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UNITED STATES DEPARTMENT OF STATE
AND THE BROADCASTING BOARD OF GOVERNORS
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**Keystone XL Pipeline Project
Compliance Follow-up Review:
The Department of State's Choice of
Environmental Resources Management, Inc.,
To Assist in Preparing
the Supplemental Environmental Impact Statement**

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PREFACE

This report was prepared by the Office of Inspector General (OIG) pursuant to the Inspector General Act of 1978, as amended, and Section 209 of the Foreign Service Act of 1980, as amended. It is one of a series of audit, inspection, investigative, and special reports prepared by OIG periodically as part of its responsibility to promote effective management, accountability, and positive change in the Department of State and the Broadcasting Board of Governors.

This report is the result of an assessment of the strengths and weaknesses of the office, post, or function under review. It is based on interviews with employees and officials of relevant agencies and institutions, direct observation, and a review of applicable documents.

The recommendations therein have been developed on the basis of the best knowledge available to OIG and, as appropriate, have been discussed in draft with those responsible for implementation. It is my hope that these recommendations will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in blue ink, appearing to read 'N. P. Brown', written in a cursive style.

Norman P. Brown
Assistant Inspector General
for Audits

Acronyms

CEQ	Council on Environmental Quality
EIS	environmental impact statement
ENR	Bureau of Energy Resources
ENV	Office of Environmental Policy
EQT	Office of Environmental Quality and Transboundary Issues
ERM	Environmental Resources Management, Inc.
FERC	Federal Energy Regulatory Commission
FOIA	Freedom of Information Act
L/OES	Assistant Legal Advisers for Oceans, International Environmental and Scientific Affairs
NEPA	National Environmental Policy Act
OIG	Office of Inspector General
OES	Bureau of Oceans and International Environmental and Scientific Affairs
PDAS	Principal Deputy Assistant Secretary
RFP	Request for Proposals
SEIS	supplemental environmental impact statement

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Executive Summary

The Keystone XL project (Keystone XL) is a proposed 875-mile pipeline that is intended to run from Alberta, Canada, through Montana and South Dakota to Nebraska, where it would link with pipelines running to the U.S. Gulf Coast. The project is to be built and operated by TransCanada Keystone Pipeline LP (TransCanada), an entity controlled by TransCanada Corporation, a Canada-based energy company. On September 19, 2008, TransCanada submitted a Presidential permit application to the Department of State (Department) because Keystone XL crosses the U.S. - Canadian border into Montana. Under Executive Order 13337, issued on April 30, 2004, the Department is the Federal agency responsible for reviewing applications for cross-border oil pipelines and deciding whether issuance of a permit to construct, operate, and maintain pipeline facilities that cross a border of the United States will serve the national interest.

As part of the permit application review process, the Department may prepare an environmental impact statement (EIS). The Department, like many Federal agencies, uses “third-party contractors” to help prepare EISs required for permit applications. In accordance with the “third-party contract” arrangement, the Department selects and directly supervises the third-party EIS contractor, independent of the permit applicant, but the permit applicant pays the contractor for its work. For TransCanada’s 2008 application, the Department selected ENTRIX, Inc., now known as Cardno ENTRIX, to prepare the EIS, which was issued in final form on August 26, 2011.¹

On December 23, 2011, the Temporary Payroll Tax Cut Continuation Act of 2011 was enacted.² It required the President to determine, within 60 days of enactment, whether Keystone XL would serve the national interest. On January 18, 2012, the Department recommended that the application be denied on the grounds that there was insufficient time to conduct the required analysis and, on the same day, the President agreed and denied the application.³

Meanwhile, based on a request received from 14 members of Congress in October 2011, the Office of Inspector General (OIG) initiated a review in November 2011 and issued a report in February 2012 that addressed concerns that TransCanada had improperly influenced the Department’s selection of Cardno ENTRIX.⁴ OIG found no evidence of improper influence, but made recommendations to improve the Department’s process for selecting third-party contractors and screening contractors for organizational conflicts of interest.

Following the President’s January 2012 denial, TransCanada filed a new Keystone XL permit application in May 2012. A supplemental EIS (SEIS) was required because the route

¹ The EIS is available at http://keystonepipeline-xl.state.gov/archive/dos_docs/feis/index.htm.

² Available at <http://www.gpo.gov/fdsys/pkg/PLAW-112publ78/pdf/PLAW-112publ78.pdf>.

³ Available at <http://www.whitehouse.gov/the-press-office/2012/01/18/statement-president-keystone-xl-pipeline>.

⁴ *Special Review of the Keystone XL Pipeline Permit Process* (AUD/SI-12-28, February 2012) is available at <http://oig.state.gov/documents/organization/183864.pdf>.

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through Nebraska proposed by TransCanada had changed, so the Department needed to select an EIS contractor to help prepare the SEIS.⁵

In May 2012, the Department published a modified version of its third-party contractor selection process⁶ in response to OIG's previous recommendations. That same month, the Department began using its revised process for the first time to select a third-party contractor for the Keystone XL SEIS. The Department selected Environmental Resources Management, Inc. (ERM).

In March 2013, the Department issued a draft SEIS for Keystone XL. Thereafter, OIG and the Department received a number of complaints asserting that ERM and its staff lacked the requisite independence to serve as the SEIS contractor and that ERM's answers in the conflict of interest questionnaire submitted as part of the SEIS contractor selection process were not accurate.⁷ In response to these concerns, OIG initiated this follow-up review to determine how well the process used to select ERM followed prescribed guidance and to determine how effective the revised process was in assessing and addressing organizational conflicts of interest for third-party contractors. As part of this review, OIG evaluated the Department's handling of potential conflict of interest issues, including conflict of interest allegations regarding ERM that were raised in the letters to OIG. To conduct this review, OIG reviewed documentation and interviewed Department officials, Federal Energy Regulatory Commission (FERC) officials, and ERM employees.

In January 2014, the Department issued the Final SEIS and posted it to its Web site with additional related documents, including organizational conflict of interest material provided by ERM and others.⁸ The Department had previously provided the organizational conflicts of interest documents to OIG during the course of OIG's review. Keystone XL is now in the National Interest Determination/Final Decision phase.⁹

Office of Inspector General Findings

Based on the information provided and interviews conducted, OIG found that the process the Department used to select ERM to help prepare the Keystone XL SEIS substantially followed

⁵ The Department maintains a public Web site, where the application and other pertinent materials discussed in this report are posted, at <http://www.keystonepipeline-xl.state.gov/>.

⁶ *Interim Guidance for the use of Third-party Contractors in Preparation of Environmental Documents by the Department of State* is available at <http://www.state.gov/documents/organization/190304.pdf>.

⁷ The April 8, 2013, letter from 11 organizations is available at <http://checksandbalancesproject.org/2013/04/09/cbp-calls-for-state-dept-investigation-into-keystone-xl-consultants-conflicts-of-interest/>. The April 22, 2013, letter from 11 organizations is available at <http://www.sierraclub.org/pressroom/downloads/IG-INVESTIGATION-REQUEST-LETTER-4-22-13.pdf>.

⁸ The additional information regarding potential organizational conflicts of interest disclosed by ERM is available at <http://www.keystonepipeline-xl.state.gov/>.

⁹ The National Interest Determination phase involves consideration of many factors, including energy security; environmental, cultural, and economic impacts; foreign policy; and compliance with relevant Federal regulations and issues. A process timeline is included in the Department's fact sheet at <http://keystonepipeline-xl.state.gov/documents/organization/221283.pdf>.

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its prescribed guidance and at times was more rigorous than that guidance. The Department's published guidance provides a general outline for the contractor selection process, and Department personnel managing the process drew on their previous experience to implement the process. For example, the Department used a selection panel of six Department employees to review the proposals submitted by the three third-party candidates that applied to serve as the SEIS contractor, and that panel interviewed each candidate. Neither the selection panel nor candidate interviews are prescribed by the published guidance. Although in two instances the Department made reasonable deviations from its prescribed guidance, OIG found that these deviations did not adversely affect the selection process. In one of the instances, for example, the Department elevated the final contractor selection decision from the office director to a higher-ranking official, an assistant secretary.

OIG also found that the process the Department used to assess organizational conflicts of interest was effective in that (i) a reasonable review was undertaken to independently evaluate ERM's certification that it had no conflict of interest and (ii) the process achieved its intended result. That is to say, the Assistant Legal Advisers for Oceans, International Environmental and Scientific Affairs (L/OES) reviewed all conflict of interest materials submitted by ERM, TransCanada, and others and made additional inquiries on potential issues. Furthermore, L/OES attorneys analyzed this information in a manner consistent with the Department's guidance, applicable regulations and guidance of the White House Council on Environmental Quality (CEQ), and relevant case law.

For example, in the case of concerns raised about ERM's alleged lack of objectivity because current ERM staff had previously worked for TransCanada and other oil and pipeline companies, OIG found that the Department's conflict of interest review was effective and that the review's conclusions were reasonable. Specifically, OIG's review found the following: (i) ERM had fully disclosed the prior work histories of its team members as part of its proposal; (ii) L/OES attorneys had reviewed and researched the nature of the prior work and had discussed the prior work with ERM during the pre-selection interview; (iii) L/OES attorneys had determined that the prior TransCanada work occurred before the staff began work at ERM and that none of the prior work had involved Keystone XL; (iv) the Department's prescribed conflict of interest guidance provides four factual scenarios that may create impairments to objectivity;¹⁰ (v) the employees' prior work histories did not involve any of those four scenarios; (vi) this prior work had not impaired ERM's objectivity; (vii) the totality of information provided by ERM to the Department was not misleading; and (viii) the Department's conflict of interest guidance is consistent with pertinent regulations and case law.

However, OIG did find that the process for documenting the contractor selection process, including the conflict of interest review, can be improved. Very little documentation is specifically required by CEQ regulations and Department guidance, and the Department has met

¹⁰ Where: (1) the contractor has been involved with the applicant on the project before the project is proposed to the Department or while it is pending with the Department; (2) the contractor has an ongoing relationship with the applicant; (3) the contractor would be called on to review its own prior work; or (4) the contractor has a financial or other interest in the outcome of the Department's decision.

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those minimal requirements.¹¹ However, the Department did not fully document its process, and additional documentation would help ensure effective management and oversight of this process. For example, the Department did not document its internal substantive analyses of the specific organizational conflict of interest issues it reviewed prior to May 2013.¹² Thus, OIG had to rely primarily on Department employee interviews to replicate this portion of the conflict of interest review process. Lack of such documentation also could lead to inconsistency in future applications of the process. The Department has acknowledged that its internal formal documentation could be improved and has begun more fully documenting its conflict of interest analysis for both the ongoing Keystone XL process and another third-party contractor process currently underway at the Department.¹³ Effective documentation is a necessary component of any government program and can go far to enhance oversight and reduce potential misperceptions of the process.

OIG also found that the Department's public disclosures concerning its conflict of interest review could be improved. The record shows that ERM provided the Department all required information, disclosures, and certifications in its initial proposal and provided supplemental submissions throughout its ongoing interaction with the Department. However, when the Department published ERM's proposal and the draft SEIS in March 2013, the Department agreed to redact information ERM considered confidential business information and did not publish any of ERM's supplemental submissions. The Department's partial disclosure apparently created misperceptions that ERM had not provided all required information to the Department and that ERM and the Department were attempting to conceal conflicts of interest. Those misperceptions might have been avoided had the Department explained its partial disclosure as part of a more comprehensive approach to disclosing information regarding its conflict of interest review.

Office of Inspector General Recommendations

OIG is making four recommendations intended to improve the documentation and public disclosure of the contractor selection process and conflict of interest review process. The Department should: (i) enhance its guidance to more fully articulate its selection and conflict of

¹¹ CEQ regulations require only a "[contractor] ... statement ... specifying that they have no financial or other interest in the outcome of the project." 40 CFR §1506.5(c). Similarly, Department guidance only specifies a few documents that potential contractors must include as part of their proposals: (i) a certification statement as required by CEQ regulations, (ii) a similar certification acknowledging that conflict of interest disclosure is an ongoing obligation throughout contract performance, and (iii) a conflict of interest questionnaire. These documents were included as part of ERM's proposal.

¹² Documentation of the Department's conflict of interest review prior to May 2013 consists of: (i) documents associated with L/OES drafting of its May 2012 conflict of interest guidance, (ii) the conflict of interest information included in ERM's original proposal, (iii) supplemental organizational conflict of interest documents submitted by ERM, (iv) organizational conflict of interest documents from ERM sub-contractors and TransCanada, and (v) email communications between the Department and ERM. OIG obtained much of the conflict of interest review process information contained in this report from interviews of Department employees. Since May 2013, the Department has more thoroughly documented its organizational conflict of interest review.

¹³ The Department is reviewing an application for a Presidential permit for the Alberta Clipper Pipeline. Available at <http://www.state.gov/e/enr/applicant/applicants/202433.htm>.

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interest review processes; (ii) explain in greater detail the definition of “organizational conflict of interest” relied upon by the Department; (iii) specify in its guidance the documentation required in the contractor selection and conflict of interest processes and establish standard operating procedures to capture and retain this information; and (iv) enhance its guidance to integrate a process for public disclosure of appropriate information.

In its February 2014 responses (see Appendix B) to the draft report, the Bureau of Oceans and International Environmental and Scientific Affairs (OES) and the Office of the Legal Adviser concurred with the four recommendations. Based on the responses, OIG considers the four recommendations resolved, pending further action. Management responses and OIG’s replies to those responses are included after each recommendation.

Background

The Keystone XL project is a proposed 875-mile pipeline that is intended to run from Alberta, Canada, through Montana and South Dakota to Nebraska, where it would link with pipelines running to the U.S. Gulf Coast. The project is to be built and operated by TransCanada, an entity controlled by TransCanada Corporation, a Canada-based energy company. On September 19, 2008, TransCanada submitted a Presidential permit application to the Department because Keystone XL crosses the U.S. - Canadian border into Montana.

The Presidential Permit Process and Applicable Laws and Regulations

Executive Order 13337 was issued by the President on April 30, 2004. The executive order requires a Presidential permit for the “construction, connection, operation, or maintenance, at the borders of the United States, of facilities for the exportation or importation of petroleum, petroleum products, coal, or other fuels to or from a foreign country.”¹⁴ It assigns the Department responsibility for reviewing applications for cross-border oil pipelines and for deciding whether issuance of a requested Presidential permit “would serve the national interest.”

Upon receiving an application for a Presidential permit, the Secretary of State must request the views of the Secretary of Defense, the Attorney General, the Secretary of the Interior, the Secretary of Commerce, the Secretary of Transportation, the Secretary of Energy, the Secretary of Homeland Security, and the Administrator of the Environmental Protection Agency. The Secretary may also consult with state, tribal, and local government officials and foreign governments. Moreover, the Secretary may publish a notice in the *Federal Register* regarding the Department’s receipt of an application to receive public comments. After considering comments, the Secretary will determine whether to approve or deny a permit based on whether issuance of the permit would serve the national interest. In preparing the national interest determination, the Secretary is required by the Executive Order to consider an array of factors, including the proposed project’s impact on economics, energy security, foreign policy, the environment, and culture.¹⁵

¹⁴ Executive Order 13337 is available at <http://www.gpo.gov/fdsys/pkg/FR-2004-05-05/pdf/04-10378.pdf>.

¹⁵ The Temporary Payroll Tax Cut Continuation Act of 2011 required the President to make this determination.

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As part of the permit application review process, the Department prepares an EIS or other environmental analysis to inform the national interest determination. The National Environmental Policy Act¹⁶ (NEPA) and CEQ regulations for implementing NEPA prescribe the process for completing an EIS. The regulations provide that any EIS prepared pursuant to NEPA shall be prepared by the Department or by a contractor selected by the Department.¹⁷ The regulations also state that the contractor be chosen solely by the Department in order “to avoid any conflict of interest” and that contractors “shall execute a disclosure statement...specifying that they have no financial or other interest in the outcome of the project.”¹⁸

The Department’s EIS contractors are outside or third-party contractors that are selected and managed by the Department to help the Department prepare the EIS. However, third-party contractors are paid through a contract with the permit applicant. In the case of Keystone XL, ERM was selected by and works for the Department but submits bills to and is paid by TransCanada. Except for the billing process, ERM is not permitted to communicate with TransCanada, unless specifically allowed by Department officials.

As discussed above, in selecting a third-party EIS contractor, Federal agencies are required to determine that the contractor has no organizational (entity-level) conflict of interest that would prevent the agency from producing an objective EIS. The CEQ regulation states that contractors must have “no financial or other interest in the outcome of the proposed project.”¹⁹ In a 1981 memorandum, published in the *Federal Register*, CEQ explained that it defines the term “financial or other interest” in the project’s outcome “broadly to cover any known benefits other than general enhancement of professional reputation.”²⁰ Later, in a 1983 memorandum also published in the *Federal Register*, CEQ further elaborated on the meaning of this provision based on the observation that some Federal agencies were interpreting the conflict of interest regulations in an overly burdensome manner. CEQ explained in the 1983 memorandum that “a firm which has an agreement to prepare an EIS for a construction project cannot, at the same time, have an agreement to perform the construction, nor could it be the owner of the construction site.”²¹ The memorandum further states that “if there are no such...interests or arrangements, and if the contract for EIS preparation does not contain any incentive clauses or

¹⁶ NEPA, as amended (Pub. L. No. 91-190, 42 U.S.C. §§ 4321-4347, Jan. 1, 1970, as amended by Pub. L. No. 94-52, July 3, 1975, Pub. L. No. 94-83, Aug. 9, 1975, and Pub. L. No. 97-258, § 4(b), Sept. 13, 1982), is available at http://energy.gov/sites/prod/files/nepapub/nepa_documents/RedDont/Req-NEPA.pdf. NEPA requires Federal agencies to assess and consider the environmental effects of their proposed actions prior to making decisions.

¹⁷ 40 CFR §1506.5(c) states, “[A]ny environmental impact statement prepared pursuant to the requirements of NEPA shall be prepared directly by or by a contractor selected by the lead agency...”

¹⁸ 40 CFR §1506.5(c) further states, “It is the intent of these regulations that the contractor be chosen solely by the lead agency...to avoid any conflict of interest. Contractors shall execute a disclosure statement...specifying that they have no financial or other interest in the outcome of the project.”

¹⁹ 40 CFR §1506.5(c).

²⁰ *Forty Most Asked Questions Concerning CEQ’s National Environmental Policy Act Regulations*, 46 Fed. Reg. 18,026, 18,027 (1981).

²¹ *Guidance Regarding NEPA Regulations*, 48 Fed. Reg. 34,263, 34,266 (CEQ 1983).

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guarantees of any future work on the project, it is doubtful that an inherent conflict of interest will exist.”²²

Federal courts applying the CEQ regulations and guidance to agencies’ use of third-party EIS contractors have rarely found a conflict of interest problem.²³ Indeed, even when an EIS contractor has a conflict of interest, courts will not necessarily invalidate an EIS if the agency can demonstrate that it has exercised control over the EIS preparation sufficient to demonstrate that the objectivity and integrity of the NEPA process has not been compromised.²⁴

The Department implements CEQ’s conflict of interest requirements through its *Interim Guidance for the Use of Third-Party Contractors in Preparation of Environmental Documents by the Department of State* (Guidance) published in May 2012.²⁵ That document gives the

²² Id.

²³ See, e.g., *Associations Working for Aurora's Residential Environment (“AWARE”) v. Colorado Dept. of Trans.*, 153 F.3d 1122, 1127 (10th Cir. 1998) (noting developments in CEQ’s guidance in 1981 and 1983 and holding that an expectation of future construction work on the project without an enforceable contract was not a sufficient conflict of interest to invalidate the EIS); *Colorado Rail Passenger Association v. Federal Transit Administration*, 843 F. Supp. 2d 1150, 1161 (Dist. Co. 2011) (finding no organizational conflict of interest where an individual consultant hired as EIS Manager for a transit station project was also an employee of the company managing development of the overall transit project because, although there was “certainly overlap,” there were no “incentive clauses or guarantees of future work in [the company’s] contract that would have been significantly impacted by the results of the EIS process”); *Northern Crawfish Frog v. Federal Highway Admin.*, 858 F. Supp. 1503, 1529 (D. Kan. 1994) (where local engineering firm participating in preparation of the EIS for a highway project allegedly would benefit financially from resulting future development on nearby properties, but firm had no incentives or guarantee of future work, there was no organizational conflict of interest); *Cmtys. Against Runway Expansion, Inc. v. FAA*, 355 F.3d 678 (D.C. Cir. 2004) (finding no organizational conflict of interest where EIS consultant had other existing contractual relationships with the applicant but certified it had no interest in the project and could participate objectively).

²⁴ See, e.g., *AWARE*, 153 F.3d at 1129 (“When reviewing an EIS prepared by a contractor who has allegedly breached a requirement imposed by 40 C.F.R. § 1506.5(c), the ultimate question for the court is...whether the alleged breach compromised the objectivity and integrity of the NEPA process.” The court “can evaluate the oversight that the agency provided to the [EIS] process as a factual matter and make a determination upholding the [EIS]”); See *Brandon v. Pierce*, 725 F.2d 555, 564 (10th Cir. 1984) (overlooking organizational conflict of interest when agency “substantially carried out its [NEPA] duties by making the ultimate decision and giving the required notice of that decision.” As allowed by HUD authorities, a city applying for a HUD grant hired and supervised the EIS contractor. However, the city had a contract for that same company to do engineering work on the project if it was approved, and the city paid for the EIS work as part of the engineering contract. The court acknowledged this created a potential conflict for the contractor, but found that the city’s supervision and control of the final EIS had maintained the objectivity of the EIS); *Citizens Against Burlington, Inc. v. Busey*, 938 F.2d 190 (D.C.Cir.), cert. denied, 502 U.S. 994 (1991) (holding that even though the Federal Aviation Administration (FAA) violated CEQ regulations in selecting the third-party EIS contractor, that error alone did not compromise the objectivity and integrity of the NEPA process. FAA had failed to obtain a conflict of interest certification from an EIS contractor that had a separate contract with the applicant for work related to the project. The court did not invalidate the EIS or enjoin the project, instead ordering FAA to obtain the required certification and “should the agency find that a conflict exists, to decide - promptly - on the measures to take in response”).

²⁵ This Guidance (available at <http://www.state.gov/documents/organization/190304.pdf>) contains a section specifically on organizational conflict of interest titled *Interim Guidance for the Disclosure of Organizational Conflict of Interest in the Use of Third-Party Contractors in Preparation of Environmental Documents by the Department of State*. For the purposes of this report, we refer to the overall document as the Guidance. In 2006, the Department, after consulting with CEQ, concluded that FERC employed the best practices for selecting third-party EIS contractors and adopted that model, with some modifications, for its Guidance.

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Department's Office of the Legal Adviser primary responsibility for undertaking a conflict of interest review. The Guidance explains that an organizational conflict of interest "exists when the nature of the work to be performed may, without some restriction on future activities: a) result in an unfair competitive advantage to a contractor; or b) impair the contractor's objectivity in performing the contract work." The Guidance then states that a conflict of interest may exist where a contractor and/or its employees "have a past, present, or ongoing financial interest in a project to be covered by the third-party contract." It then provides four examples of circumstances under which an organizational conflict of interest may exist. Specifically, a conflict may exist if the contractor:

- (1) has been involved with the applicant on the project or any of the proposed project's connected actions before the project is proposed to the Department or while it is pending with the Department;
- (2) has an ongoing relationship with the permit applicant, or any of the applicant's subsidiaries and/or parent companies;
- (3) would be called on to review its own prior work; or
- (4) has a financial or other interest in the outcome of the Department's decision.

Department Bureaus and Offices Primarily Responsible for the Keystone XL Environmental Impact Statement

The OES Office of Environmental Quality and Transboundary Issues (EQT),²⁶ among other things, leads the Department's environmental review process for Presidential permitting of infrastructure that crosses U.S. borders and was responsible for preparing the EIS for the Keystone XL permit.

The Bureau of Energy Resources (ENR) formulates policy to advance U.S. energy security interests in the fields of petroleum, natural gas, biofuels, and other energy resources and manages the Department's overall national interest determination process.

Office of the Legal Adviser provides legal advice to Department leadership and all components as well as to the executive branch on legal and legal policy issues in connection with U.S. foreign policy and Department activities. Legal advisers work closely with OES and ENR throughout the EIS and the national interest determination processes. Legal advisers also assist OES with selection and oversight of third-party contractors and have primary responsibility for assessing potential contractor conflict of interest.²⁷

²⁶ This office was formerly named the Office of Environmental Policy (ENP), which appears in documents cited in this review. The name was changed on October 1, 2012, to EQT.

²⁷ *Interim Guidance for the use of Third-party Contractors in Preparation of Environmental Documents by the Department of State* is available at <http://www.state.gov/documents/organization/190304.pdf>.

Keystone XL Presidential Permit Application Timeline

The Keystone XL permitting process formally began on September 19, 2008, when TransCanada submitted a Presidential permit application to the Department. Thereafter, the Department selected Cardno ENTRIX as the third-party contractor to help prepare the EIS. On August 26, 2011, the Department issued a final EIS.

On October 26, 2011, 14 members of Congress requested that OIG “launch an investigation into the State Department’s handling of the EIS and National Interest Determination.”²⁸ In response, OIG initiated a special review and began fieldwork on November 10, 2011. The primary objective of that review was to determine to what extent the Department complied with Federal laws and regulations relating to the Keystone XL Presidential permit process.

On December 23, 2011, the President signed into law the Temporary Payroll Tax Cut Continuation Act of 2011, which included a provision requiring that “not later than 60 days after the enactment of this Act, the President ... shall grant a permit under Executive Order No. 13337 ... for the Keystone XL pipeline” unless “the President determines that the Keystone XL pipeline would not serve the national interest.”²⁹ On January 18, 2012, the Department recommended that the application be denied due to insufficient time to conduct the required analysis.³⁰ The same day, the President publicly stated that he agreed with the Department’s recommendation³¹ and issued a memorandum to the Secretary of State directing him to “submit the report to the Congress as specified in section 501(b)(2) of the Temporary Payroll Tax Cut Continuation Act of 2011 and to issue a denial of the Keystone XL pipeline permit application.”³²

On February 8, 2012, OIG issued a report³³ that addressed the issues raised in the October 26, 2011, congressional letter. OIG found no evidence that TransCanada had

²⁸ They were: Senators Bernard Sanders, Sheldon Whitehouse, and Ron Wyden and Representatives Earl Blumenauer, Steve Cohen, Raul M. Grijalva, Mazie Hirono, Michael M. Honda, Hank Johnson, Dennis J. Kucinich, Chellie Pingree, Mike Quigley, Tim Ryan, and Peter Welch.

²⁹ H.R. 3765, the “Temporary Payroll Tax Cut Continuation Act of 2011” is available at <http://www.gpo.gov/fdsys/pkg/PLAW-112publ78/pdf/PLAW-112publ78.pdf>.

³⁰ The Department described this part of the project’s procedural history in congressional testimony on January 25, 2012, available at <http://energycommerce.house.gov/sites/republicans.energycommerce.house.gov/files/Hearings/EP/20120125/HHRG-112-IF03-WState-KJones-20120125-SD001.pdf>.

³¹ Available at <http://www.whitehouse.gov/the-press-office/2012/01/18/statement-president-keystone-xl-pipeline>. The President issued a statement explaining his denial as follows: “The rushed and arbitrary deadline [of February 21, 2012, established by Congress]...prevented a full assessment of the pipeline’s impact.” The President’s statement further noted that his decision was “not a judgment on the merits of the pipeline, but the arbitrary nature of a deadline that prevented the State Department from gathering the information necessary to approve the project and protect the American people.”

³² Presidential Memorandum -- Implementing Provisions of the Temporary Payroll Tax Cut Continuation Act of 2011 Relating to the Keystone XL Pipeline Permit, available at <http://www.whitehouse.gov/the-press-office/2012/01/18/presidential-memorandum-implementing-provisions-temporary-payroll-tax-cut>.

³³ AUD/SI-12-28, February 2012. Available at <http://oig.state.gov/documents/organization/183864.pdf>.

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improperly influenced the Department's selection of Cardno ENTRIX as the EIS third-party contractor. However, OIG made recommendations to improve the Department's process for selecting third-party contractors and for screening conflicts of interest. Specifically, OIG recommended that the Department: (1) redesign its process for using third-party contractors in order to maximize the Department's control of each step and minimize the permit applicant's role in the process; (2) fill at least one full-time position within OES with staff who have experience and expertise in handling NEPA issues and the EIS process; and (3) redesign the process for selecting and using third-party contractors in order to improve the Department's conflict of interest screening process.³⁴

On May 4, 2012, TransCanada filed a new application for Keystone XL. On May 10, 2012, the Department approved its modified third-party contractor selection process (the previously discussed Guidance). In May 2012, the Department began the process of selecting a third-party contractor to assist with the preparation of the SEIS.³⁵ On July 13, 2012, the Department advised TransCanada of its selection of ERM as the SEIS contractor, and on August 16, 2012, the Department posted a notice on the project-specific Web site for Keystone XL³⁶ announcing the selection of ERM.

On March 1, 2013, the Department published its draft Keystone XL SEIS, prepared with the assistance of ERM, and posted a redacted copy of the documents ERM submitted in June 2012 when it applied to serve as the SEIS contractor. Notably, however, as discussed below, the Department did not publish any other documents that ERM had submitted to the Department over ensuing months (until the release of the final SEIS in January 2014).

On April 8, 2013, representatives of 13 organizations sent a letter to the Secretary and OIG calling for an investigation of two issues they identified in the posted ERM documents: (i) incomplete statements made by ERM on its conflict of interest disclosure statement and (ii) the Department's determination that ERM had no conflicts of interest to serve as the Department's EIS contractor notwithstanding that three ERM experts had done work for "TransCanada and other oil companies within the past three years."³⁷

On April 22, 2013, representatives of 11 additional organizations sent a letter to OIG to request that OIG initiate an investigation into the Department's selection of ERM as the SEIS third-party contractor. The letter cited "misleading disclosures on ERM's conflict of interest

³⁴ On September 28, 2012, OIG reviewed and accepted documentation showing that the Department had implemented the steps necessary to close the three recommendations issued in the previous report. The Department (1) redesigned its process for using third-party contractors, including the organizational conflict of interest screening process and (2) filled a full-time Civil Service NEPA Coordinator position with staff who have experience and expertise in handling NEPA issues and the EIS process.

³⁵ During 2011, Cardno ENTRIX completed its contractual obligations to help prepare the Keystone XL EIS under the 2008 permit application. As discussed previously, an SEIS was needed to address the changed route through Nebraska and other new issues associated with the 2012 permit application.

³⁶ The Department maintains a public Web site, where it posted announcements on the Keystone XL project, at <http://www.keystonepipeline-xl.state.gov/>.

³⁷ The April 8, 2012, letter is available at <http://checksandbalancesproject.org/2013/04/09/cbp-calls-for-state-dept-investigation-into-keystone-xl-consultants-conflicts-of-interest/>.

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questionnaire; the Department's failure to independently verify ERM's statements; potential conflicts of interest between ERM and entities that may benefit from Keystone XL; the Department's apparent attempt to conceal ERM employees' prior work experience on TransCanada projects; and whether the Department violated its own conflict-of-interest screening guidelines."³⁸

OIG's Office of Investigations conducted a preliminary inquiry based on those April 2013 allegations and determined that the matter did not warrant opening a criminal investigation.

On September 18, 2013, the OIG Office of Audits initiated this follow-up review of the process used to select ERM.

On October 30, 2013, 24 organizations (many of which signed the April 8 and April 22 letters) sent OIG a letter, again urging an inquiry and requesting, among other things, that ERM be disqualified from acting as the Department's SEIS contractor based on alleged concealment of connections with parties with interests in Keystone XL. The letter further asserted that the Department had failed to independently verify ERM's statements denying the existence of any conflict of interest.³⁹

On January 31, 2014, the Department issued the Final SEIS and posted it to its Web site with additional related documents including organizational conflict of interest material provided by ERM and others.⁴⁰ The Department had previously provided the organizational conflicts of interest documents to OIG during the course of OIG's review. The Final SEIS is not a decisional document on whether to approve or deny the proposed project but is a technical assessment of the potential environmental impacts related to the proposed pipeline. Keystone XL is now in the National Interest Determination/Final Decision phase.⁴¹

Review Objective

OIG conducted this follow-up review to determine (1) whether the process used by the Department in selecting a third-party SEIS contractor followed prescribed guidance and (2) whether the process used by the Department to review third-party contractor organizational conflict of interest issues was effective.

³⁸ The April 22, 2013, letter is available at <http://www.sierraclub.org/pressroom/downloads/IG-INVESTIGATION-REQUEST-LETTER-4-22-13.pdf>.

³⁹ The October 30, 2013, letter is available at http://libcloud.s3.amazonaws.com/93/81/6/3298/Linick_Letter_Final.pdf.

⁴⁰ The additional information regarding potential organizational conflicts of interest disclosed by ERM is available at <http://www.keystonepipeline-xl.state.gov/>.

⁴¹ The National Interest Determination phase involves consideration of many factors, including energy security; environmental, cultural, and economic impacts; foreign policy; and compliance with relevant Federal regulations and issues.

Review Results

Finding A. The Process Used To Select the Department's Third-Party Contractor Substantially Followed Prescribed Guidance

The process used by the Department in selecting a third-party contractor to help prepare the Keystone XL SEIS substantially followed and at times was more rigorous than its prescribed Guidance. In addition, the Department's selection process met the CEQ requirement that the selection be made by the Department.

The Department's published Guidance provides only a general outline for the process. However, the Department officials managing the process drew on their earlier experience to implement the process, especially when no specific direction was prescribed in the Guidance. For example, the Department used a selection panel consisting of six Department officials to review submitted proposals. That panel interviewed each of the three companies that submitted a proposal. Neither the use of selection panels nor interviews are prescribed by the Guidance.

OIG also noted two instances in which the Department made reasonable deviations from portions of the process that are specifically described in the Guidance. However, OIG found that these deviations did not adversely affect the selection process. First, the Department elevated the final selection decision to the Assistant Secretary for OES, whereas the Guidance indicates that the Director of the OES Environmental Policy Office, a lower-ranking official, will make the final selection decision. The Director is a subordinate of the Principal Deputy Assistant Secretary (PDAS) and, in this case, the PDAS and the Director participated as members of the selection panel. As a result, the panel's collective recommendation was forwarded to the PDAS' superior, the Assistant Secretary, for final action. Second, the Guidance states that the Department will share copies of the proposals with the permit applicant so the applicant can verify that no conflicts exist between the potential contractor and the permit applicant. However, in this instance, the Department decided not to share all three proposals with TransCanada because only one potential contractor made it through the Department's screening and assessment of the proposals. The Department did send ERM's proposal to TransCanada, and TransCanada provided the required written certification that it had no conflict of interest with ERM.

Department Guidance for Selecting a Third-Party Contractor to Prepare SEIS and Other Environmental Documents

In response to OIG's February 2012 report, the Department approved its new Guidance in May 2012.⁴² The Guidance establishes the Department's processes for developing a Request for Proposals (RFP), reviewing the proposals, selecting a third-party contractor, and managing the work of a third-party contractor to assist the Department with its environmental reviews.

⁴² *Interim Guidance for the use of Third-party Contractors in Preparation of Environmental Documents by the Department of State* is available at <http://www.state.gov/documents/organization/190304.pdf>.

Preparation of the Request for Proposals

The Department's guidance requires that, in the first instance, the permit applicant prepare a draft RFP for the purpose of soliciting third-party contractors interested in preparing environmental documents. Once the Department receives the draft, it is reviewed and finalized. The Department will circulate the final RFP to a targeted list of contractors (whenever possible, at least seven), publish notice of the RFP in the *Federal Register*, or otherwise publicize the RFP to solicit responses from potential contractors.

If a targeted list of contractors is employed, the Department develops the list after considering any contractors suggested by the permit applicant and obtaining recommendations from other agencies with expertise in similar types of environmental reviews, such as FERC or the Department of Transportation's Pipeline and Hazardous Materials Safety Administration. The Department will normally provide 14 days for potential contractors to submit proposals, and potential contractors must submit the responses directly to the Department.

Selection of the Third-Party Contractor

Department staff screens and assesses proposals on the basis of three criteria: technical adequacy, managerial capacity to address the needs of the project, and potential organizational conflict of interest. A contractor whose proposal does not include an organizational conflict of interest statement or who has an organizational conflict of interest that cannot be mitigated to the Department's satisfaction will be rejected. The Department staff shares copies of proposals with the permit applicant. The permit applicant must then review all conflict of interest materials to verify that the applicant has no organizational conflict of interest with the contractor candidate, or identified subcontractor candidates, that would affect the potential contractor's ability to impartially perform the required environmental services for the Department. The Office of the Legal Adviser conducts the final conflict of interest review.

The Guidance states that the Director of the OES Environmental Policy Office will make the final contractor selection. Following contractor selection, the Department notifies the permit applicant, who negotiates a contract and submits the final contract to the Department for approval.

Department's Implementation of the Guidance To Select Environmental Resources Management, Inc.

In May 2012, the Department hired a NEPA Coordinator with 30 years of experience in the public sector dealing with NEPA and other environmental issues. This action was consistent with the recommendation in OIG's February 2012 report that the Department fill at least one full-time Civil Service position within OES with staff who have experience and expertise in handling NEPA issues and the EIS process. The NEPA Coordinator was involved in the Keystone XL SEIS contractor selection process. In particular, she consulted with other Federal agencies regarding potential third-party contractors, reviewed proposals, interviewed potential third-party contractors, and participated on the contractor selection panel.

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In addition, OES and L/OES officials who had experience with prior pipeline permit applications were also involved in the process. They reviewed proposals, interviewed potential third-party contractors, and participated on the contractor selection panel. In the case of L/OES attorneys, they also conducted the organizational conflict of interest review.

On May 7, 2012, TransCanada submitted a draft RFP to OES and L/OES for review. Department staff reviewed, edited, and approved the RFP. The staff consisted of representatives from ENR, EQT, and L/OES.

The Department sent the final RFP to 10 potential third-party contractors to solicit their responses.⁴³ In accordance with the Guidance, the list was developed by EQT after consulting with Federal agencies with expertise managing environmental reviews of similar types of projects and considering suggestions from TransCanada.⁴⁴ The Department then gave 10 potential contractors 14 days to submit proposals in response to the RFP.

The Department ultimately received proposals from three contractors: Ecology and Environment, Inc.; ICF International; and ERM. The Department then employed a selection panel consisting of six Department officials from OES, ENR, and L/OES to review the three proposals. Although the Guidance does not require use of a panel, the Department had employed a similar panel to select the original Keystone XL EIS contractor in 2008.

OIG interviewed the panel members, who said that they had screened and assessed the proposals on the basis of the three criteria listed in the Guidance: technical adequacy, managerial capacity to address the needs of the project, and potential organizational conflict of interest. Part of the screening process included interviewing representatives from each of the three companies. During these interviews, the representatives made a presentation to the panel about their expertise and ability to perform the work outlined in their proposals.

L/OES attorneys also reviewed the conflict of interest material submitted by each applicant. Their review process is described in Finding B. Panel members also considered potential conflict of interest issues during the selection process, including during the interviews of the potential contractors. However, consistent with the Guidance, the other four panel members ultimately deferred to the two L/OES panel members on conflict of interest issues. As discussed above, the Guidance provides that the Office of the Legal Adviser is responsible for conflict of interest determinations.

⁴³ The contractors were: Cardno ENTRIX; ICF International; Ecology and Environment, Inc.; ERM; AECOM; JBR Environmental Consultants, Inc.; Tetratex, Inc.; CH2M Hill; Mergent, Inc.; and Science Applications International Corporation.

⁴⁴ The Department's NEPA Coordinator obtained lists of recommended contractors from FERC, the Department of Energy, the Department of Transportation's Pipeline and Hazardous Materials Safety Administration, the Department of the Interior's Bureau of Land Management, the Department of Agriculture's Rural Utility Service, and the permit applicant. The NEPA Coordinator created the final list by choosing the 10 contractors who were included in more than one list.

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Only one potential contractor, ERM, made it through the Department's screening and assessment process. Consequently, the Department only forwarded ERM's proposal to TransCanada. Although the Guidance states that the Department will share copies of all the proposals with the permit applicant, in this instance, the Department had already eliminated the other proposals from consideration and therefore did not need TransCanada's review or input on the other proposals. Sharing the eliminated proposals with TransCanada would have contributed nothing to the Department's selection process. OIG concludes that, under these circumstances, it was reasonable to share only ERM's proposal with TransCanada. TransCanada certified that it had no conflicts of interest with ERM.

The panel summarized its assessment and recommendation to select ERM in a decision memorandum sent to the Assistant Secretary for OES. The Assistant Secretary agreed with the panel's recommendation. Although the guidelines require only that the Office Director for EQT make the final determination, the Director, along with his supervisor (the PDAS for OES) served on the selection panel. Accordingly, the selection was elevated to the Assistant Secretary. OIG concludes that, under the circumstances, the elevation was appropriate.

On July 13, 2012, OES advised TransCanada of the Department's selection of ERM. TransCanada and ERM then negotiated over the payment terms of ERM's contract, and TransCanada submitted the final contract for approval to the Department on July 27, 2012.

Finding B. The Process Used To Assess Organizational Conflicts of Interest was Effective

OIG found that the process the Department used to assess organizational conflicts of interest was effective in that (i) a reasonable review was undertaken to independently evaluate ERM's certification that it had no conflict of interest and (ii) the process achieved its intended result. That is to say, L/OES attorneys reviewed all conflict of interest materials submitted by ERM, TransCanada, and others and made additional inquiries on potential issues. Furthermore, L/OES attorneys analyzed this information in a manner consistent with applicable CEQ regulations and guidance, relevant case law, and the Department's Guidance.

OIG's review found that L/OES attorneys gathered sufficient information to conduct an effective conflict of interest review. L/OES attorneys, consistent with CEQ regulations discussed above, focused on whether ERM had a financial or other interest in the outcome of Keystone XL. L/OES attorneys began by reviewing the conflict of interest disclosures submitted by ERM in its proposal. The proposal included a section on ERM's qualifications and experience, including descriptions of energy transportation projects in which ERM provided assistance.⁴⁵ The proposal also included a conflicts of interest section in which ERM stated that it "has no business relationship with TransCanada or its affiliates...."⁴⁶ The proposal package

⁴⁵ "ERM Proposal to United States Department of State, Keystone XL Oil Pipeline Project Request for Proposal No. 6152012 Supplemental Environment Impact Statement Third-Party Contractor Services," at 20-32, is available at <http://keystonepipeline-xl.state.gov/admindocs/index.htm>.

⁴⁶ Id. at 38.

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was posted on the Department's Web site on March 1, 2013, in redacted form to omit information ERM claimed and the Department agreed was confidential business information.

The attachments accompanying the conflicts of interest section of ERM's proposal included an organizational conflict of interest Representation Statement from the ERM project manager, certifying that no conflict existed, as well as a one-page description of the internal procedures ERM followed to identify potential conflicts of interest⁴⁷ and an additional certification from the project manager acknowledging that avoiding an "[organizational conflict of interest] is an ongoing obligation" for ERM.⁴⁸ ERM also submitted answers to a 13-question organizational conflict of interest questionnaire required as part of its proposal. In the answers, signed by the project manager, ERM asserted, among other answers, that ERM had "no existing contract or working relationship with TransCanada" in response to the question asking whether "[w]ithin the past three years, have you (or your organization) had a direct or indirect relationship (financial, organizational, contractual or otherwise) with any business entity that could be affected in any way by the proposed work."⁴⁹ ERM's written response on the questionnaire did not directly answer the question that was asked because it was broad and sought information about existing and past relationships with any business entity that could be affected by the work. Instead, ERM limited its response to existing relationships with one business entity, TransCanada. However, as discussed below, the broader information sought by this question was included in other sections of ERM's proposal (including information about ERM's past work in the oil and pipeline industries and relationships with other business entities), and L/OES attorneys requested and received additional information as needed. ERM's submissions, taken as a whole, provided all of the information required for the Department's conflict of interest analysis.

ERM provided an organizational chart identifying ERM's affiliated companies (including OASIS Environmental, Inc., [OASIS]) and listed 13 employees whom ERM expected to work on the SEIS and provided resumes for each employee. The resumes identified each employee's title, fields of competence, professional credentials, publications and presentations, representative projects, and included a short narrative about the employee's pertinent professional experiences.⁵⁰ The Deputy Project Manager/Cultural Resources Officer listed TransCanada on his resume—specifically, that he had done work for TransCanada on a natural gas pipeline project from 2005 to 2006, for TransCanada on various natural gas pipelines from 2007 to 2010, and for ExxonMobil and TransCanada on the Alaska Pipeline Project from 2010 to 2011. The resumes were publicly posted on the Department's Web site, along with the other ERM material described above, although the Web site versions were redacted to exclude the key representative projects because ERM asserted and the Department agreed that that information was confidential business information.

OIG learned during interviews of L/OES attorneys that they reviewed ERM's submitted information, asked ERM follow-up questions about some information, and took additional steps

⁴⁷ Id. at 39-40.

⁴⁸ Id. at 41.

⁴⁹ Id. at 42-45.

⁵⁰ Id. at 47-74.

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to determine the accuracy of ERM's representations. In particular, the attorneys told OIG that they reviewed ERM's Web site and conducted Internet searches to determine if ERM was doing business with or had done business with TransCanada in the recent past. OIG replicated the L/OES attorneys' review steps based on information they orally articulated and found no evidence of any organizational conflict of interest between ERM and TransCanada. With regard to the Deputy Project Manager/Cultural Resources Officer's prior work for TransCanada, L/OES attorneys told OIG that in accordance with Department Guidance, they concluded that no conflict of interest existed because the prior work did not involve Keystone XL, the employee did not have an ongoing relationship with TransCanada, and the employee would not be called upon to review his own prior work. Notably, however, L/OES attorneys did not document their analysis and conclusions. Following this initial conflict of interest review and subsequent reviews of specific issues, the L/OES attorneys orally relayed their conclusions to the NEPA Coordinator and other Department staff.

The Department's conflict of interest review is an ongoing process that continues throughout the third-party contractor's work for the Department. As part of that process, in July and August 2012, and in July 2013, ERM submitted three supplemental disclosure statements containing information on prior work by ERM affiliates discovered through its ongoing internal conflict of interest review.

The July 2012 supplemental disclosure was in response to an L/OES request for greater detail regarding ERM's internal conflict review. The disclosure detailed ERM's internal organizational conflicts of interest check. Using a list of TransCanada's subsidiaries and affiliates, ERM performed a "Client Representation Check," which is an email inquiry sent to appropriate key personnel throughout ERM asking if there are any ongoing projects that may cause a conflict of interest. ERM also checked all their databases, including the client database, accounting database, and the sales force database.

In its August 2012 supplemental disclosure, ERM stated that OASIS, an ERM affiliate purchased by ERM in 2011, had previously done work on the Alaska Pipeline Project (Alaska Pipeline). The disclosure stated that OASIS had worked as a subcontractor to URS Corporation, an environmental consultant on the Alaska Pipeline. That project was a joint venture of ExxonMobil and TransCanada. Although ERM had disclosed OASIS as one of its affiliates in its original June 2012 SEIS contractor proposal, it did not disclose the Alaska Pipeline work at that time. ERM told OIG that at the time of its original proposal, its management was unaware of this indirect connection to TransCanada through OASIS's work on the Alaska Pipeline.⁵¹ To verify the accuracy of the supplemental disclosure, an L/OES attorney told OIG that he conducted Internet research and had a phone conversation with ERM regarding OASIS to ensure that they understood the nature of the Alaska Pipeline work. L/OES attorneys also made inquiries of ERM to ascertain whether TransCanada or ExxonMobil paid OASIS. L/OES

⁵¹ In the August 2012 supplemental disclosure, ERM erroneously advised the Department that OASIS had been a subcontractor to a consultant of TransCanada and that OASIS's work on the project had been completed by October 2011. In fact, in a July 17, 2013, supplemental disclosure to the Department, ERM stated that OASIS had been a subcontractor to ExxonMobil and its work was completed in June 2012.

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attorneys found out that ExxonMobil paid URS, as it was the contractor, and URS paid OASIS as its subcontractor.

L/OES attorneys told OIG that they analyzed the disclosure and concluded that the OASIS Alaska Pipeline work did not constitute a conflict of interest under the prescribed guidelines. The prior work did not involve Keystone XL and OASIS did not have an ongoing relationship with TransCanada. However, L/OES attorneys again did not document their analysis and conclusions.

ERM also disclosed to the Department in July 2013,⁵² that a second ERM affiliate, ERM-West, Inc., had also done some work for ExxonMobil on the Alaska Pipeline. To verify the accuracy of this disclosure, the L/OES attorneys told OIG that they followed up with ERM to understand better the circumstances regarding this work, and again had ERM check their billing records to see specifically who paid for the work (ERM advised L/OES that the work had been paid for by URS). L/OES attorneys also told OIG that they reviewed the supplemental disclosure and concluded, as was the case with OASIS and based on a similar analysis, that this previous work on a project other than Keystone XL did not constitute an organizational conflict of interest. L/OES attorneys again did not document their verification of the supplemental disclosures and their conflict of interest analysis and conclusions.

While serving as the Department's SEIS contractor, ERM has also made the Department aware of various ERM business opportunities that have arisen involving other projects and parties. L/OES attorneys thoroughly analyzed each of these disclosures based on both the organizational conflict of interest definition established by CEQ guidance and related case law and the Department's concerns regarding perceived conflict of interest. In responding to these ERM disclosures, the Department was more restrictive than legally required. It attempted to avoid even the appearance of any organizational conflict of interest by asking ERM to turn down some potential work for other parties on other pipelines. The L/OES attorneys' analysis and conclusions regarding these disclosures is adequately documented in the related correspondence.

In sum, OIG finds that the Department's conflict of interest review was effective. L/OES attorneys reviewed disclosure materials provided by ERM and made follow-up inquiries to learn additional details about potential conflict of interest issues, and analyzed the information developed based on CEQ regulations and guidance, relevant case law, and the Department's own Guidance. However, L/OES attorneys did not document their analysis or conclusions, a matter which OIG discusses in greater detail below.

Allegations Regarding Organizational Conflict of Interest

As discussed above, in April and October 2013, both OIG and the Department received communications challenging the accuracy of ERM's conflict of interest disclosures and asserting

⁵² L/OES told OIG that it had continuously reminded ERM that avoiding and disclosing potential organizational conflicts are ongoing obligations.

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conflicts of interest should have raised concerns about ERM. OIG addresses here the allegations and the Department's review of the specific issues that were raised.

ERM Employee Prior Work Histories

A number of communications contend that a conflict of interest exists because one ERM employee assigned to the Keystone XL project had previously worked for TransCanada. As discussed above, L/OES attorneys concluded that the employee's prior work history did not disqualify ERM because it did not constitute an organizational conflict of interest as defined by CEQ regulations and guidance, relevant case law, and Department Guidance. OIG finds that was a reasonable determination.

Partial Redaction of ERM Employee Resumes

Communications have been critical of the Department's public posting of the partly redacted ERM employee resumes discussed above. In particular, they cite the redaction of information about the employees' prior work for TransCanada and at other companies that would benefit from approval of Keystone XL. As discussed above, L/OES attorneys were aware of the work histories and concluded that they did not create an organizational conflict of interest for ERM.

ERM requested the partial redaction of the resumes and other client information in its proposal because ERM considered the client information and employees' prior work on specific projects to be confidential business information. L/OES attorneys told OIG that they had concluded the redacted material was confidential business information and that their analysis of this issue was informed by confidential business information analysis under the Freedom of Information Act (FOIA).⁵³ Client names and non-public work by employees are items that have sometimes been held to be exempt from FOIA disclosure as confidential business information.⁵⁴ It is uncertain whether a court would uphold those redactions if challenged under FOIA, but the Department's decision was not unreasonable. OIG confirmed with FERC that it would also look to FOIA analyses when determining what information to redact or withhold from the public.

⁵³ 5 U.S.C §552(b). Exemption 4 of the FOIA protects from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential." OIG confirmed with FERC that it also uses a similar FOIA-based analysis in determining whether to protect similar information as confidential business information.

⁵⁴ See *Department of Justice Guide to the Freedom of Information Act* (2009 Edition) (the "DOJ Guide"), "Exemption 4," pp 263-356, available at http://www.justice.gov/oip/foia_guide09/exemption4.pdf. As noted on p. 309 of the DOJ Guide, for example, "in some contexts customer names have been withheld because disclosure would cause substantial competitive harm and in other contexts customer names have been ordered released because disclosure would not cause substantial competitive harm." See *RMS Indus. v. DOD*, No. C-92-1545, slip op. at 3, 6 (N.D. Cal. Nov. 24, 1992) (holding that FOIA allowed agency withholding of names and background of key employees and suppliers, customer and subcontractor names, and equipment descriptions submitted in connection with government contract, because "bidders only submit such information if it will not be released to their competitors"); but see *Hecht v USAID*, Civ. Action No. 95-263-SLR, 1996 U.S. Dist. LEXIS 22894 (D. Del. Dec. 18, 1996) (holding that disclosure of "biographical information" about contractor's employees would not cause competitive harm because "possibility of another company recruiting away one's employees is present in nearly every industry").

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However, FERC has not had to consider whether to redact client names or employee work histories from third-party contractor proposals because FERC does not publicly post its contractors' proposals.

It appears that the Department's decision to redact portions of the ERM employees' resumes was reasonable. However, for the reasons discussed in Finding C, the issue of keeping the public better informed warrants greater attention from the Department.

ERM an "Energy Concern?"

Communications also questioned the veracity of ERM's "No" to the question in the conflicts of interest questionnaire: "Are you (or your organization) an 'energy concern?'"⁵⁵ An L/OES attorney advised OIG that in his opinion, ERM's response to the question was not incorrect because the concept of "energy concern" does not include environmental consultants like ERM. OIG confirmed that the "energy concern" question is a carryover from FERC's conflict of interest questionnaires. FERC officials told OIG that "energy concern" is not a defined term and that responses to the question have never proved significant in their selection process. L/OES attorneys also told OIG that they are considering removing this question from the Department's conflict of interest questionnaire because it is too broad and because it is a FERC concept not relevant to issues likely to be faced by the Department. Under these circumstances, OIG finds that L/OES's treatment of ERM's response to the "energy concern" question was reasonable.

ERM's Other Work for TransCanada

One communication, the October 30, 2013, letter to OIG from 24 organizations states that ERM's prior work for TransCanada should have raised concerns about ERM. The letter stated that "ERM has worked for TransCanada at least since 2011 on the Alaska Pipeline Project." As discussed above, the relationship between ERM, its two subsidiaries (OASIS and ERM-West, Inc.), and TransCanada concerning the Alaska Pipeline Project was reviewed by L/OES attorneys. They concluded that none of those relationships constituted an organizational conflict of interest as defined in applicable regulations, case law, and guidance. OIG finds that to be a reasonable determination.

⁵⁵ As defined in the FERC Handbook (available at <http://www.ferc.gov/industries/hydropower/enviro/tpc/tpc-handbook.pdf>) and in the Department's Guidance, the term "energy concern" includes any person: (1) significantly engaged in the business of developing, extracting, producing, refining, transporting by pipeline, converting into synthetic fuel, distributing, or selling minerals for use as an energy source, or in the generation or transmission of energy from such minerals or from wastes or renewable resources; (2) holding an interest in property from which coal, natural gas, crude oil, nuclear material or a renewable resource is commercially produced or obtained; (3) significantly engaged in the business of producing, generating, transmitting, distributing, or selling electric power; (4) significantly engaged in development, production, processing, sale or distribution of nuclear materials, facilities or technology; and (5) significantly engaged in the business of conducting research, development, or demonstration related to an activity described in (1) through (5) or any person significantly engaged in conducting such research, development, or demonstration with financial assistance under any Act the functions of which are vested in or delegated or transferred to the Chair of the [FERC].

ERM's Work for Other Energy Companies Involved in Canadian Tar Sands

The letters to OIG also questioned the veracity of ERM's answer of "No" to the question on the conflict of interest disclosure questionnaire: "Within the past three years, have you (or your organization) had a direct or indirect relationship (financial, organizational, contractual or otherwise) with any business entity that could be affected in any way by the proposed work?" The October 30, 2013, letter cites publicly available documents showing that between 2009 and 2012 ERM "worked for over a dozen of the largest energy companies involved in the Canadian tar sands. These companies stand to benefit if Keystone XL is built...."

As previously discussed, ERM's written response to the questionnaire did not provide a complete response to the question referenced above. ERM's answer to this question was "No. ERM has no existing contract or working relationship with TransCanada."⁵⁶ However, ERM included in other parts of its proposal and supplemental submissions all of the information, including identification of its other clients and work, sought by the Department for its conflict of interest analysis. L/OES attorneys were aware that some of those clients and some of the work was directly or indirectly related to the oil industry and pipeline projects. According to L/OES, such a connection was insufficient under the Department's prescribed guidance, as well as under applicable law and regulations, to constitute a conflict of interest, let alone a conflict of interest of sufficient import to warrant ERM's disqualification. L/OES attorneys told OIG that they did not regard ERM's answer to be misleading or that ERM's experience with energy companies impaired its objectivity. OIG finds the Department's conclusions to be reasonable.

ERM's American Petroleum Institute Membership

The communications also cite the fact that ERM is "a dues-paying member of the American Petroleum Institute, a staunch advocate for Keystone XL and the tar sands industry.... This membership should have raised concerns about possible bias from ERM on the project." An L/OES attorney stated that he did not consider membership in an industry or trade organization to be a disqualifying organizational conflict of interest.⁵⁷ In this case, OIG finds that to be a reasonable conclusion.

In conclusion, OIG found that the Department's review of the issues raised in the communications was effective and that most of the review occurred prior to the receipt of those communications.

⁵⁶ ERM told OIG that it had qualified the answer because it intended this "no" only as an answer regarding relationships with TransCanada.

⁵⁷ Membership in a business or trade association does not establish any of the circumstances defined in governing authority as constituting an "organizational conflict of interest" as described in the Department's prescribed guidance.

Finding C. The Department Should Enhance Documentation and Disclosure of the Third-Party Contracting Process

OIG finds that the Department's current Guidance, while exceeding current CEQ requirements, can be improved further. The Department could improve transparency of the process by providing more background information and detail regarding the third-party contractor selection and conflict of interest review processes, including how the Department defines organizational conflict. The current Guidance is silent concerning both the documentation required to memorialize the processes and public disclosure of information regarding the processes. Areas for improvement should include more thoroughly describing the selection and organizational conflict of interest review processes, addressing required documentation of the processes, and maintaining appropriate public disclosure. These improvements would benefit all stakeholders and may help avoid future misperceptions of the processes.

The Department's Guidance for the Use of Third-Party Contractors Needs Additional Details Regarding Background and Context

The Department's selection of ERM was its first use of the current Guidance.⁵⁸ This first application has resulted in the identification by OIG and the Department of opportunities to improve the Guidance and the underlying processes.

The current Guidance does not provide complete background information or context regarding the Department's use of third-party contractors. Section III, entitled "Preparation of the Environmental Document," only briefly describes the Department's control of the third-party contractor and the environmental review process. Although the Guidance describes the basic steps of the third-party contractor selection process and identifies the three substantive criteria by which prospective contractors will be assessed, the Guidance does not provide further detail or address documentation of the process.

The Guidance provides a definition of organizational conflict of interest, which was adopted from FERC's guidance, but the Department should further clarify the definition of organizational conflict of interest and explain how the Department applies that definition in reviewing and addressing organizational conflicts of interest. The Department's determinations that ERM had no organizational conflict of interest that would impair its objectivity in its work for the Department are consistent with the narrow definition of organizational conflict of interest established by CEQ guidance and case law. In fact, the Department was even more restrictive than legally required in its conflict of interest review, as the Department attempted to avoid even the appearance of any organizational conflict of interest by asking ERM to turn down potential work for other parties on other pipelines. Amending the Guidance to provide a more thorough

⁵⁸ The Department adapted the current Guidance from FERC guidance, making modifications consistent with OIG's recommendations in its February 2012 report. The recommendations were intended to enhance Department control and reduce the permit applicant's role in the third-party contractor selection process. The Department also obtained input from various sources to develop its Guidance and obtained CEQ review and input before finalizing the Guidance.

explanation of the Department's organizational conflict of interest review would benefit all stakeholders.

Improved Documentation of the Deliberative Process Is Needed

As discussed above, the Department did not fully document its due diligence, analysis, and conclusions regarding potential organizational conflict of interest issues. Very little documentation is specifically required by CEQ regulations and Department guidance, and the Department has met those minimal requirements. However, due to the minimal documentation, OIG had to rely primarily on Department employee interviews to replicate this portion of the conflict of interest review process. Lack of such documentation also could lead to inconsistency in future applications of the process.

Adequate documentation should be a high priority for the Department. By way of example in this case, if the process is not adequately documented, subsequent selections of third-party contractors may not follow a consistent and thorough process. Also, future conflict of interest determinations may not be consistent with prior determinations. Third-party contractor selections and conflict of interest determinations that do not follow or do not appear to follow a consistent process/analysis are more likely to be subject to challenge. Additionally, the risk may be higher for the Department because of its practice of rotating Foreign Service personnel through assignments every few years. Subsequent to the selection of the third-party contractor and issuance of the draft SEIS in this case, Department officials recognized that the internal formal documentation could be improved, and they have begun to more fully document conflict of interest analysis for both the ongoing Keystone XL process and another third-party contractor process currently underway at the Department.⁵⁹

To eliminate uncertainty regarding required documentation of the deliberative process, the Department should determine and specify required documentation in its Guidance or in standard operating procedures. The documentation guidance should be based on what is necessary for effective operation, management, and oversight.

The Department Should Improve Public Disclosure Concerning Aspects of the Selection and Organizational Conflict of Interest Review Processes

In addition to the need for better documentation, the Department should improve its public disclosures concerning its selection and use of third-party contractors. Indeed, in this case, the Department's partial release of information contributed to perceptions of potential conflicts of interest and inaccurate contractor statements to the Department, where none actually exist.

For example, when the Department published the draft SEIS on March 1, 2013, it also posted to its Web site ERM's original proposal and accompanying organizational conflict of

⁵⁹ The Department is reviewing an application for a Presidential permit for the Alberta Clipper Pipeline. Available at <http://albertaclipper.state.gov/>.

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interest materials. However, as discussed above, the Department posted a partially redacted version of ERM's proposal and did not post ERM's supplemental conflict of interest submissions made in July and August 2012 and in July 2013. The partial release of information, without any further explanation, may have contributed to public misperceptions and concerns regarding ERM's disclosure of information and the Department's conflict of interest review. As discussed in Finding B, ERM's initial publicly posted proposal did not disclose that OASIS, an ERM affiliate, worked as a subcontractor on the Alaska Pipeline Project in which TransCanada was a joint venturer. ERM did disclose this fact to the Department in its August 2012 supplemental disclosure. However, the Department waited until January 2014, when the Final SEIS was published, to publicly post that supplemental disclosure.

As the OASIS example illustrates, some of the concerns that have been publicly voiced could have been easily addressed at earlier junctures by other information in the Department's possession or by better explanations of the Department's review and oversight of third-party contractors. Improved public disclosure regarding the process may not resolve all concerns, but it may mitigate some concerns resulting from misperceptions or partial information.

The need for greater transparency does not mean that all Department documentation related to this process must be publicly released. Indeed, FERC staff has advised OIG that they do not release much of the information that was released by the Department in this case. In revising its Guidance and standard operating procedures, the Department needs to integrate the disclosure of appropriate information to ensure all stakeholders have sufficient information to fully understand and maintain confidence in the process, while also protecting information that should legitimately be protected from public release on a case-by-case basis.

OIG recommends that the Department take the following corrective actions to enhance its process for selection of third-party contractors and the associated organizational conflict of interest review.

Recommendation 1. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to more fully articulate its third-party contractor selection and conflicts of interest processes.

Management Response: The Department agreed with the recommendation, stating that it will "provide additional detail in its Guidance with respect to its procedures for selecting third-party contractors and assessing potential conflicts of interest to provide better transparency to the public."

OIG Reply: OIG considers this recommendation resolved, pending further action. The recommendation can be closed when OIG reviews and accepts documentation showing that the Department's Guidance has been revised to more fully articulate its third-party contractor selection and conflicts of interest processes.

Recommendation 2. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal

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Adviser, enhance its Guidance to explain in greater detail the definition of organizational conflict of interest relied upon by the Department.

Management Response: The Department agreed with the recommendation, stating that it will “add additional detail to its Guidance to explain its definition of organizational conflict of interest” and will “provide additional detail on how that definition is applied in reviewing and addressing potential conflicts of interest.”

OIG Reply: OIG considers this recommendation resolved, pending further action. The recommendation can be closed when OIG reviews and accepts documentation showing that the Department’s Guidance has been revised to explain in greater detail the definition of organizational conflict of interest relied upon by the Department.

Recommendation 3. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, specify in its Guidance the documentation required during the deliberative process for selecting third-party contractors and assessing organizational conflicts of interest and establish standard operating procedures to consistently capture and retain this information.

Management Response: The Department agreed with the recommendation, stating that it will “further clarify in its Guidance the kind of documentation and information required for its review and will develop internal procedures to enhance [its] ability to obtain and retain such information.”

OIG Reply: OIG considers this recommendation resolved, pending further action. The recommendation can be closed when OIG reviews and accepts documentation showing that (i) the Department’s Guidance has been revised to specify the documentation required during the deliberative process for selecting third-party contractors and assessing organizational conflicts of interest and (ii) the Department has established standard operating procedures to consistently capture and retain this information.

Recommendation 4. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to integrate a process for public disclosure of appropriate information.

Management Response: The Department agreed with the recommendation, stating that it will “enhance its Guidance to describe how information provided by third-party contractors will be disclosed to the public, where appropriate, and the circumstances in which information may be protected from public release.”

OIG Reply: OIG considers this recommendation resolved, pending further action. The recommendation can be closed when OIG reviews and accepts documentation showing that the Department’s Guidance has been revised to integrate a process for public disclosure of appropriate information.

List of Recommendations

Recommendation 1. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to more fully articulate its third-party contractor selection and conflicts of interest processes.

Recommendation 2. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to explain in greater detail the definition of organizational conflict of interest relied upon by the Department.

Recommendation 3. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, specify in its Guidance the documentation required during the deliberative process for selecting third-party contractors and assessing organizational conflicts of interest and establish standard operating procedures to consistently capture and retain this information.

Recommendation 4. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to integrate a process for public disclosure of appropriate information.

Scope and Methodology

The Office of Inspector General (OIG) conducted this follow-up review to determine (1) whether the process used by the Department in selecting a third-party SEIS contractor followed prescribed guidance and (2) whether the process used by the Department to review third-party contractor organizational conflict of interest issues was effective. This review is associated with a previous OIG report concerning the Keystone XL permit process.¹ OIG conducted fieldwork for this review from September 2013 to December 2013 in the Washington, DC, metropolitan area.

The review followed the *Council of the Inspectors General on Integrity and Efficiency Quality Standards for Inspection and Evaluation*, January 2012, and conducted such tests and procedures as are considered necessary for the assignment. These standards require that OIG plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the review objectives. OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the review objectives.

To obtain background and criteria for the review, OIG researched and reviewed documentation. OIG also reviewed relevant authorities that apply to the presidential permitting and environmental impact statement processes, such as Executive Order 13337, the National Environmental Policy Act of 1969, White House Council on Environmental Quality regulations, and relevant case law. Additionally, OIG reviewed Freedom of Information Act regulations, the Department of Justice Guide to the Freedom of Information Act, and relevant case law.

To address the review objective, OIG reviewed documentation received from Department officials in the Bureau of Oceans and International Environmental and Scientific Affairs; the Bureau of Energy and Resources; and the Office of the Legal Adviser. This documentation included the Request for Proposals, submitted proposals, supplemental disclosures, and the Department's decision memorandum. OIG reviewed relevant *Federal Register* notices issued by the Department and briefing memoranda and correspondence between the Department and other entities that related to the Keystone XL SEIS third-party contractor. OIG interviewed Department officials and officials from the Federal Energy Regulatory Commission. In addition, OIG interviewed employees from the selected third-party contractor, Environmental Resources Management, Inc.

¹ *Special Review of the Keystone XL Pipeline Permit Process* (AUD/SI-12-28, February 2012) available at <http://oig.state.gov/documents/organization/183864.pdf>.

**Bureau of Oceans and International Environmental and Scientific Affairs
and Office of the Legal Adviser Response**



United States Department of State
Washington, D.C. 20520

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MEMORANDUM

February 20, 2014

TO: OIG/AUD – Norman P. Brown

FROM: OES – Kerri-Ann Jones *KAJ*
L – Newell Highsmith *NH*

SUBJECT: Keystone XL Pipeline Project Compliance Follow-up Review

We have reviewed the Draft Report on the Keystone XL Pipeline Project Compliance Follow-up Review (Report) prepared by the Office of Inspector General (OIG). We have been pleased to work with the OIG in providing documents and information in support of the preparation of the Report. We commend the OIG for the thorough, thoughtful, efficient, and professional manner in which it has conducted the Follow-up Review.

We welcome the Report's findings, including that "the process used to assess organizational conflicts of interest was effective" and that "the Department's process to select ERM either followed or at times was more rigorous than the requirements in the prescribed guidance." We also note and accept the four recommendations suggested by the OIG to improve the process.

Our responses to the recommendations are as follows:

Recommendation 1. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to more fully articulate its third-party contractor selection and conflicts of interest processes.

Response. We agree with this recommendation. The Department will provide additional detail in its Guidance with respect to its procedures for selecting third-party contractors and assessing potential conflicts of interest to provide better transparency to the public.

Recommendation 2. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal

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Adviser, enhance its Guidance to explain in greater detail the definition of organizational conflict of interest relied upon by the Department.

Response. We agree with this recommendation. The Department will add additional detail to its Guidance to explain its definition of organizational conflict of interest. Additionally, the Department will provide additional detail on how that definition is applied in reviewing and addressing potential conflicts of interest.

Recommendation 3. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, specify in its Guidance the documentation required during the deliberative process for selecting third-party contractors and assessing organizational conflicts of interest and establish standard operating procedures to consistently capture and retain this information.

Response. We agree with this recommendation. The Department will further clarify in its Guidance the kind of documentation and information required for its review and will develop internal procedures to enhance our ability to obtain and retain such information. As noted in the Report, the Department has already enhanced its documentation of processes related to third-party contracting for current and upcoming projects, and developing guidance on the documentation process will help ensure consistency in this documentation from project to project.

Recommendation 4. OIG recommends that the Bureau of Oceans and International Environmental and Scientific Affairs, in coordination with the Office of the Legal Adviser, enhance its Guidance to integrate a process for public disclosure of appropriate information.

Response. We agree with this recommendation. The Department will enhance its Guidance to describe how information provided by third-party contractors will be disclosed to the public, where appropriate, and the circumstances in which information may be protected from public release. We note, as reflected in the Report, that the Department may be constrained from releasing certain types of information, primarily personally identifiable information and confidential business information.

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