Editor's note: appealed - aff'd, sub nom. Monsanto Co. v. Watt, Civ. No. 81-4013 (D. Idaho March 8, 1985), aff'd, No. 86-3509 (9th Cir. Sept. 3, 1987) 827 F.2d 483

STAUFFER CHEMICAL CO. ET AL.

IBLA 78-500, etc. Decided September 5, 1980

Consolidated appeals 1/ from decisions of the Director, Geological Survey, affirming Area Mining Supervisors' orders reassessing value of production from phosphate leases for royalty purposes.

Affirmed.

1. Geological Survey--Hearings--Phosphate Leases and Permits: Royalties--Rules of Practice: Appeals: Generally--Secretary of the Interior

Where the Secretary has decided that production from phosphate leases should be valued in accordance with a particular method and what the value should be, the Board's review authority is limited to determining whether the Geological Survey Area Supervisor who issues orders to the phosphate lessees has properly followed the Secretary's instructions. No hearing is required as a prerequisite to the order.

2. Accounts: Generally--Geological Survey--Phosphate Leases and Permits: Royalties--Secretary of the Interior

Where the Department has not formally adopted any methodology for determining the value of production from phosphate leases, but has instead allowed lessees simply to pay royalty based on the minimum value specified in the lease after having advised them that a new method of determining a realistic value was being developed, it may

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1/ See appendix.

assert that royalty was incorrect even after it has accepted these royalty payments, and may impose the method as approved by the Secretary.

APPEARANCES: Fredrik S. Waiss, Esq., San Francisco, California, for Stauffer Chemical Co.; Allan Abbott Tuttle, Esq., Don A. Allen, Esq., J. Gordon Arbuckle, Esq., and Timothy A. Vanderver, Jr., Esq., Washington, D.C., for Beker Industries Corp.; Wm. Charles Carr, Esq., and Dennis M. Olsen, Esq., Idaho Falls, Idaho, for Monsanto Co.; Dennis R. Jones, Esq., Boise, Idaho, for J. R. Simplot Co.

OPINION BY ADMINISTRATIVE JUDGE STUEBING

Stauffer Chemical Corp. (Stauffer), et al., have appealed from the several decisions of the Director, Geological Survey (GS), affirming orders of GS Mining Supervisors (Supervisors) establishing minimum floor prices for phosphate produced from Federal leases. Owing to the similarity of the issues presented therein, we have consolidated them for review.

Under the terms of the leases in question, lessees are liable to pay the Government royalty on leased deposits produced from the leased area. The terms of most of these leases 2/ provide that this royalty shall not be less than $0.25 per ton. As the royalty rate specified in these leases is 5 percent, these provisions effectively establish a minimum value of $5 per ton of mine-run crude ore for the purpose of calculating minimum royalty.

Although the material supplied by GS as the "administrative record" is not complete, 3/ so that it is difficult to state some dates with certainty, it appears that the Branch of Mining Operations (BMO), GS, became concerned as early as September 1973 that the price of phosphate ore was increasing and that this $5 per ton presumptive

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2/ Lease W-24275, held by Stauffer Chemical, provides for a sliding scale of minimum royalty based on the percentage of P_2O_5. However, $0.25 per ton falls in the middle of this scale, so that it would appear that this scale is also based on an effective minimum of $0.25 per ton.

3/ Resolution of these appeals has been delayed by the gross inadequacy of the materials originally forwarded to this Board as the purported "administrative records." It was necessary to issue several orders to supplement the materials originally submitted, with which GS has attempted to comply. GS now asserts that it has exhausted its sources of records, and, although there are clearly some gaps in the record which lessees have pointed out, we are satisfied that it is adequate to allow for full administrative review.

value no longer afforded a viable premise on which royalty calculations could be based. 4/ In April 1974, BMO apparently requested that the Department's Office of Audit and Investigation (OAI) audit lessees' records and establish a value for phosphate rock. This audit was initiated in September 1974, and information was demanded from lessees concerning production, costs, and sales of phosphate produced from the leased areas. OAI explained to lessees that the audit was directly concerned with the payment of royalties under the terms of phosphate leases.

Following an intradepartmental discussion between GS and the Bureau of Mines as to how to establish an accurate value for phosphate production for royalty purposes, the question was submitted to the Secretary for resolution via an option paper on November 20, 1975. Rather than summarily decide the matter, the Secretary convened a meeting of phosphate lessees on December 16, 1975, at which he requested financial and production data from them concerning phosphate values. On December 23, 1975, the Assistant Secretary advised lessees that this material would be reviewed before the Secretary decided what method to adopt.

On May 10, 1976, a second option paper was presented to the Secretary. On May 13 he decided to adopt a specific valuation procedure

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4/ The background to the problem was described as follows in the option paper submitted to the Secretary in May 1976 discussed below:

"In the past, phosphate royalty payments to the Government and the Indians have been based on a flat rate of $0.25 per ton for public land leases and $0.22 - $0.50 per ton for Indian leases depending upon the grade of ore. These flat rates per ton represent minimum allowable royalties calculated under the terms of leases which require a minimum cents per ton royalty payment <u>or</u> a percent of the gross value of mine output -- <u>whichever is the greater</u>.

"In 1967, the Geological Survey completed a study and estimated a reasonable value of mine output to be around $5 per ton. Since a typical royalty rate on public land phosphate leases is 5%, a minimum royalty payment of $0.25 per ton was felt to be reasonable. Also, in 1967, the Bureau of Labor Statistics' (BLS) price indicater beneficiated phosphate rock was 100. In subsequent years, the BLS price index fell below 100 and remained below 100 until 1973. Thus, it was felt that the minimum flat rate royalty of $0.25 per ton was equal to or greater than 5% of the gross value of mine output.

"Since 1973, however, the BLS price index for phosphate rock has reached a level of 400, or four times as great as the 1967 base period level. In spite of this rapid increase in the price of beneficiated phosphate rock and, by implication, the gross value of mine output, royalty payments have continued to be made at the minimum flat rate of $0.25 per ton. Since this minimum rate of $0.25 per ton is based on an assumed 1967 price of mine output of $5 per ton (.05 X $5/ton = $0.25/ton), there can be little doubt that 5 percent of the 'gross value of mine output' must be greater than $0.25 per ton at recent prices."

by initialling options from among several offered to him for consideration on three issues. "Issue 1" was a formulation of the basic question, that is, how to compute the value of phosphate ore for royalty purposes. The Secretary considered two methods, the "assigned profits" and "proportion of profits" methods, and elected to adopt the latter. 5/

Under this method, royalty is the percentage specified in the lease of the "gross value of crude ore," which figure in turn depends directly on the "price of beneficiated rock." "Issue 2" before the Secretary was the corollary question of how to determine this price of beneficiated rock. The Secretary considered three possible methods and elected to adopt "the weighted average of all reported sales (long-term contract and spot market), [used] to calculate a base period price" as the "gross value of all beneficiated rock produced by all lessees." 6/

The option paper on which the Secretary based his choices noted that, "Tables 1 and 2 show the value calculations using the profit allocation methods discussed in Issue 1 and each of the beneficiated rock prices identified in Issue 2." The gross value of crude ore is calculated in Column 1 of Table 1 according to the actual method chosen by the Secretary. This value is set out as 28.2 cents per each

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5/ This method was described therein as follows:

"The Proportion of Profits Method is similar in concept of [sic] the method the Internal Revenue Service uses to calculate the value to be used for depletion allowance calculations. The Proportion of Profits Method would take the cost of mining the raw rock and add the cost of beneficiating the rock to get the total cost of beneficiated product. This total cost (on a per ton of beneficiated rock basis) would be subtracted from the selling price of beneficiated rock to obtain total gross profit. Gross profit is then allocated between the mining and beneficiating processes in proportion with the cost of each process. Mining costs plus mining profit is called the gross value of crude ore and taken to be the appropriate price for royalty calculations. In the event of zero or negative profits, the price of royalty calculations would equal mining costs. Thus, mining costs acts as minimum price for royalty calculations." 1/

1/ As discussed above, current leases set a minimum royalty of $0.25/ton for Federal leases. If mining costs exceeds $5/ton, the minimum royalty set by mining cost would be larger than the $0.25/ton minimum."

6/ "Issue 3" presented to the Secretary for decision was what method to adopt to assure that the price of beneficiated rock, on which royalty is ultimately based under the valuation method which he adopted, remains in conformity with current actual prices. Here, the Secretary opted to require that the price be recomputed at periodic intervals.

percent of P_2O_5 in a ton of crude ore. The table bears the heading "1975," thus showing that the calculation was intended to apply to production in 1975.

On May 17, 1976, Jackson W. Moffitt, GS Area Mining Supervisor for the Utah area, wrote Stauffer to advise it that the Secretary had established a value of 28.2 cents for each P_2O_5 unit in dry ton of phosphate rock, and to direct it to use this value in computing royalty payments due under leases Wyoming 24275, and Utah 14450 beginning June 1, 1976, and until further notice.

On June 22, 1976, the Acting Chief, Conservation Division, GS, sent all area mining supervisors guidelines on how to implement the Secretary's decision. These guidelines provided in part that the value established by the Secretary would be applied to all production after January 1, 1975. On June 27, 1976, Moffitt wrote Stauffer again to correct his earlier communication and to direct it to use this value from January 1, 1975, and to adopt the method specified in these guidelines to provide GS with data needed to recompute the value yearly. Stauffer was ordered to submit data concerning sales of marketable phosphate rock, cost of mining and processing and related production data, and ratio of concentration data, within 30 days after the end of each calendar year. Stauffer was advised that this information would be used to calculate the new royalty rate.

On July 7, 1976, John T. Skinner, GS Area Mining Supervisor for the Idaho area, advised all lessees that all royalty on production after January 1, 1975, would be computed with a minimum value of 28.2 cents per unit of P_2O_5. He also implemented the data-reporting procedures specified in the Conservation Division's guidelines, as had Moffitt earlier.

At various times in late July and early August 1976, lessees filed appeals of the Area Supervisors' orders to the Director, GS, insofar as these orders directed them to recompute royalty for phosphate rock produced between January 1, 1975, and May 31, 1976. Lessees objected to the assessment of royalties based on this valuation method during this period, asserting that the Department could not do so retroactively, and that full and final payment of royalty had been accepted by the Department. The lessees also objected to the 30-day deadline established for submitting data, seeking, rather, to have 90 days within which to do so.

On May 3, 1978, the Director, GS, issued his decisions in which he observed that the Secretary has the authority to determine value for purposes of determining royalty, that the lease terms and regulations set forth criteria by which the Secretary may establish a reasonable minimum value of phosphate, and that lessees were obliged to pay royalty based on fair market value when this value exceeded the effective minimum value provided for in the leases, i.e., $5 per ton of crude ore. The Director approved the reassessment of royalty due from January 1, 1975, rejecting lessees' argument that the Department was retroactively reassessing value for royalty purposes by so doing, and finding instead that the Government was collecting royalty under the terms of the lease which had been in effect in identical form since lessees' acceptance of the lease terms. The Director approved lessees' request to have 90 days following the end of the calendar year in which to file the required sales and production data. Lessees filed timely notices of appeal of the Director's decisions to this Board insofar as they directed lessees to recompute royalty from January 1, 1975, through July 6, 1976.

Monsanto has requested that a hearing be held on issues of fact.

[1] The sole issue presented in these appeals is whether lessees may be directed to recompute royalty on phosphate ore produced from these leases between January 1, 1975, and May 31, 1976, on the basis of a prescribed value of 28.2 cents per each percent of P_2O_5 contained therein. The Secretary has already ruled on this question in his decision of May 13, 1976, and he concluded that royalty should be recalculated according to a specific method which prescribes this figure as the value for royalty purposes. Where the Secretary, the chief executive officer for the Department, has previously ruled on issues presented in an appeal to this Board, the Board's review authority is limited to determining whether the Secretary's instructions in this decision have been properly followed. Texas Oil and Gas Corp., 46 IBLA 50 (1980); Belco Petroleum Corp., 42 IBLA 150, 153 (1979); Woods Petroleum Corp. 12 IBLA 247 (1973); Marvin E. Weaster, 10 IBLA 227 (1973); see Kreuger v. Morton, 539 F.2d 235, 237 (D.C. Cir. 1976).

We find nothing inimical to the terms of the Secretary's decision in either the Area Supervisors' orders or the Director's decisions affirming these orders. The order from Area Supervisor Moffitt to Stauffer dated May 17, 1976, was incorrect, in that it failed to implement the Secretary's decision to recompute value for the year 1975. However, this order was subsequently superseded and effectively withdrawn by his order of June 27, 1976, in which he correctly directed Stauffer to recompute the value for 1975.

The Area Supervisors' orders specify a minimum value of 28.2 cents per each percent of P_2O_5 in the crude ore produced from these leases from January 1, 1975, to their dates. This is in accord with the Secretary's decision. In considering what method of valuation to adopt, the Secretary had before him specific figures contained in Table 1, Column 1, which were presented to him as an integral part of the options to be considered by him. Therefore, when he adopted the specific valuation method described above, he also adopted the figures specified in this table, including the 28.2 cents per each percent P_2O_5 value.

Appellants confine their appeal to the retroactive application of the formula and minimum price. The propriety of the formula and computation of the minimum price have not been disproven. Under Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950) no hearing is appropriate. The Court ruled at 821:

> The leases which General and Continental have signed and accepted contain the express delegation to the Secretary of the power to fix the value of gas for royalty purposes. Similar contract provisions have been enforced by the courts. (See cases in footnote, United States v. Beuttas, 324 U.S. 768, at page 772, 65 S.Ct. 1000, 89 L.Ed. 1354.) In this situation there is no rule requiring notice or hearing as prerequisite to the order, but the determination is valid in the absence of fraud or mistake so gross as to imply bad faith. It may well be said that the net realization order was not only an exercise of the Secretary's reserved power to determine the value, but that it was altogether reasonable for him to conclude that the gas was worth what the lessees were able to realize therefrom.

The Area Supervisors' orders to recompute royalty using this value for the period from January 1, 1975, forward, notwithstanding the fact that lessees had already submitted royalty payments for this period, embodies also complies with the Secretary's decision, as this decision clearly contemplates applying this value throughout 1975. To interpret the Secretary's decision otherwise would be to rule that he intended to accept a royalty computed on a basis other than value, in derogation of the duty referred to in Continental Oil Co. v. United States, supra. Therein, the Court stated at 821: "In our opinion the net realization order was made in an effort to carry out the Secretary's duty to collect royalty on the basis of value, and it was a proper exercise of the Secretary's reserved power to determine value for royalty purposes." (Emphasis added.) Therefore, we hold that the Area Supervisors' orders properly directed lessees to recompute royalty from January 1, 1975, forward, based on the prescribed value of 28.2 cents per each percent of P[2]O[5], as the Secretary himself directed that this be done.

[2] Even if it were necessary for us to consider the propriety of the Area Supervisors' orders, we would uphold these orders, as lessees have not convinced us that they were improper. Lessees cite Continental Oil Co. v. United States, supra, for the proposition that the Department may not reassess royalty at a value in excess of that previously determined and billed by the Department. However, the Continental case is clearly distinguishable.

The most apparent distinction is that the 1976 computation by the Secretary is not retroactive but rather is a computation based on current data. As discussed, supra, the Court of Appeals in Continental

Oil, supra at 821, recognized the obligation of the Secretary to collect royalty on the basis of value. Under Continental and the facts herein, the Secretary was thus required to set a minimum royalty. To do this, the necessary facts must be compiled. The "weighted average of all reported sales" for a given year (Issue 2, supra) cannot be determined in advance of that year. Here the minimum value for 1975 was determined by May 13, 1976. Lessees were aware that the minimum was being established and were notified of the formula by July 1976. If the Secretary is to discharge his "duty to collect royalty on the basis of value," the figures computed for 1975 values must be applied for 1975 royalties.

There is a second ground for distinguishing Continental. In Continental, the 'Department issued an order on June 4, 1931, which recited that the value of natural gas produced from oil and gas leases in California would be $0.05 per mcf (thousand cubic feet) and that the value of casing-head gasoline produced from the leases would be $0.06 below the San Francisco price of tank-wagon lots, or alternatively would be the amounts actually received by the lessees, if greater than the said amounts. This order was changed on June 23, 1931, to tie the floor value of gasoline to the retail market, but no change in the fixed minimum value of gas was ordered. United States v. General Petroleum Corp., 73 F. Supp. 225, 232 (S.D. Cal. 1946), aff'd, Continental Oil Co. v. United States, supra. On June 7, 1937, more than 6 years after making this official announcement on how the values of lease products would be determined, the Department issued another order again altering this policy to require the "net-realization" 7/ method of valuation where it produced more royalty than the "actual-price-above-specified-minimum" method in effect since 1931. Ibid at 255. Thus, in 1937, the Department invoked a major change in the existing valuation procedure. Before the Ninth Circuit, the Department argued that it could not only apply the new, 1937 method to collect royalties on production realized after the effective date of the order establishing it, but could also use it to recompute royalties from production realized before this date where the lessee had not yet paid them. In the section cited by lessees, the Ninth Circuit held that the method adopted in 1937 could be applied prospectively only, and not to production between 1931 and its issuance.

7/ In the "net-realization" method, the values of the component parts of the gas stream (gasoline, propane, butane, ethane, etc., and the residue gas remaining after these products are removed) are determined after they have been separated from the gas stream by processing. The aggregate of the values of these component parts is determined, and an allowance for the cost of manufacturing (separating) the component parts is subtracted from it. The difference is regarded as the value under the net-realization method, being the net value of the products realized from the crude gas stream.

By refusing to allow the Department to alter retroactively the application of this evaluation method during the time when, as far as lessees could know, this method was still in effect, the Ninth Circuit tacitly recognized in Continental that lessees were entitled to rely on the method which was then in effect because the Department had officially established and announced this specific method in 1931, and had done nothing subsequently to change this policy. The situation in the instant case is materially different, as the Government had not previously formally initiated any policy as to what method would be used to evaluate production, but had simply allowed the use of the of the presumed $5 per ton minimum value specified in the leases. 8/ It works no injustice that the Department is collecting royalty based on the fair market value of lease production during this period, as, unlike Continental, lessees here had no reasonable basis to believe that the prevailing royalty method, i.e., minimum royalty, would remain in effect indefinitely. To the contrary, lessees knew or should have known before and throughout the 18 months in question, that the minimum value royalty method no longer applied and that it was only a matter of time until the Department imposed a more realistic "gross value of the output of the leased deposits" computed by a new method of evaluation, as GS and OAI had explained to lessees in 1974 that they needed data from lessees in order to determine what fair market price was, in view of the sharp rise in phosphate prices.

This fact serves not only to distinguish the instant case from Continental, but also shows the error of lessees' companion argument that the Department, by accepting their monthly reports which state that value was the minimum $5 per ton, and by issuing statements of account based on these reports and accepting payment of the amounts stated therein, exercised its discretion and elected to consider the minimum value as final, so that the Department may not now change the value on which royalty is computed. Where the lessees knew that a new method of evaluating production from these leases was in preparation, they should have known that these monthly reports and statements of account, which contained nothing to indicate that they represented final Departmental determinations of value for royalty purposes, would be subject to revision when the new method was developed. 9/

8/ With one exception (see n.2), the terms in lessees' phosphate leases expressly provide that they pay the Government "a royalty of 5 percent of the gross value of the output of leased deposits at the mine, which royalty shall be not less than 25 cents per ton of 2,000 pounds mine run." As noted above, the effect of the latter half of this provision is to establish a minimum value of $5 per ton of mine-run crude phosphate ore.

9/ Area Mining Supervisor Saarela expressly notified lessees in August 1975 that royalty payments made for July 1975 and thereafter based on the minimum value would be considered as estimated payments which would be retroactively adjusted when the new evaluation methods were adopted. Monsanto was advised no later than during a meeting with the Chief of GS Conservation Division on March 27, 1975, that the new method of calculation would apply to previous production.

Appellants have not shown the agreement necessary for accord and satisfaction or account stated, nor the justifiable reliance for estoppel.

In sum, where the Department has not previously adopted any methodology for determining the value of a lease product, but has instead allowed lessees simply to pay royalty based on the minimum value specified in the lease after having advised it that a new method of determining a realistic value was being developed, it may assert that the royalty paid during a given period was incorrect even after accepting payments of a lesser amount.

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.

Edward W. Stuebing
Administrative Judge

We concur:

Joseph W. Goss
Administrative Judge

James L. Burski
Administrative Judge

APPENDIX

Docket No.	Case Name	Serial Number
78-500	Stauffer Chemical Company	ID 40373, etc.
78-509	Beker Industries Corporation	ID 04
78-510	Monsanto Company	I 011451
78-511	J. R. Simplot	ID 04494