

Editor's note: 95 I.D. 89; Reconsideration denied by Order dated Feb. 13, 1989; Appeal filed, No. 91-1079 L (Cl. Ct. April 12, 1991), aff'd in part, rev'd in part, March 1, 1993, 27 Fed. Cl. 699; both sides appealed, DOI appeal No. 93-5149 (Fed. Cir.), ordered Cl.Ct. judgment vacated, (Oct. 23, 1993) Cl. Ct. vacated judgment, dismissed as moot (was settled) (Nov. 16, 1993).

BLACK BUTTE COAL CO.

IBLA 86-361

Decided July 21, 1988

Appeal from a decision of the Director, Minerals Management Service, disallowing certain deductions for transportation and processing expenses and ordering appellant to pay additional royalties on production from coal lease W-6266. MMS-84-0009-MIN.

Affirmed in part, affirmed in part as modified, and reversed in part.

1. Coal Leases and Permits: Royalties--Federal Oil and Gas Royalty Management Act of 1982: Royalties--Mineral Leasing Act: Royalties

Where the language of a negotiated coal lease provides that the value for royalty computation purposes shall be the price received by the lessee as adjusted for transportation and processing costs incurred between the point of delivery from the pit and the point of sale, and it is clear from the record that all transportation costs from the pit to the processing plant were intended to be deductible, the point of delivery from the pit is properly held to be the point when the haul trucks have been loaded in the pit.

2. Coal Leases and Permits: Royalties--Federal Oil and Gas Royalty Management Act of 1982: Royalties--Mineral Leasing Act: Royalties

Royalties, production and severance taxes, black lung taxes, and reclamation fees are properly considered to

be elements of the costs of mining and, as such, no part of these expenses will be allowed to be deducted from value for royalty computation purposes as an indirect cost of transportation or processing.

APPEARANCES: Mary Anne Sullivan, Esq., George W. Miller, Esq., and Jonathan L. Abram, Esq., Washington, D.C., for appellant; Howard Chalker, Esq., Peter J. Schaumberg, Esq., and Geoffrey Heath, Esq., U.S. Department of the Interior, Washington, D.C., for Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

This appeal is brought by Black Butte Coal Company from a November 27, 1985, decision of the Director, Minerals Management Service (MMS), ordering the appellant to pay additional royalties on coal mined on Federal coal lease W-6266. The basis for the decision was the disallowance of credits claimed by appellant for certain expenses charged to the transportation and processing of coal mined from the lease and sold from February 1980 through December 1982.

The coal lease at issue in this case was entered into on April 1, 1976, by the United States and Rosebud Coal Sales Company, appellant's predecessor in interest. Section 5(a) of the lease provides a "production royalty shall be due on Coal extracted by the Lessee from the Leased Lands" in the amount of 10 percent of the gross value of coal produced by strip mining methods and 8 percent of the gross value of coal produced by underground mining. The essence of this dispute involves two provisions of section 5(b)

of the lease critical to the calculation of royalties due thereunder. Section 5(b) provides in relevant part that:

(1) The gross value shall be considered to be the price received by the Lessee, adjusted for transportation and/or processing costs so that it is a measure of the value of the Coal at the mine mouth (or in the case of strip mining that point where the Coal is delivered from the pit) * * *.

(2) The Area Mining Supervisor may make deductions from gross values for costs of preparing and transporting Coal which are incurred by the Lessee between the mine mouth, or in the case of strip mining that point to which the Coal is first delivered from the pit, as designated by the Supervisor, and the point of sale. He will make such deductions only when, in his judgment and subject to his audit, the Lessee provides him with an accurate account of the costs so incurred.

The Director's decision acknowledged that the Black Butte Mine is a large strip mining operation in which coal is mined from several separate pits spread over a broad area. 1/ Bruce M. McKay, an engineer employed by appellant, explained in an affidavit submitted with appellant's statement of reasons for appeal that the mine involves a total of 13 different pits connected by an "extensive transportation network for moving mined coal from the several outlying pits to the central plant for processing and shipment" (Exh. 5 at 3). McKay further stated:

[T]rucks transport the coal out of the pit and along the haul roads to a primary crusher, either at the central plant or at one of the two overland conveyor systems. The coal which is trucked to a primary crusher at an overland conveyor is then moved by the conveyor to the central plant. The "grizzly" is simply the iron bars that protect the opening to the primary crushers; thus, there are grizzlies at the primary crusher in the central plant and at

1/ Lease W-6266 embraces almost 15,000 acres of public lands.

the outlying primary crushers located at the beginning point of each overland conveyor.

Exh. 5 at 6.

The Director's decision explained that the Royalty Management Program (RMP) of the MMS had issued a demand letter dated March 15, 1984, to appellant following a 1983 royalty audit. Although the audit report found that the sale prices used to establish royalty value and the production volumes reported by the lessee were acceptable, payment of additional royalty in the amount of \$3,875,189 and interest was demanded. The demand was based on unauthorized deductions by the lessee from the sale price for costs (direct and indirect) of transportation and processing of the coal prior to sale. 2/ The Director's decision further explained that the RMP had determined that no deductions were allowable in the royalty calculation under section 5(b) of the lease because the point where the coal is delivered from the pit is the point of sale at the railroad line.

The Director in his decision did not accept the position taken by the RMP. 3/ Rather, the Director concluded that the coal is "delivered from the pit" at the point where the mined material is dumped into the grizzly

2/ Of this amount demanded, \$3,837,931.54 was identified as involving improper deductions for transportation and processing costs. The decision of the Director found that the balance of the sum demanded by the RMP letter, involving improper deductions against royalty for advance rental payments, was not at issue.

3/ The Director also expressly rejected appellant's contention that it is "entitled to deduct all expenses incurred after the overburden is removed and the coal is exposed."

serving the pit. Hence, he determined that appellant was entitled to deduct transportation and processing costs incurred after that point. The Director elaborated on those expenses which are deductible and those which are not as follows:

Black Butte may deduct from its sales price direct and indirect costs, as determined by generally accepted accounting principles, and approved by MMS, which are directly attributable to transportation, preparation, and processing activities between the point at which the coal enters the grizzly chute and the point of sale. All costs incurred prior to the coal entering the grizzly chute are not deductible. The following additional costs are not deductible: management fees (not attributable to transportation, preparation and processing activities), royalties, reclamation fees, and taxes.

Exh. 2 at 9. Refusing to uphold RMP's finding that all claimed deductions for transportation and processing costs should be disallowed because of appellant's failure to obtain prior approval of the Mining Supervisor (the deductions came to light in a subsequent royalty audit), the Director ordered appellant for future years commencing with 1986 to pay royalties on the basis of the full sales price subject to filing an application with MMS within 90 days after the close of the calendar year for deductions for costs of preparation and transportation of coal.

In the statement of reasons for appeal, Black Butte argues that the Director erred in holding that the point of delivery from the pit occurs at the grizzly, thus limiting its deduction for transportation costs to those occurring after that point. Appellant notes this would eliminate the deduction for roads and transportation of the coal by truck from the pit to the conveyor belt for that portion of the coal transported by conveyor

and from the pit to the central processing plant for the coal which enters the grizzly at that point. Thus, the only transportation costs allowed would be for the conveyor system, a means of transportation which appellant asserts was not even contemplated at the time the lease was negotiated. Black Butte contends it is entitled to deduct all transportation expenses from the point at which the coal is severed from the pit to the point of delivery to the rail cars.

Appellant also asserts error in the disallowance of certain indirect costs including royalties, reclamation fees, and taxes (including black lung and severance taxes) to the extent they may be allocated to the deductible activities (transportation and processing) which contribute to the value of the coal upon which the royalty is assessed. Appellant further argues that profit, as a cost of capital, is a deductible expense to the extent it may be allocated to deductible expenses.

Finally, Black Butte asserts error in the requirement imposed by the Director that it receive a credit for allowable expenses only after filing a claim for refund within 90 days after the close of each calendar year. Appellant contends there is no authority for this procedure either in the lease terms or the regulations.

In answer to appellant's statement of reasons, MMS contends that mining of coal involves not only severing it from the ground but also bringing it to the surface which would include removal to a point outside the pit. MMS asserts that the operation of frontend loaders to load coal into trucks in

the mine is a part of the mining rather than the transportation process and hence such costs are not deductible. Further, MMS argues that the phrase in section 5(b) of the lease terms referring to the point where coal is "delivered from the pit" necessarily imports a location distinct from the mine pit itself. MMS contends this point is logically construed to be the grizzly to which the coal is delivered as the Director held.

With respect to the issue of indirect costs, MMS notes that royalty is defined as a share of production free of the costs of production. MMS argues that reclamation fees, black lung tax, and state taxes have no relation to transportation and processing. Rather, they are costs of production based on tonnage of coal produced and/or sold which would be incurred even if there were no transportation and processing costs. Similarly, MMS asserts that any overriding royalty paid by the lessee is a component of the value of the coal at the mine and cannot be allocated to transportation and processing costs.

MMS further contends that allowable deductions are limited to costs of transportation and processing and thus no element of profit is properly included in such a deduction. Regarding the requirement to pay royalty on the full value and then make application for approval of deductions after the close of the calendar year, MMS asserts on appeal that once deductions are authorized for the first calendar year, this level of deductions could be taken as payments are made on a monthly basis during the succeeding year, subject to adjustment after the close of the year.

Accordingly, the issues raised by this appeal are twofold. The first controversy entails determining at what point in the process coal is "delivered from the pit" in order to ascertain what transportation and processing costs are incurred thereafter and, hence, are deductible from the sale price of the coal. The second issue is what indirect costs may properly be attributed to transportation and processing.

[1] The language of section 5(b)(1) of the lease clearly states that value for royalty computation purposes shall be the price received by the lessee as adjusted for transportation and processing costs to reflect the value of the coal at the point where coal is delivered from the pit. Section 5(b)(2) of the lease confirms that deductions from the gross value of the coal are authorized for costs of preparing and transporting the coal incurred by the lessee between the point where the coal is first delivered from the pit and the point of sale. Although MMS argues that the phrase delivery "from" the pit requires a finding that delivery must occur at some point remote from the pit, this is not the only logical construction of the phrase. In the case of Hillard v. Big Horn Coal Co., 549 P.2d 293 (Wyo. 1976), the Supreme Court of Wyoming had occasion to examine the question of where mining stops in reviewing the assessment of the value of coal at a strip mine for tax purposes. The Court found that "[m]ining is not completed until the coal has been loaded for removal from the pit" on the rationale that loading of the coal must be completed before further stripping which is part of the mining process, may be accomplished. 549 P.2d at 302.

This construction of the lease term is consistent with the apparent intent of the parties to the lease. Donald Sturm, a director of Peter Kiewit Sons, Inc., ^{4/} and a member of the Black Butte management committee since formation of the joint venture, has stated in an affidavit submitted with the statement of reasons for appeal (Exh. 3) that this lease was carefully negotiated by the parties since it was issued at a time when the Department of the Interior had placed a moratorium on coal leasing (subject to limited exceptions) and was using no standard form lease. Sturm's affidavit relates that a preliminary mining plan was developed in 1974 (Exh. 3G) which detailed the plans for removal of the coal from the pits and transporting it to the central processing facility. He further states:

In negotiating with the Department for a definition of gross value that excluded transportation and processing costs, I understood that the costs of the equipment and facilities described in the preliminary mining plan for removing the coal from each pit, delivering it to the processing facilities, processing it and, finally, delivering it to the point of shipment at the Union Pacific Railroad line at the loadout building, shown as "G" on Figure 13, Exhibit 3G, would be excluded. It was clear to all involved that the lessee would be able to deduct its transportation and processing expenses.

Exh. 3 at 8. This understanding is corroborated in most respects by the affidavit of Hugh Garner (Exh. 4) who, as the Associate Solicitor for Energy and Resources at the time the lease was negotiated, was actively involved in lease issuance. Garner states in his affidavit:

^{4/} Black Butte Coal Company is a joint venture of Wytana, Inc., a Kiewit subsidiary, and Bitter Creek Coal Company, a subsidiary of Rocky Mountain Energy Company.

7. It was my thought that, under the terms of Section 5(b)(1), Rosebud would be entitled to deduct all costs incurred from the point at which coal was extracted from the ground to the point of sale. This included both the costs of transporting coal from each pit to the rail cars, which were to be the point of sale for the coal, and for processes such as crushing, washing and oil spraying, provided those costs were incurred prior to the point of sale.

This understanding is further supported by the fact that the preliminary mine plan called for virtually all transportation of coal from the pits to the central processing facility to be accomplished by trucks rather than conveyor facilities. See Exh. 3G (mine plan); Exh. 5 (McKay affidavit) at 3. Thus, the interpretation urged by MMS would, under the scenario envisioned at the time, have resulted in denying a deduction for virtually all of the transportation costs. When construing the language of contracts, it is fundamental that where the terms are susceptible to more than one meaning, the terms shall be construed in a manner which gives meaning to

the intent of the parties. See 4 S. Williston, A Treatise On The Law Of Contracts | 618 (3d ed. 1961). Accordingly, we find that the point of delivery from the pit occurs when the coal has been loaded into the trucks for transportation from the pits to grizzlies at the overland conveyor or at the processing plant. Applying this rationale, the cost of the loaders used to fill the trucks is a part of the costs of mining as opposed to transportation, but the costs of the trucks and the haul roads constitute transportation costs.

The remaining issue is whether the Director erred in not allowing as indirect costs of transportation and processing the pro rata share of royalties, reclamation fees, and taxes (including black lung and severance

taxes). A subsidiary question raised by appellant is whether the allowance of indirect costs of transportation and processing includes an allocable share of profit.

[2] Appellant's argument proceeds as follows. Under standard accounting practices, certain indirect costs which cannot be directly attributable to any specific phase of an operation are treated as general overhead costs and are apportioned through all phases of the production process in the proportion that other costs at each particular phase contribute to the total value of the product. Appellant contends that since, under its contract, it is permitted to deduct certain transportation and processing costs, it should also be permitted to deduct so much of the general overhead costs as can be apportioned to the transportation and processing phase. It is appellant's position that included in these general overhead costs are the standard reclamation fee, the black lung tax, the State of Wyoming production tax, certain overriding royalties retained by Rosebud Coal Company when it assigned the lease to appellant, and proportionate management fees and elements of profit.

In his decision, the Director, MMS, agreed that Black Butte could deduct those indirect costs "which are directly attributable to transportation, preparation, and processing activities," expressly disallowing those management fees not directly attributable to transportation, preparation, and processing activities, as well as royalties, reclamation fees, and taxes (MMS Decision at 9).

While we do not disagree with appellant's theoretical argument that, under the specific terms of its lease, it may deduct so much of general overhead expenses which are properly allocable to the transportation and processing phase, we substantially agree with the Director, MMS, that the deductions which appellant seeks for royalties, reclamation fees, and taxes are not properly allowable.

We believe that the general fallacy of appellant's argument lies in its assertion that the royalties, reclamation fees, and taxes are not specifically allocable to the mining phase. In its submissions, appellant argues that inasmuch as the amount of the reclamation fees, taxes, and overriding royalty may be dependent upon costs associated with the transportation and processing, such costs are properly allocable to general overhead rather than to mining. Thus, appellant notes that the reclamation tax is assessed at the rate of \$0.35 per ton or 10 percent of the value at the point of sale, whichever is less, while the black lung tax is assessed at the rate of \$0.55 per ton or 4.4 percent of the sales price, whichever is less. See Exh. 6 at 25. Appellant argues, in effect, that since these taxes could be based on costs associated with transportation and processing, 5/ these fees are properly treated as general overhead costs rather than specifically attributable to the mining phase. We do not agree.

5/ There is a certain disingenuousness to appellant's argument as it relates to the black lung tax and the reclamation fee. In point of fact, according to the audit report, the lowest selling price per ton for the period in question was \$21.906 in June 1980. Thus, since both taxes are assessed as the lower of either a fixed rate or a percentage rate, appellant, in reality, never once tendered any payments which were dependent upon any of its production or processing costs. Rather, appellant, for every single month, paid the fixed rate provided in the statute which is determined independent of any transportation or processing costs.

Appellant has confused the question of whether costs are directly attributable to a specific phase with the issue of how they are computed. The obligation to pay the reclamation fee and the black lung tax arises solely from appellant's mining of the coal. Or, to utilize appellant's terminology, the expenditure is directly "caused" by the mining phase.

This is readily apparent if one assumes that, rather than transport and process the coal, appellant sold the freshly mined coal at the mine mouth

to a third party. In such a situation appellant, as the operator, would

be totally liable for the reclamation fee and the black lung tax. The individual who purchased the unprocessed coal would be assessed no costs therefor. Clearly, therefore, the costs of these assessments arise not from the general operations but from the specific act of mining. In this regard, the precedents are well-settled: production, severance taxes, reclamation fees and the like are properly considered to be a cost of production and may not be subtracted from the gross value for Federal royalty computation purposes. See Peabody Coal Co., 72 IBLA 337 (1983); Knife River Mining Co., 43 IBLA 104, 86 I.D. 472 (1979).

Accordingly, we must reject appellant's assertion that it should be permitted to deduct any amounts for reclamation fees, black lung tax, or the Wyoming severance and county ad valorem taxes. 6/

6/ Indeed, since appellant admits that both the severance tax and the ad valorem taxes are based on the value of the coal at the point where the coal "is removed from the pit * * * and prior to any beneficiation or further processing is placed in storage prior to transportation to market" (Exh. 6 at 26), it is difficult to even discern the theoretical basis for its assertion that part of this tax should be allocated to the transportation and processing phase.

Appellant's assertions with respect to the overriding royalty which it pays to Rosebud Coal Company suffers a similar infirmity. Thus, while the amount that it pays may be dependent upon allowable transportation and processing cost deductions, its obligation to pay any amount is directly attributable to the mining phase. Moreover, since royalty has generally been defined as a share of the production reserved to another party, free of the costs of production, royalty has been held to be a component of the value of the coal at the mine not to be apportioned between mining and processing. Hillard v. Big Horn Coal Co., supra at 301. Thus, we must agree with the Director, MMS, that no deduction may be allowed for the overriding royalty which appellant pays to Rosebud Coal Company.

Finally, with regard to the question of whether a share of profit may be allocated as an indirect cost of transportation and processing, we note, as counsel for MMS has pointed out, that deductions are limited to indirect costs attributable to transportation and processing. We also note that while the Director allowed indirect expenses with certain specific exceptions which we have affirmed, he did not purport to decide whether "profit" is a proper element of indirect expenses. While it would seem that costs of capital and costs of debt service may constitute an indirect cost of transportation and processing, we find it premature to rule on the broader question in the absence of an adverse ruling by the Director.

With regard to the question of the deferral of deductions for transportation and processing expenses until the filing of an application therefor within 90 days after the end of the calendar year for which the

deductions are claimed, we note that counsel for MMS has modified this position on appeal. As indicated previously, counsel has stated that once deductions are authorized for the first calendar year, this level of deductions could be taken as payments are made during the succeeding year subject to adjustment after the close of the year. Appellant has indicated that it could accept this approach. Hence, the decision is modified in this respect.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director, MMS, is affirmed in part, affirmed in part as modified, and reversed in part.

C. Randall Grant, Jr.
Administrative Judge

We concur:

Anita Vogt
Administrative Judge
Alternate Member

James L. Burski
Administrative Judge