the best interests of the Federal Government and American public is made.

Having said all this, however, I must commend the Department for some significant changes it has made to the land appraisal program and process. In November 2003, following the issuance of our Report concerning the San Rafael Land Exchange in July of that year, the Secretary directed the consolidation of the Department's real estate appraisal functions, establishing the Appraisal Services Directorate within the Office of the Secretary, to ensure appraiser independence, accountability, high standards, appropriate training, and oversight of Departmental appraisal functions. Over the course of the next year, an Appraisal Reform Implementation Team conducted a comprehensive review of appraisal policies and practices in the Department, which culminated in a Secretarial Order – "Policy Guidance Concerning Land Valuation and Legislative Exchanges." This Order establishes, among other things, policy on alternative methods of valuation and policy on legislative exchanges, both of which were issues of concern to us in both the San Rafael and the BCNP matter. I am quite confident that these reforms will, if strictly adhered to, correct most, if not all, of the problems we discovered in these instances.

Mr. Chairman and members of the Committee, before I conclude, I would like to credit the two case agents who have worked on this matter tirelessly for nearly 21 months. Beginning without any background in appraisals, land exchanges, mineral interests or tax, these two investigators diligently assembled the multifaceted complexities of this deal, and patiently unraveled them to tell an understandable story.

In the end, I firmly believe that these two civil servants saved the American taxpayers $120 million.

This concludes my formal testimony. Thank you for the opportunity to appear here before the Committee today. I will be happy to answer any questions you may have.