WESTERN ENERGY CO.

IBLA 88-647 Decided june 21, 1991

Appeal from a decision of the Montana State Office, Bureau of Land Management, denying applications for coal royalty rate reductions on Federal coal leases M-073109, M-42381, M-54711, M-54712, and M-54713.

Affirmed.

1. Coal Leases and Permits: Leases--Coal Leases and Permits: Royalties--Mineral Leasing Act: Royalties

A coal lessee seeking reduction of the royalty rate on production from 12-1/2 percent to 8 percent must show that such relief would encourage the greatest ultimate recovery of coal, advance the interest of conservation, and either be necessary to promote development or be directed to a lease that cannot be successfully operated under the lease terms. Rejection of such an application may be affirmed where the record supports a finding that a royalty reduction is not necessary to encourage the greatest ultimate recovery of the Federally leased coal in that the bypass of any such coal in favor of privately leased coal would be merely temporary.

APPEARANCES: Arthur V. Wittich, Esq., and Edward F. Bartlett, Esq., Butte, Montana, for Western Energy Company.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Western Energy Company (Western) has appealed from an August 4, 1988, decision of the Montana State Director, Bureau of Land Management (BLM), denying its applications for reduction of royalty for five Federal coal leases, M-073109, M-42381, and M-54711 to 54713. Western sought a reduction of the royalty rate from the current 12-1/2 percent to 8 percent under section 39 of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 209 (1988). Appellant sought to qualify under the expanded recovery category of the BLM royalty reduction guidelines issued effective June 30, 1987.

It appears from the record that the Federal leases are part of the Rosebud Mine located in Rosebud County, Montana, which is operated by appellant. As a consequence of the checkerboard pattern of land ownership in the area, the mine consists of a combination of coal leases from the Federal Government, the Burlington Northern Railroad, and the State of Montana. The record shows that Western submitted its applications March 9, 1988, requesting a rate reduction because of the changing conditions in the market served by the five Federal leases, stating:

> We find it necessary to seek a royalty rate reduction as part of our total effort to avert a complete loss of our market share in our traditional upper-midwest market area, and to keep our coal prices to the mine-mouth Colstrip power plants in line with the market. In order to regain parity with the market and be able to compete in our traditional markets, Western Energy Company must attempt to reduce costs in every area which affects its overall coal price.

(Cover Letter of Mar. 9, 1988).

Western's applications noted the disadvantages Montana coal producers were facing in trying to compete with Wyoming Powder River Basin mines for the same market, stating:

> In summary, the competition for coal sales to the upper midwest market is based on the delivered price of coal from the Wyoming Powder River Basin Mines. Wyoming's producers have a number of advantages including lower mining costs, lower production taxes, compliance coal, excess capacity, and competitive transportation rates. This has resulted in a steady erosion of the Rosebud Mines' market share of western coal sales to this market. Only an aggressive pricing strategy based on lowering our production costs can reverse the trend.

(Royalty Reduction Applications at 10).

Although Western's applications recited the competitive pressures which prompted the applications, the specific grounds for the applications were stated as follows: "The basis of this application for federal coal lease royalty rate reduction is that the difference in royalty rates between the federal and adjacent nonfederal leases, within the same operation, makes the federal coal less economically recoverable in the near term" (Royalty Reduction Applications at 12). After comparing the year-to-date weighted average royalty per ton of coal produced from the Federal leases with the weighted average royalty per ton of coal produced from the adjacent Burlington Northern leases, 1/ the applications stated that: "The difference was significant enough that Western revised its 1987 Operation Plan to maximize the production of lower royalty cost nonfederal coal for the next two years." Id.

After reviewing all the data and narrative submitted on each lease by Western, BLM rejected its request, finding that denial was mandated by section 39 of the Mineral Leasing Act, 30 U.S.C. § 209 (1988), because a rate reduction in this case "would not encourage the greatest ultimate

1/ The comparison of royalty rates per ton of production did not include the State lease included in the Rosebud Mine.

recovery and/or a royalty rate reduction would not be in the interest of conservation of natural resources" (BLM Decision at 2 (emphasis in original)). The decision stated:

> The analysis completed April 28, 1988, of the data submit-ted by Western Energy determines that the "* * * applications for royalty reduction do not provide persuasive evidence that any federal coal will be bypassed * * *." The recommendations completed in connection with these reductions dated May 3, 1988, further support this finding in that: "Western Energy's applications strongly suggest a time-delayed recovery of the resource rather than loss due to bypass." Copies of these reports are enclosed.
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> Denial is based on the fact that although the private coal adjacent to the subject federal leases can currently be mined at an economic advantage, the applications do not contain persuasive evidence of permanent bypass or pose a threat to future recovery. [Emphasis in original.]

(BLM Decision at 1).

On appeal, Western alleges in its statement of reasons (SOR) that:

> The weighted average royalty amounts paid by Western on federal leases in 1987 at the 12.5 percent rate were 400 percent greater than those paid on the adjoining private leases, which have a cents per ton rate. The difference was significant enough that Western revised its operating plan to maximize the production of lower royalty non-Federal coal. The revised operation plan will result in the loss of approximately five million tons of Federal coal production during 1988 and 1989. (The 2-year royalty reduction period requested by Western.)

(SOR at 1-2).

Western contends that the BLM decision denying the royalty rate reduction in the absence of a threatened "permanent bypass" of the coal was an abuse of the discretion under section 39 of the Mineral Leasing Act to reduce royalty rates to "encourage the greatest ultimate recovery of coal." Further, appellant argues the BLM royalty reduction guidelines fail to adequately implement the Mineral Leasing Act by improperly restricting the BLM's discretion in this regard. Appellant also asserts that the BLM decision misapplied the expanded recovery criteria of the guidelines, contending that royalty relief is available under this provision when Federal coal is less economically recoverable than coal on non-Federal leases which are part of the near-term mining sequence in the operation. Appellant argues that the guidelines do not require a showing of permanent bypass of the Federal coal, but rather a bypass in the near-term mining sequence of the operation.

Unfortunately, when BLM initially forwarded the administrative record in this appeal, the file contained neither the April 28, 1988, analysis of the data submitted by appellant in support of its applications nor the May 3, 1988, recommendations based thereon. Accordingly, by order of December 6, 1990, the Board directed BLM to provide for our review copies of the reports cited as enclosures with the decision. BLM was provided 30 days in which to submit this additional information and to make any response to Western's SOR. BLM was required to provide a copy of its submission to Western, which was allowed a period of time to respond.

Discretionary authority to grant reductions in production royalties is provided in section 39 of the Mineral Leasing Act, as amended:

> The Secretary of the Interior, for the purpose of encouraging the greatest ultimate recovery of coal, oil, gas, oil shale, gilsonite (including all vein-type solid hydrocarbons), phosphate, sodium, potassium and sulfur, and in the interest of conservation of natural resources, is authorized to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold, or on any tract or portion thereof segregated for royalty purposes, whenever in his judgment it is necessary to do so to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein. [Footnotes omitted.]

30 U.S.C. § 209 (1988). A request for Federal coal lease royalty reduction is properly made by submission of an application containing specified information. 43 CFR 3485.2(c)(2). The authorized BLM officer must consider the request and determine whether relief is warranted. 43 CFR 3480.0-6(d)(6), 3485.2(c)(4).

When BLM originally issued its regulations for its coal management program it emphasized the Department's policy of limiting the exercise of authority conferred by section 209, stating: "This authority to reduce production royalty below that specified in the lease will be used sparingly, if at all, only upon a convincing showing of hardship, and only for a temporary period or periods on any lease." 44 FR 42584, 42607 (July 19, 1979); see Peabody Coal Co., 93 IBLA 317, 325, 93 I.D. 394, 399 (1986).

The Board has recognized BLM's attempt to avoid undercutting statu-tory provisions establishing a minimum production royalty by strictly applying the requirements of the Act. In Peabody we pointed out that there are no circumstances under section 209 which require BLM to reduce royalty, stating:

> The discretionary authority conferred by section 209 enables BLM to exercise prudent business judgment to accept the alternative that best protects the economic interest of the United States as owner of the mineral resource. It necessarily follows that if the circumstances of a given case do not confront BLM with such a choice, the case presents no opportunity for BLM to exercise the

> discretion conferred by section 209. This conclusion is underscored by the fact that section 209 requires BLM to make one of two alternative threshold determinations before its discretionary authority can be invoked: (1) that a reduction "is necessary to promote development," or (2) "the leases cannot be successfully operated under the terms provided therein." On the basis of material that an appellant is required to submit in its application, BLM must be able to find there is a reasonable probability operations would cease or development, recovery, or conservation of the resource would be jeopardized before it can even consider exercising its discretion to grant relief. Otherwise, the Federal mineral owner has nothing to gain by reducing the royalty. [Footnote omitted.]

Peabody Coal Co., supra at 326-27, 93 I.D. at 399-400.

Moreover, we have also pointed out that such reductions are not granted merely because economic circumstances would make the removal of coal more difficult and less profitable in any given case. We have specifically emphasized the fact that:

> It is the lessee, however, not the Government, who assumes the risk arising from changing market conditions and increases in the costs of operations. There is no evidence that Congress enacted section 209 to make BLM the guarantor of its lessee's profits. Rather, * * * section 209 operates to give the Government additional options to protect its interest as owner of the mineral deposit if the ultimate recovery from that deposit is threatened * * *.

Peabody Coal Co., supra at 328, 93 I.D. at 400.

Subsequent to the decision in the Peabody case, BLM published notice of the promulgation of Final Guidelines applicable to the reduction of royalty rates for coal and other solid mineral leases effective June 30, 1987. 52 FR 24347 (June 30, 1987). 2/ The Guidelines state that: "The Secretary's policy provides for a temporary royalty rate reduction to be granted when necessary based upon expanded recovery, extension of mine life, or financial considerations" (Guidelines at 8). Under the Guidelines, BLM is allowed to process applications under the expanded recovery criteria:

> Where a lessee certifies that, without a royalty rate reduction, * * * the lease royalty rate, all geologic and engineering conditions being the same or similar, makes the solid leasable mineral resources identified in the application likely to be bypassed because they are less economically recoverable than

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2/ Although the Final Guidelines were not published in the Federal Register, provisions relating to reduction of royalty for coal leases are codified in section 3485.23 of the BLM Manual.

> resources on non-Federal leases that are part of the near-term mining sequence within the same operation.

(Guidelines at 9). In elaborating on the criteria for reductions based on expanded recovery, the Guidelines provide that:

> These resources [that would be mined as a result of the reduced royalty rate] must be judged by the BLM to be * * * less economically recoverable--and therefore likely to be bypassed--than resources on non-Federal leases with lower royalty rates which are part of the near-term mining sequence within the same operation, all geologic and mining conditions being the same or similar. If a determination is made that a reduction in the royalty rate would encourage the greatest ultimate recovery of the resource, be in the interest of conservation, and promote development of the mineral resources identified in the application, then the application may be approved by the BLM State Director.

(Guidelines at 19).

In support of its application appellant cites the regulatory definition of "bypass coal" found in the regulations at 43 CFR 3400.0-5:

> (d) Bypass coal means an isolated coal deposit that cannot, for the foreseeable future, be mined economically and in an environmentally sound manner either separately or as part of any mining operation other than that of the applicant for either an emergency lease under the provisions of § 3425.1-4 of this title or a lease modification. [3/]

Appellant argues that the "foreseeable future" is coextensive with the life of the royalty reduction request and that adjudication of royalty reduction requests should be governed by our perception of what is likely to happen during the life of the reduction, in this case, 2 years (Royalty Reduction Application at 17).

The BLM memorandum of April 28, 1988, upon which the recommendation to reject appellant's application was based, noted that, if the reduction is granted, the applicant proposes to mine an additional 4,989,428 tons of Federal coal during the 2-year period in addition to the 7,578,100 tons of Federal coal to be mined under the existing plan. The attachments to the memorandum examined the projected impact of the requested reduction in the four producing areas of the mine. In Area A the report noted that, without the reduction, mining would be restricted primarily to coal leased from

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3/ The definition of bypass coal owes its origin to the coal leasing moratorium of the 1970's where an exception was recognized for the leasing of coal deposits which would otherwise be bypassed by existing operations and hence lost. See Natural Resources Defense Council v. Hughes, 454 F. Supp. 148, 156 (D.D.C. 1978); 44 FR 16804 (Mar. 19, 1979) (explanatory preamble to proposed 43 CFR Subpart 3425).

Burlington Northern rather than Federal coal, resulting in a reduced production of Federal coal of approximately 1.7 million tons. The report noted that:

> One of the reasons for this mining scenario is that the terms of Western Energy's BN [Burlington Northern] leases are due to be readjusted during June of 1989. The mining of as much BN coal as possible before June of 1989 would likely save Western Energy and their customers money. The savings would result if BN succeeds in getting a higher royalty rate than the present * * * cents/ton rates.

(Attachment 1 to April 28 memorandum). The report indicates that the 1.7 million tons of Federal coal the mining of which would be deferred during the 2-year period "would not be physically lost or of such marginal value to the applicant (or subsequent parties) that it would not likely be recovered." Id. Similarly, with respect to Federal coal in Areas B, C, and D, which would be mined during the 2-year period of the requested royalty reduction, the report noted that the coal would not be lost or rendered uneconomic to recover.

Based upon this memorandum and report, the Chief, Mining Regulation Section, Montana State Office, BLM, recommended in a May 3, 1988, memorandum that the application for royalty reduction be denied. This recommendation became the basis for the BLM decision. The recommendation was based on the conclusion that a "qualifying criteria [sic] would be loss of resource not a time-delayed recovery of the resource" (May 3 Memorandum at 2 (emphasis in original)). The memorandum concluded that it would not be proper to reduce the royalty if, as the analysis indicated here, the coal would ultimately be recovered without a reduction.

[1] We find this application of the Royalty Reduction Guidelines to be consistent with the both the statutory and regulatory criteria for royalty reduction. The Secretary is authorized to reduce the royalty "for the purpose of encouraging the greatest ultimate recovery of coal * * * and in the interest of conservation of natural resources * * * whenever in his judgment it is necessary to do so in order to promote development." 30 U.S.C. § 209 (1988); see 43 CFR 3485.2(c)(1). The expanded recovery provision of the BLM Royalty Reduction Guidelines implements this authority. This provision allows reduction where Federal leased coal resources are "less economically recoverable--and therefore likely to be bypassed--than resources on non-Federal leases with lower royalty rates which are part of the near-term mining sequence within the same operation" (Guidelines at 19). Application of this provision is subject to the express qualification that "a determination is made that a reduction in the royalty rate would encourage the greatest ultimate recovery of the resource, be in the interest of conservation, and promote development of the mineral resources identified in the application." Id. This Board has held that:

> [I]t would not be proper to reduce the royalty if the coal would ultimately be recovered and natural resources conserved in the absence of such a reduction. Unless an applicant shows that

> these goals cannot be met without a royalty reduction, the sta-tute [30 U.S.C. § 209 (1988)] confers no authority on the Department to grant such a reduction.

Peabody Coal Co., supra at 328, 93 I.D. at 400. The record before us supports BLM's determination that a royalty reduction was not necessary to encourage the greatest ultimate recovery of coal as development of the Federal lease would be, at worst, merely deferred. 4/

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

C. Randall Grant, Jr.
Administrative Judge

I concur:

Will A. Irwin
Administrative Judge

4/ While BLM decisions necessarily must be based on the information known at the time of the adjudication, we note that subsequent events have supported BLM's determination that reduction of royalty was not necessary to encourage the greatest ultimate recovery of Federal coal.
When BLM responded to this Board's order requiring copies of the Apr. 28 and May 3, 1988, memoranda, it provided the following observation:

"It is pertinent to note that during the two years in question, 1988 and 1989, Western Energy actually mined and paid royalty at the 12.5 percent rate on 12,631,131 tons of Federal coal. This tonnage is in excess of what was proposed for mining if the royalty reductions were granted on the five Federal leases. As of this date, no Federal coal has been permanently bypassed and the mine is operating according to the approved mining and reclamation plans.

"The two coal leases which Western Energy has with the private coal owner, Meridian Minerals Company, were due for renewal June 1, 1989. It is our understanding that the cents per ton royalty rates on these two leases have been brought into line with the Federal rate of 12.5 percent of the value.

"The appellant, Western Energy Company, is being served a copy of this memorandum together with the aforementioned attachments as directed by your office."
(BLM Response at 1).