

STAUFFER CHEMICAL CO. OF WYOMING

IBLA 79-261

Decided April 14, 1981

Appeal from decision of the Director, Geological Survey, affirming in part and reversing in part a determination by the Area Mining Supervisor that royalties payable under certain Federal sodium leases, W 0111730 and W 0111731, must be recomputed. GS-14.

Affirmed.

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

Sales commissions are not an allowable deduction in the computation of royalty under sodium leases.

2. Mineral Leasing Act: Royalties--Sodium Leases and Permits: Royalties

To the extent that a commission is granted to distributors or jobbers who purchase soda ash for resale, such a discount represents an allowable deduction from the royalty base; however, where one company has a managing interest in a second company and under a sales agreement the first company purchases all the second company's product and reimburses the second company on the basis of the "net sales proceeds" received by the first company minus a retained commission, the first company cannot be considered a distributor for resale so as to allow the retained commission to be deducted from the royalty base. In such a situation the retained commission is properly characterized as a sales commission and not deductible.

3. Mineral Leasing Act: Royalties--Sodium Leases and Permits: Royalties

In computing royalty under sodium leases where one company has a managing interest in a second company and under a sales agreement the first company purchases all the second company's product, if the first company buys the soda ash for consumption at its own plants, it cannot use an unpublished preferential sales price in determining the amount owed the second company. The second company is properly required to pay royalties on the basis of the published delivered prices paid by the first company's customers less the customary rail freight equalization allowances.

4. Mineral Leasing Act: Royalties--Sodium Leases and Permits: Royalties

In computing royalty under sodium leases where one company has a managing interest in a second company and under a sales agreement the first company purchases all the second company's product, exchange agreement billings by the first company, which amount to discounts, understate the gross value of the soda ash for royalty purposes.

APPEARANCES: Fredrik S. Waiss, Esq., San Francisco, California, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

Stauffer Chemical Company of Wyoming has appealed from a decision of the Director, Geological Survey (Survey), dated January 31, 1979, affirming in part and reversing in part a determination by the Area Mining Supervisor, dated August 26, 1976. The Area Mining Supervisor required appellant to submit retroactive payment of royalties due under Federal sodium leases, Wyoming 0111730 and Wyoming 0111731, with respect to unreported sales due to managing interest commissions for 10 calendar years ending December 1975 and with respect to improper deductions for the years 1972-74. He also directed appellant to recompute royalty bases for the period from January 1, 1976, to August 26, 1976, with respect to unreported sales due to managing interest commissions and for

6 years prior to August 26, 1976, with respect to improper deductions and to institute operating and reporting procedures in accordance with proper computational measures. The Area Mining Supervisor acted on the basis of an audit report issued by the Office of Audit and Investigation, Department of the Interior, covering the years 1972-74.

The Director upheld the Area Mining Supervisor's decision concerning unreported sales and improper deductions, but he allowed sales discounts from the royalty base to the extent that distributors and jobbers purchased soda ash for resale. He also limited the time period for which appellant would be required to recompute and pay royalties to the 6 years prior to the date of the Area Supervisor's August 26, 1976, letter.

Appellant was organized in 1961 by Stauffer Chemical Company (SCC) and Union Pacific Railroad Company to operate soda ash mine and plant facilities located at Big Island, Wyoming. SCC is the managing interest, with 51 percent stock ownership. In addition, pursuant to a sales agreement, dated July 18, 1961, SCC agreed to purchase appellant's "total production of refined soda ash and other saleable refined or processed sodium products" at the Big Island plant.

Under the terms of the sales agreement SCC agreed to pay appellant the "net sales proceeds received by [it] from the resale of [each] shipment less five percent (5%) of such proceeds." With respect to shipments intended for SCC's own consumption, SCC agreed to pay the net sales proceeds which would be derived from customers purchasing for the same end use in like quantities "less five percent (5%) of that amount." In July 1974 the sales agreement was amended, changing the percentage of net sales proceeds retained by SCC and putting a limit on such amounts.

On appeal appellant asserts that there is a "fundamental misconception" of the relationship of appellant to SCC with respect to the sale of soda ash. It contends that SCC never acted as appellant's sales agent and the fact that the soda ash pricing formula provided a percentage discount from the amount realized on resale misled the auditors and Director into categorizing the percentage deduction as a sales commission. Appellant believes that the percentage deduction is "far more comparable" to a distributor discount which the Director specifically recognized as a proper deduction. Appellant alleges that even though SCC buys its entire output, that fact is only a difference in degree and that this "super distributorship" should not be treated any differently from any other distributorship.

Appellant contends that SCC's relationship to it should not influence the determination of the case. It admits that SCC owns 51 percent of its stock and has responsibility for managing and staffing the company, but that in the area of management critical to the appeal, that

of sale of the soda ash, SCC and Union Pacific's Stockholders' Agreement "spells out" the terms in detail. Appellant asserts that even though SCC controls other aspects of its operation, its sales agreement with SCC is bona fide and that the other stockholder's 49 percent interest provides "ample safeguard against any overreaching by SCC."

The pertinent statute requires that in the case of sodium leases the royalty rate shall be applied to the "gross value of the output of sodium compounds and other related products at the point of shipment to market" 30 U.S.C. § 262 (1976). The applicable regulation, 30 CFR 231.61 (1976), sets forth the royalty basis as follows: ^{1/}

The sale price basis for the determination of the rates and amount of royalty shall not be less than the highest and best obtainable market price of the ore and mineral products, at the usual and customary place of disposing of them at the time of sale, and the right is reserved to the Secretary of the Interior to determine and declare such market price, if it is deemed necessary by him to do so for the protection of the interest of the lessor. [Emphasis added.]

^{1/} In his decision the Director cited the language of 30 CFR 231.61 (1978) which shifted the emphasis on setting royalty to the contract sales price. That regulation reads:

"§ 231.61 Value basis for royalty computation.

"(a) The gross value for royalty purposes shall be the sale or contract unit price times the number of units sold, provided, however, That where the Mining Supervisor determines:

"(1) That a contract of sale or other business arrangement between the lessee and a purchaser of some or all of the commodities produced from the lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the commodities, or (2) That no bona fide sales price is received for some or all of such commodities because the lessee is consuming them, the Mining Supervisor shall determine their gross value, taking into account: (i) All prices received by the lessee in all bona fide transactions, (ii) Prices paid for commodities of like quality produced from the same general area, and (iii) Such other relevant factors as the Mining Supervisor may deem appropriate; and provided further, That in a situation where an estimated value is used, the Mining Supervisor shall require the payment of such additional royalties, or allow such credits or refunds as may be necessary to adjust royalty payment to reflect the actual gross value."

Under that language the safeguard insuring fair return to the Government is reliance on the bona fide nature of the transaction. However, the applicable language is that cited above which was in force at the time the leases were issued in 1961, and also when the Area Mining Supervisor issued his decision in 1976.

[1] The Director characterized the arrangement between appellant and SCC in which appellant receives the net sales proceeds of SCC minus the agreed upon commission as one involving a sales commission. As such, he affirmed the Area Mining Supervisor's disallowance of the commissions as deductions. Sales commissions have not been regarded by the Department as an allowable deduction in computing the gross value of a lease product to which royalty attaches. FMC Corp., 54 IBLA 77 (1981). However, the question for resolution is whether such amounts are sales commissions or, as asserted by appellant, distributor discounts which are under certain circumstances deductible.

[2] We cannot agree with appellant that the amounts represent distributor discounts. Under the sales agreement between appellant and SCC, SCC is required to pay appellant the net sales proceeds received by SCC from resale minus a percentage commission. Net sales proceeds is defined for purposes of the agreement as gross sales price to SCC's customers less certain listed possible deductions. 2/ Thus, it is

2/ The listed deductions are:

"(1) The transportation charges from the Big Island plant to the point where delivery is made by Buyer to its customer in cases where Buyer resells such shipment at a price f.o.b. its customer's receiving point and bears such transportation charges.

"(2) Freight equalization if allowed by Buyer to its customer upon the resale of such shipment where such resale is made at a price f.o.b. the Big Island plant. Freight equalization is defined to mean the difference between the higher transportation charges on such shipment from the Big Island plant to the receiving point of Buyer's customer and the lower transportation charges then applicable on a similar shipment from the competing source of supply from which the transportation charges to such receiving point are the lowest.

"(3) Cash discounts.

"(4) The distributor's commission, not exceeding five percent (5%) of the price f.o.b. Seller's plant paid by Buyer's customers, where such shipment is resold for the account of Buyer by a distributor; provided, however, that distributor's commissions on more than ten percent (10%) of the total tonnage of all shipments resold by or for account of the Buyer in any calendar year shall not be considered in determining the total net sales proceeds unless agreed to by Seller.

"(5) Price adjustments granted by Buyer to its customer for

"(a) Non-adherence to Buyer's customer's specifications resulting from failure of Seller to comply with the requirements of Section 3 thereof.

"(b) Soda ash or other refined products damaged in transit, less any amount recovered by Buyer from carriers in connection with such damage; or

"(c) Any other reason where the adjustment represents liability to Buyer's customer properly assumed by Buyer in the normal course of business."

clear that SCC to a large extent controls the "net sales proceeds" flowing to appellant through its influence over the possible deductions for the gross sales price. In addition, under this arrangement appellant is not assured of payment regardless of SCC's ability to dispose of the leased products. The sales agreement does not indicate any duty to pay on the part of SCC, unless there is resale. The key to receipt of payment by appellant for its product is resale by SCC. It cannot be said that SCC is purchasing for resale on its own account. To the extent that a percentage deduction is granted to distributors or jobbers who purchase soda ash for resale, a deduction is allowable. The record does not support a finding that SCC maintains a distributor or jobber relationship with appellant. The "net sales proceeds" less commissions retained by SCC does not represent "gross value at the point of shipment to market," nor does it represent the "best obtainable market price at the time of sale."

Appellant argues that the other stockholder's interest safeguards against any overreaching on the part of SCC because of its managing relationship with appellant. Even assuming this were true, 3/ it does not change the nature of the sales agreement which was analyzed above. The commissions retained by SCC were correctly categorized by Survey as sales commissions and, therefore, not deductible.

[3] Survey also disallowed use of an alleged preferential price with regard to computation of the royalty base for soda ash shipped to three SCC consuming plants in the Chicago, Illinois, area. The prices billed to the consuming plants were based on an unpublished discount price granted by long-term contract to Monsanto Company on shipments to its sodium phosphate plant at St. Louis, Missouri. The price charged to SCC's consuming plants was "about \$ 6 per ton lower than the delivered prices charged to arm's-length customers in the Chicago area" and "was not met by any other Federal lessee who sold soda ash." (Memorandum Audit Report, Stauffer Chemical Company of Wyoming, p. 11.) The auditors stated that the unpublished discount to the Monsanto Company was preferential. They concluded that the discount price bore no relationship to the open market price for soda ash in the Chicago area. Id.

Appellant contends that the sales agreement between it and SCC provided for computation of the royalty base with regard to shipments intended for SCC's own consumption using the price charged "other customers who purchase for the same end use in like quantities" and

3/ The record of the audit report seems to indicate otherwise. See IV B-11/2.4-1 which is a letter from appellant to Union Pacific Railroad Company, dated Jan. 11, 1966. Review of the letter reveals that at one time Union Pacific notified appellant that the retained commission was at variance with the Stockholder's Agreement.

that the price actually used represented the only price for the "end use of sodium silicate manufacture." ^{4/}

Computation of the royalty base must be made using a sale price not less than the "highest and best obtainable market price." 30 CFR 231.27 (1976). This may or may not be represented in a sale where the buyer is purchasing for a particular end use. Thus, it matters little whether the price used by SCC was the "only" price charged for soda ash intended for the manufacture of sodium silicate. Soda ash has a much broader market. Appellant has offered no evidence that the price used by Survey in recomputing the royalty base (published price less rail freight equalization) was not the "highest and best obtainable market price" and that the price used by SCC was not preferential.

[4] The Director also held that for royalty computation purposes the soda ash shipments made by SCC in exchange for soda ash produced by Diamond Shamrock Corporation (Diamond) should be considered purchases by SCC for its own consumption and valued accordingly. These allowances were based on an exchange agreement with Diamond whereby Diamond agreed to ship a guaranteed supply of synthetic soda ash from its Painesville, Ohio, plant to SCC's Morrisville, Pennsylvania, sodium tripolyphosphate plant, thereby saving SCC the additional freight cost on shipments from appellant's Wyoming plant. In return, appellant shipped equal amounts of natural soda ash to Diamond's customers and plant. SCC billed Diamond either at published prices less varying freight allowances or at net prices substantially below published prices. In many instances the freight allowances or price reductions granted to Diamond by SCC exceeded the rail freight equalization which SCC allowed on shipments to its regular customers in the same area. (Memorandum Audit Report, Stauffer Chemical Company of Wyoming, p. 14.)

Appellant contends that freight equalization allowances are recognized as a legitimate deduction from the royalty base and that SCC's sharing of freight savings with Diamond contributes to "more efficient and lower cost manufacturing operations" and should be encouraged.

The exchange agreement resulted in discounts being granted to Diamond either in the form of favorable freight allowances or actual

^{4/} We note that appellant's argument relates only to the price for the end use of sodium silicate manufacture. Two of the three plants in the Chicago area were sodium phosphate plants. Only the Joliet, Illinois, plant was a sodium silicate plant. The Memorandum Audit Report, p. 11, indicates that the prices billed to SCC's consuming plants were based on the unpublished discount price granted to a Monsanto sodium phosphate plant. Appellant refers to the Monsanto plant as manufacturing sodium silicate (Appellant's Statement of Reasons, p. 9).

price reductions. They did not result in any "more efficient and lower cost manufacturing operations." They benefited only SCC and Diamond. In effect, SCC transferred raw material purchase expense from SCC to appellant by requiring appellant to accept reduced sales proceeds because of the allowances made by SCC. The exchange agreement prices billed to Diamond understated the gross value of soda ash and distorted the "highest and best obtainable market price," by which the production of soda ash must be gauged in computing the royalty base. The Director properly required recomputation of the royalty based on the published open market price less freight equalization.

Appellant has directed our attention to certain specific language in the Director's decision with which it takes exception. We have reviewed that language and find no reason to disturb it.

Accordingly, 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.

Bruce R. Harris
Administrative Judge

We concur:

Bernard V. Parrette
Chief Administrative Judge

Edward W. Stuebing
Administrative Judge

