

WESTERN FUELS-UTAH, INC.

IBLA 90-424

Decided July 8, 1994

Appeal from a decision of the Director, Minerals Management Service, valuing coal produced from the Deserado Mine for royalty purposes and denying in part transportation and coal washing allowances.

Affirmed.

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

Under the pre-1989 regulations governing valuation of coal for royalty purposes, one of the factors to be considered in valuing coal sold under a non-arm's-length contract is the price reported to FERC.

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

Valuation of coal disposed of under a non-arm's-length contract at the higher of a price determined in a fair market value study or the cost of coal reported to FERC by the consuming utility will be affirmed.

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

Inclusion in the royalty valuation of coal disposed of under a non-arm's-length contract of that part of the cost of coal reported to FERC which consists of the cost (interest and amortization of principal) to repay a loan secured for development of the mine is proper. The fact that the payments included by the utility in the cost of coal reported to FERC are repaid by the lessee to the utility which extended the loan for development of the mine does not alter this result.

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

Under coal royalty valuation regulations effective Mar. 1, 1989, the value of coal disposed of under a non-arm's-length contract shall not be less than the gross proceeds accruing to the lessee less relevant allowances. Prices reported to the Energy Information Administration, Department of Energy, by lessee's affiliated coal purchaser, an electric utility, are an appropriate measure of gross proceeds.

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

Under the pre-1989 regulations, a transportation allowance is authorized when coal is valued for royalty purposes at a market point remote from the lease where the production is obtained. Costs of storing and loading the coal are costs of mining and are not allowed as a deduction. Where coal storage and loadout facilities are located offlease because the terrain precludes location on the leasehold, a decision denying a transportation allowance for an overland conveyor extending 1.2 miles from the lease to the loadout facilities will be affirmed.

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

Under the coal royalty valuation regulations effective Mar. 1, 1989, a transportation allowance is authorized for the "reasonable, actual costs incurred by the lessee" for moving coal to a point of sale or delivery remote from the mine and the lease. Movement of coal from the mine portal to storage facilities and loadout facilities of the mine situated offlease because of the terrain on the leasehold is considered part of the mining operation for which a transportation allowance is properly denied.

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

Under the pre-1989 royalty valuation regulations for coal, allowances for washing and transportation of coal are properly limited to certain costs of preparation/ transportation of the coal which enhance the value of the coal prior to sale. A decision to deny washing and transportation allowances for payments made to local governmental entities pursuant to a socioeconomic impact mitigation agreement will be affirmed.

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

Under the coal royalty valuation regulations effective Mar. 1, 1989, transportation allowances are limited to lessee's actual costs for transportation and washing, including operating and maintenance expenses; overhead; and depreciation and a return on undepreciated investment. Socioeconomic impact payments to local government entities do not qualify as directly allocable and attributable operating expenses and, hence, are not an allowable expense.

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OPINION BY ADMINISTRATIVE JUDGE GRANT

Western Fuels-Utah, Inc. (Western-Utah) appeals an April 26, 1990, decision of the Director, Mineral Management Service (MMS), upholding an order determining the value of coal produced from the Deserado Mine for royalty purposes. ^{1/} In addition to appealing the basis of the royalty valuation itself, the appeal also challenges the MMS decision to deny a transportation allowance for an overland conveyor belt to transport coal and to disallow a claim for socioeconomic impact costs paid by appellant when computing an allowance for coal washing and transportation expenses.

Western-Utah, a wholly owned subsidiary of Western Fuels Association, Inc. (Western Fuels) and the Deseret Generation & Transmission Co-Operative (Deseret), was formed for the purpose of developing and operating the Deserado Mine, an underground coal mine located on public lands under Federal coal lease in northwestern Colorado. The Deserado Mine is part of an integrated electric power project which includes the mine itself, an overland conveyor belt for transportation of coal, a railroad transportation system, and the Bonanza Power Plant. All production from the mine is sold to the Bonanza Power Plant, a coal-fired electrical generation facility in eastern Utah, pursuant to a non-arm's-length contract. The Bonanza Power Plant is owned and operated by Deseret, which supplies electricity to six rural electrification associations serving customers in six states. Certain

^{1/} Consideration of this appeal was deferred by the Board at the request of the appellant and with the concurrence of MMS in view of ongoing negotiations with MMS regarding issues "very similar to those now pending before the Board in this case." When settlement negotiations proved unfruitful, appellant filed a second supplemental brief and a motion to supplement the record with copies of certain correspondence between appellant and MMS. Subsequently, MMS filed a brief in response to appellant's submission.

facts regarding the integrated power project are detailed in the Board's prior decision in a separate appeal concerning an application for reduction of the royalty rate and/or waiver of rentals on the Federal coal leases. 2/ With respect to sale of the coal produced from the leases, we related:

On October 28, 1981, [Deseret] and [Western-Utah] * * * entered into a coal sales agreement. Under this agreement, [Deseret] pays [Western-Utah] for coal at the cost of production and transportation. [Western-Utah] also may collect from [Deseret] payments for a post mining reclamation fund and a capital recovery and equipment replacement fund. However, [Western-Utah] does not receive any profit or return on investment from the sale of its coal to [Deseret].

Western Fuels-Utah, Inc., 119 IBLA 231, 232 (1991).

On September 6, 1985, Western-Utah requested a formal determination from the MMS as to the value of coal produced from the Deserado Mine for royalty purposes. Subsequently, on December 20, 1985, Western-Utah applied to MMS for coal washing and transportation allowances for the Deserado mining operation.

By decision dated November 17, 1987, the MMS Royalty Valuation and Standards Division (RVSD) determined that MMS would value the coal for royalty purposes based on the higher of (1) Bonanza Power Plant's cost of delivered coal as reported to the Federal Energy Regulatory Commission (FERC) on FERC Form No. 423, less applicable allowances, or (2) the Norwest market survey figure as adjusted (Decision at 1).

In a separate decision dated November 18, 1987, RVSD approved coal washing and transportation allowances for the Deserado Mine. The coal transportation allowance was limited to the railroad transportation system "[f]rom the Deserado Mine rail loadout facility to the Bonanza Power Plant" and did not include an allowance for the overland conveyor system. The coal washing allowance was granted for the Deserado Mine wash plant, but did not include housing and other socioeconomic costs. Western-Utah appealed both decisions to the Director, MMS. The Director, in his April 1990 decision,

2/ Western-Utah holds six Federal coal leases that are associated with the Deserado Mine. Federal coal lease Nos. C-023703, C-0126669, C-8424, C-8425, and C-44693 provide for a royalty on production of 8 percent of the value of production. Federal coal lease No. D-047201 which provides for a cents-per-ton royalty is not involved in this royalty valuation appeal.

Authority for reduction of production royalties on Federal leases is provided by section 39 of the Mineral Leasing Act which permits the Secretary of the Interior to reduce the royalty "whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein." 30 U.S.C. § 209 (1988).

affirmed RVSD's decisions in relevant part (Director's Decision at 15). From the Director's decision, this appeal ensued.

Three major issues are raised by this appeal. The first concerns the proper regulatory standard for valuation of the Federal leased coal. A second issue involves whether costs associated with the overland conveyer belt and associated loadout facilities are properly allowable as a deduction for transportation expenses. A further issue entails whether socioeconomic impact costs paid to local government entities may be included in the computation of transportation and washing allowances.

I. Coal Valuation

Appellant argues on appeal that the valuation of the Federal leased coal should be based on the fair market value of the coal. Western-Utah asserts that the market value study prepared by its consultant, Norwest Resource Consultants, properly determined the value of the coal, contending that the accuracy of this market value finding was conceded by MMS. ^{3/} Appellant contends the fair market value thus determined is more representative of the "value" of the leased coal than the cost of delivered coal reported by Deseret to FERC. ^{4/} In its supplemental brief, appellant

^{3/} Appellant is incorrect to the extent it implies that RVSD approved the employment of the market survey in all instances. Rather, RVSD indicated that the market value should be used only when it is determined that the comparable f.o.b. mine value of coal in the marketplace exceeds the delivered cost of coal at the Bonanza Power Plant as reported to FERC on Form No. 423, less MMS approved transportation costs (Nov. 17, 1987, Decision at 1).

In all cases, however, where MMS permitted use of the market survey the market survey value as adjusted was equal to or greater than the value reported by appellant on its Form No. 423. Thus, employing this method MMS permitted appellant for sales months December 1985 through April 1987 to use the market survey with no transportation allowances. In those months when the market survey value as adjusted fell below the value reported on FERC Form No. 423 "[b]eginning the sales month of February 1987," MMS directed "the cost reported to FERC [Form No. 423] should be reported as the sales value and the transportation allowance should be reported and taken." Id. at 2.

^{4/} Appellant notes that:

"While for the first three years of its application the MMS decision did not result in significant differences in the calculation of 'value' for royalty purposes, as of 1988 the Norwest 'value' number and the FERC 'cost' number sharply diverged. For 1988 alone the difference in calculation results in as much as a \$1.672 million difference in the amount of royalty paid by Western-Utah. See Supplemental Affidavit of Don Deardorff (September 9, 1988). MMS has not disputed this."

(Appellant's Brief at 8 n.7). Deardorff asserts in his affidavit that the divergence is "based largely on the fact that Deseret and Western-Utah are no longer capitalizing certain development costs, and those costs are now being included in the FERC cost number" (Affidavit of Sept. 9, 1988, at 1).

explains that, after Western-Utah was created, Deseret loaned it money to finance construction of the mine and transportation facilities. Appellant is obligated to repay the loan which it accomplishes by amortizing the debt in the cost of coal sold to Deseret. Appellant contends that, because the amortized cost is repaid to the buyer of the coal, the net effect is a wash transaction between affiliates and, thus, is not properly treated as an element of the value of the coal.

Western-Utah argues that BLM itself has recognized that the delivered cost of the coal was higher than the value of the coal when it granted the lessee a reduction in royalty pursuant to section 39 of the Mineral Leasing Act, 30 U.S.C. § 209 (1988). It is contended that valuing the coal at its cost "ignores the very nature of these cooperative entities and their contractual relationships. Deseret and its members must pay for the coal, and for the power generated at Bonanza, because their take-or-pay contracts obligate them to do so. This is not a competitive market" (Second Supplemental Brief at 8). 5/ Further, appellant relates that "Deseret undertook a major debt restructuring in 1990 in an effort to maintain the economic viability of the overall Bonanza Project," involving a substantial write-down (Second Supplemental Brief at 5). 6/ Western-Utah contends that the entire write-down should be allocated to the portion of the debt used to finance the mine operation. Appellant asserts it is the fuel cost, rather than the cost of generation or transmission facilities, which makes it so hard for Deseret to compete in the power market. 7/

In answer to appellant's brief, MMS asserts that the pertinent regulation identifies several factors which may be utilized in valuing the coal for royalty purposes and that MMS has discretion to determine the most relevant measure of value in a particular case. MMS contends that it is not required to give equal weight to all factors and that the price reported to FERC was reasonably determined to be the most relevant factor. The cost of coal reported by Deseret is asserted to be an appropriate measure

5/ In an affidavit tendered in support of the appeal, Deseret's Chief Financial Officer states that:

"When Deseret began operations in 1980, Deseret's members signed all additional power requirement contracts with Deseret, committing themselves to buy their additional power supply requirements from Deseret. These sales are set at prices aimed at paying Deseret's full costs of production, including the cost of coal produced by and then purchased from Deseret's captive entity, Western-Utah under a 'take or pay' contract." (Affidavit of Soren Sorensen dated Mar. 30, 1993).

6/ Appellant states that "Deseret was forced to go to the Rural Electrification Administration and the other creditors because it could not sell all of the power being generated at the new plant, at prices sufficient to pay all the costs of the operation" (Second Supplemental Brief at 5).

7/ Such a proposal was made by Deseret to MMS while the parties to this appeal were attempting to negotiate a settlement. This suggestion was rejected by letter of Mar. 4, 1993, from the Chief, Valuation and Standards Division, Royalty Management Program, MMS.

of Western-Utah's gross price or value received for the Federal leased coal. MMS argues that "the inter-company interest could not be eliminated from royalty value because Deseret's costs for the coal include the cost of capital incurred to construct and develop the mine" (Supplemental Brief at 3). Inclusion of the interest paid to finance the mine (as opposed to interest incurred to finance power generation or transmission facilities) in the cost of coal is asserted to reflect the reality of this integrated project where "the cost of coal reported to FERC should be equal to the total cost of mining, washing and transportation." Id. at 6.

[1] The relevant regulations in effect at the time RVSD made the royalty value determination provided that for captive operations or other than arm's-length transactions "the District Mining Supervisor shall determine gross value and the point of sale." 30 CFR 203.200(f) (1987). It is not disputed that the coal purchase contract at issue is not arm's-length. With respect to non-arm's-length transactions, the relevant regulation provided in pertinent part that:

MMS shall determine the gross value of such coal taking into account:

(i) Any consideration received or paid by the operator/ lessee in other related transactions.

(ii) The average price paid for coal of like quality produced from the same general area during the Federal lease month.

(iii) Contracts or other business arrangements, between coal producers and purchasers for the sale of coal other than coal produced under such Federal lease, which are comparable in terms, volume, time of execution, area of supply, and other circumstances.

(iv) Mining cost plus reasonable profit margin.

(v) Prices reported to a public utility commission and/or the Federal Energy Regulatory Commission.

(vi) Such other relevant factors as the District Mining Supervisor may deem appropriate.

30 CFR 203.200(g) (1987).

This Board has previously dealt with allegations that MMS abused its discretion under this royalty valuation regulation in applying one of the indicia of valuation set forth in the regulation rather than another. In Lone Star Steel Co., 117 IBLA 96 (1990), appellant argued that MMS improperly applied the regulation by failing to consider either mining costs plus reasonable profit margin on the one hand, or prices reported to a public utility commission or FERC on the other hand in valuing the mined

coal for royalty purposes. 8/ We noted that the discretion of the Secretary in applying the regulatory factors to valuation of production for royalty purposes has been recognized by the courts:

The regulation enumerates several factors to be considered in determining reasonable value, but does not mandate that any particular formula be used to compute reasonable value. In fact, the Associate Director is expressly directed to consider, in addition to the enumerated factors, "other relevant matters." The thrust of the regulation is that the value for royalty computation purposes set by the Associate Director must be reasonable. The only specific requirement in the regulation is that this value be no less than "gross proceeds." Thus this regulation vests considerable discretion in the Associate Director to decide what the "reasonable value" for royalty purposes shall be.

Id. at 105, quoting Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1382 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987). 9/ The Board held in Lone Star that, once it is established from the record that the royalty valuation is supported by one or more of the relevant factors under the regulation, the issue is whether the failure to use one of the other factors renders the valuation unreasonable. Lone Star Steel Co., supra at 105.

[2] The essence of appellant's argument before the Board is that valuation should be based on an objective fair market value standard rather than upon proceeds realized from disposition of the coal. A similar contention was rejected by the court in the Marathon case. In that case, valuation of Marathon's gas was made by MMS on the basis of a net-back approach calculated from sales of liquefied natural gas which was specially processed and shipped by tanker to market in Japan, less certain allowances for costs of processing and transportation. This approach was upheld by the court even though the majority of the gas from the same field was produced and sold for the domestic market at a price which resulted in a lower valuation. The court held that this method was both necessary to ensure that the valuation was not less than the gross proceeds accruing to the lessee and, further, provided a reasonable calculation of the "value of production" at the leasehold. Marathon Oil Co. v. United States, 604 F. Supp. at 1385-87.

8/ In Lone Star the value was set by MMS on the basis of the purchase price paid by appellant for other coal produced from the same seam. 117 IBLA at 103.

9/ The Marathon case entailed application of the royalty valuation regulations promulgated under the Mineral Leasing Act concerning oil and gas production. While the coal royalty valuation regulations in 1987 contained no explicit proviso requiring that the valuation not be less than the gross proceeds received by the lessee/operator, such a consideration would fall within the regulatory scope of "other relevant factors." See 30 CFR 203.200(g)(2)(vi) (1987).

[3] Appellant has not shown that the valuation of the coal by MMS was unreasonable. Notwithstanding the contention that the element of cost consisting of the interest paid on the loan to finance mine development was in one sense a wash transaction for the utility because the interest was repaid by appellant to Deseret, the interest on the funds required to develop the mine was a cost of producing the coal which had to be paid. The cost to repay the loan to develop the mine would have been a part of the cost of producing coal if paid by the lessee to a third-party lender. The result is not different where the loan to finance mine development is obtained through the consuming utility, Deseret, and the cost of the loan is repaid to Deseret. Thus, this cost of developing the mine was an element of the cost of coal paid by the venture which developed the mine and generated and sold the electricity. Further, it appears from the record that this interest element of the cost of coal was recovered from the consumers of electricity. Although appellant contends that its fuel cost figures reported to FERC are not included in the utility's "rate base," it is conceded that fuel costs "are part of the energy charge in a utility's rates" (Western-Utah's Comments on RVSD Field Report (Sept. 12, 1988) at 3). The valuation of the coal for royalty purposes cannot be less than the gross proceeds to the lessee on disposition of the coal even if the proceeds exceed fair market value. See Transco Exploration Co., 110 IBLA 282, 320, 96 I.D. 367, 388 (1989). ^{10/} Accordingly, the decision of the MMS Director must be affirmed to the extent it held that under the 1987 royalty valuation regulations the value is properly based on the higher of the cost of the coal reported by Deseret to FERC or the market based valuation method.

Although the regulation at 30 CFR 203.200(g)(2) (1987) was in effect at the time appellant requested a value determination for the leased coal (September 6, 1985) and at the time RVSD issued its initial decision on November 17, 1987, new valuation regulations were promulgated effective March 1, 1989. Because the royalty valuation decision has prospective effect beyond the date of the initial RVSD decision, the Director also considered the impact of the new regulations.

[4] Effective March 1, 1989, new coal royalty valuation regulations became effective. The regulation at 30 CFR 206.257(c) now provides:

(1) The value of coal from leases subject to this section and which is not sold pursuant to an arm's-length contract shall be determined in accordance with this section.

(2) If the value of the coal cannot be determined pursuant to paragraph (b) of this section [involving arm's-length sales], then the value shall be determined through the application of

^{10/} Appellant argues that the lessee, Western-Utah, and the parent firm, Deseret, should be viewed as a single entity when valuing the coal produced at this captive mine. We find this approach has merit, but that it supports, rather than undercuts, the MMS valuation decision. Thus it appears that the cost of coal recovered by the member utilities from their customers and by Deseret in turn included the cost of mine development.

other valuation criteria. The criteria shall be considered in the following order, and the value shall be based upon the first applicable criterion: [11/]

(i) The gross proceeds accruing to the lessee pursuant to a sale under its non-arm's-length contract (or other disposition of produced coal by other than an arm's-length contract) provided that those gross proceeds are within the range of gross proceeds derived from, or paid under, comparable arm's-length contracts between buyers and sellers neither of whom is affiliated with the lessee for sales, purchases or other dispositions of like-quality coal produced in the area. In evaluating the comparability of arm's-length contracts for the purpose of these regulations, the following factors should be considered: price, time of execution, duration, market or markets served, terms, quality of coal, quantity, and such other factors as may be appropriate to reflect the value of the coal.

(ii) Prices reported for that coal to a public utility commission.

(iii) Prices reported for that coal to the Energy Information Administration of the Department of Energy;

(iv) Other relevant matters including, but not limited to, published or publicly available spot market prices or information submitted by the lessee concerning circumstances unique to a particular lease operation or the salability of certain types of coal.

(v) If a reasonable value cannot be determined using paragraphs (c)(2)(i), (ii), (iii), or (iv) of this section, then a net-back method or any other reasonable method shall be used to determine value. [12/]

11/ MMS acknowledged in comments on the new regulation "that the prioritized valuation criteria procedure is a departure from past practice. The benchmark system has been adopted to provide certainty in valuing coal for royalty purposes."

12/ The discussion of comments in the preamble to the final rulemaking reveals that:

"In the July 15, 1988 notice, the coal industry had commented that in today's weak coal market MMS should not receive a royalty computed on a cost-based contract that exists between affiliates. These comments were based on the premise that in today's environment mining costs often exceed the price for which coal can be sold in the marketplace. Therefore, MMS specifically requested comments on whether the final rules should include a provision whereby royalty value for non-arm's length sales in mine mouth or

The relevant regulations also mandate that valuation of coal for royalty purposes shall not be less than the gross proceeds accruing to the lessee after deduction of certain allowances:

Notwithstanding any other provision of this section, under no circumstances shall the value for royalty purposes be less than the gross proceeds accruing to the lessee for the disposition of produced coal less applicable provisions of paragraph (b)(5) of this section and less applicable allowances determined pursuant to §§ 206.258 through 206.262 and § 206.265 of this subpart.

30 CFR 206.257(g).

Reaching the same valuation result under the new regulations, the MMS Director held that value may not be based on less than the gross proceeds accruing to the lessee and that one reliable indicator of gross proceeds is the cost of the coal as reported by the purchaser. On appeal, counsel for MMS defends the valuation under the revised (1989) regulations on a slightly different basis. MMS now admits that there are no gross proceeds and that, since Deseret is a cooperative rather than a utility, its prices are not reported to a public utility commission (MMS Answer at 9). Hence, MMS

fn. 12 (continued)

captive mine situations should be based principally on current market determinants such as spot prices.

"Several comments were received responding to this specific request. The majority of commentators supported the non-arm's length valuation procedures as proposed by MMS; i.e., the first applicable benchmark but in no case less than gross proceeds. One commentator stated:

"The prices in such [non-arm's-length] contracts nonetheless represents the value of coal to the purchaser, at least to the extent that such contract prices are accepted and passed on to consumers by the appropriate electric utility regulatory body, and they are gross proceeds to the producer. It would be grossly unfair to allow producers to pay a royalty only on the current spot market price of coal when they receive, and electricity consumers pay, far more for the coal."

To these comments, MMS responded:

"The MMS has decided not to disturb the arm's length valuation criteria as listed in the July 15, 1988 notice. Therefore, the first criteria to be applied are market based value determinants. The lessee would be required to compare its non-arm's-length contract with its comparable arm's length contracts and to other comparable arm's length contracts of coal producers in the same area. Using the comparability criteria in paragraph (c)(2) will ensure that long term contracts are compared only to other long term contracts and not to spot contracts. Likewise in valuing a lessee's spot sales contract, only other spot sales contracts will be used. Failing to establish a value using the arm's length comparability test, the lessee would then establish the coal's value using the prices approved by a state public utility commission, or following that prices reported to the Energy Information Administration of the Department of Energy."

54 FR 1515 (Jan. 13, 1989) (emphasis added).

argues that the first applicable criterion for coal valuation under the 1989 regulations is the cost reported to the Energy Information Administration (EIA), Department of Energy. Id. at 9-10.

Disposition of leased coal to an affiliated entity or entities has always posed certain valuation problems and has led to the detailed regulation which is being applied in this case. It appears from the record before us that the lessee is part of a vertically integrated power generation venture whose proceeds on disposition of the coal, realized on the sale of electricity, included the cost of coal reported to the EIA. Accordingly, since March 1, 1989, the MMS royalty valuation decision is properly sustained on the ground that the value of the coal may not be less than the cost of coal reported to the EIA.

II. Transportation Allowance

Regarding the allowance for transportation costs, appellant asserts that costs associated with the overland conveyor system from the mine to the rail loadout should be included since the valuation of the coal used for royalty purposes is the cost at the point of delivery at the power plant. Western-Utah disputes the MMS finding that the conveyor belt constitutes "in-mine transportation" rather than a part of the transportation from the mine to the nearest market. Appellant asserts that "mining and cleaning operations cease once the clean coal leaves the preparation plant and enters the transportation system" (Brief at 17). Appellant avers that the history of the project supports the inclusion of the conveyor system in the calculation of the transportation allowance, noting that it was impractical because of the terrain to build a railroad all the way to the mine (Brief at 14). Western-Utah explains that prior to construction several studies were done to evaluate the transportation alternatives including highway and off-highway trucks, railroad, overland conveyor, and slurry pipeline. Studies concluded that an overland conveyor from the mine to the Bonanza Power Plant was environmentally and economically superior to other alternatives. As shown in the 1980 Environmental Assessment (EA), a 31.1-mile overland conveyor was planned to transport the Deserado coal directly from the mine portal to the power plant. The conveyor would have originated at the clean coal silos, only some 400 yards from the mine entrance (Exh. C, at 2-49 to 2-55). Appellant explains that, because of opposition to the conveyor by regulatory authorities, a railroad was constructed to the power plant and a shorter conveyor was built to the rail loadout point. Western-Utah contends it would be improper to ignore the reasons for the bifurcated transportation system in order to find that the conveyor is a part of the mine operation as opposed to the transportation system.

In answer to appellant's contention, MMS asserts that the rail, loading, and storage facilities are not located at the mine portal because of the lack of available space given the steep terrain (Answer at 10). MMS argues that it is the lessee's duty to place the coal in a marketable condition, there is no way the coal could be marketed at the mine portal, and that the conveyor system is analogous to a gathering system in an oil and gas field, the cost of which is not deductible as a transportation allowance. Id. at 10-11. Disallowance of the conveyor costs is contended to be

consistent with the pre-1989 regulation providing the value of coal for royalty purposes shall be the gross value at the point of sale. While acknowledging that there is not a "sale" under the facts of this case, MMS asserts that the coal could not be sold at that point because of the inability to locate scales for measuring coal or a storage facility for washed coal at that point. Id. at 11-12. MMS argues that the conveyor system is an "in-mine transportation cost" not allowable under the revised regulations.

The MMS Director's decision found that the loading facility has historically been considered by the Department to be the point at which coal is placed in the transportation system, thus making it inappropriate to make an allowance for conveyance of the coal to the loadout point (Decision at 11). The Director acknowledged that the transportation allowance might have been different if appellant "had constructed a mine-to-power-plant conveyor instead of a railroad." Id. at 12.

[5] At the time appellant's application for transportation allowance was filed in 1985, the regulations provided no specific guidance regarding the granting of transportation allowances. The regulations provided, however, that the "value of coal for Federal royalty purposes shall be the gross value at the point of sale, normally the mine * * *." 30 CFR 203.200(f) (1987) (emphasis added). The coal valuation regulation authorized MMS to consider "other relevant factors" in setting the value of the coal. 30 CFR 203.200(g)(vi) (1987). Similar language in royalty valuation regulations pertaining to other leasable minerals has been held to authorize allowance of transportation costs where the value is determined at a market point remote from the lease where the production is obtained. See Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, 171 (1990) (onshore gas transported to first point of sale remote from the field); Shell Oil Co., 52 IBLA 15, 20, 88 I.D. 1, 4 (1981) (cost of transporting offshore oil production to first available market onshore). This principle is applicable to coal royalty valuation and supports an allowance for transportation costs where the valuation is made at a point remote from the mine. See generally Black Butte Coal Co., 103 IBLA 145, 95 I.D. 89 (1988).

Proper application of the transportation allowance under the pre-1989 regulations requires analysis of the facilities at issue. A deduction is not allowed for certain types of expenses. By regulation, "costs of primary crushing, storing, and loading" shall not be deducted from gross value in determining the value for the purpose of Federal royalty. 30 CFR 203.200(h) (1987). The record indicates that appellant requested a transportation allowance "for the cost of moving clean coal from the tailgate of the coal wash plant to the Bonanza Power Plant" including the costs of

the overland conveyor from the wash plant to the slot storage facility, the slot storage facility, the slot storage emergency discharge tower, the conveyor from slot storage to the railroad loadout facility, the railroad loadout facility, and the Railroad Transportation System from the loadout facility to the Bonanza Power Plant.

(MMS Memorandum of July 18, 1988, at Attachment C, Enclosure 1, "RVSD Findings and Conclusions," at 4-5).

The terms of the relevant royalty valuation regulation barring a deduction for costs of storing and loading the coal reflect that, as a general rule, the rail loadout marks the end of the mining and the beginning of the transportation process. 30 CFR 203.200(h) (1987). Related regulations regarding production accounting define the term "mine" to mean "an underground or surface excavation or series of excavations and the surface or underground support facilities that contribute directly or indirectly to mining, production, preparation, and handling of coal or other solid minerals." 30 CFR 216.6(o) (1987). The definition of "facility" includes "a structure(s) used to store or process Federal or Indian mineral production prior to or at the point of royalty determination." 30 CFR 216.6(f) (1987). It appears from the record that the rail loadout facility was located off the lease ^{13/} because the terrain at the mine portal precluded location of the rail loadout on the leasehold. It is the obligation of the lessee to place the coal in a marketable condition. This generally entails placing the coal in a loadout facility where the buyer can readily take possession. Under the relevant regulation, this cost of storing and loading the coal is not deductible from the gross value. 30 CFR 203.200(h) (1987). The fact that the terrain required location of the rail loadout at an off-lease site does not make the conveyor to the coal storage and rail loadout an allowable transportation expense. To the extent that appellant argues that our decision in Black Butte Coal Co., *supra*, requires a different result, we must reject this contention because that case involved the terms of a unique negotiated lease and was not controlled by the regulations at issue here. The acknowledgement by the Director that this facility might have been treated differently if the overland conveyor had been part of a continuous conveyor from mine to power plant as originally proposed is simply irrelevant to the facts at issue.

[6] The coal royalty valuation regulations revised effective March 1, 1989, are more explicit in authorizing a transportation allowance, but we find the result on the facts of this case is the same. Valuation of coal for royalty purposes is subject to applicable coal washing and transportation allowances. 30 CFR 206.257(a). By way of definition, the new regulations provide:

"Transportation allowance" means an allowance for the reasonable, actual costs incurred by the lessee for moving coal to a point of sale or point of delivery remote from both the lease and mine or wash plant, or an approved MMS-initially accepted deduction for costs of such transportation, determined pursuant to this subpart.

30 CFR 206.251. The revised regulations provide in pertinent part:

^{13/} MMS has indicated that the loadout is situated 1.2 miles from lease C-8424.

[W]here the value for royalty purposes has been determined at a point remote from the lease or mine, MMS shall, as authorized by this section, allow a deduction in determining value for royalty purposes for the reasonable actual costs incurred to:

(1) Transport the coal from a Federal or Indian lease to a sales point which is remote from both the lease and the mine; or

(2) Transport the coal from a Federal or Indian lease to a wash plant when that plant is remote from both the lease and the mine and, if applicable, from the wash plant to a remote sales point. In mine transportation costs shall not be included in the transportation allowance.

30 CFR 206.261(a).

In response to comments on the proposed regulations, including a suggestion that a transportation allowance should be authorized if a lessee is compelled by topographical reasons to transport coal from a lease to mine facilities off the lease, MMS sought to clarify what qualifies as "remote" in the preamble to the revised regulations. 54 FR 1503 (Jan. 13, 1989). Regarding coal transportation occurring "in what could reasonably be considered the vicinity of the mine, lease, etc." the preamble noted that such

would constitute de facto mine haulage and would not qualify for a transportation allowance. Coal movement outside the lease boundary from where it was extracted but inside a larger encompassing mine boundary is not unusual. Any coal movement about the mine premise and between mine processing facilities is at the direction of the mine manager, who ultimately exercises control over the flow of coal from the point of extraction through all processing circuits and loadout facilities.

Id. Further, the preamble noted that "[c]oal movement from * * * the portals (in the case of an underground mine) to crushing facilities, preparation plants, surge bins, stockpiles, silos or other storage, loading, or sales facilities of the mine is common trade practice and considered part of the mining operation." Id.

In the context of the present case where the location of the railhead loadout facilities is dictated by the terrain at the mine portal, we find the expenses of the overland conveyor and the loadout facilities are properly considered to be costs of mining rather than an allowable transportation expense. Accordingly, the decision of the Director, MMS, rejecting a transportation allowance for the overland conveyor and the coal storage and loadout facilities at the railhead is affirmed.

III. Socioeconomic Mitigation Costs

With respect to appellant's claim for socioeconomic and housing costs, the MMS Director noted:

The Appellant states that as of December 31, 1987 it had provided approximately 19.4 million in socioeconomic and housing mitigation funding to Rio Blanco County and the City of Rangely, Colorado, as a condition to approval by the County of a special use permit which allowed appellant to construct the Deserado transportation system, wash plant, and mine. The Appellant is seeking a deduction from royalties for costs incurred in obtaining special use permits from Rio Blanco County for the Deserado Mine project. The transportation and coal washing allowances granted to Western-Utah by RVSD did not include socioeconomic and housing costs.

(Director's Decision at 13). The Director affirmed the RVSD decision to the extent that it rejected these impact costs. The request to allow socioeconomic costs paid by the lessee as an element of transportation and washing expenses deductible from the valuation of coal for royalty purposes raises a question of first impression before the Board.

In support of its appeal, Western-Utah explains that during project development it was necessary to secure a permit from local governments within whose jurisdiction the mine and transportation facilities were located. Protracted negotiations ended in June 1981 when Western-Utah signed the "Socioeconomic Impact Mitigation Agreement" for the Deserado mine, Bonanza station and associated facilities with Rio Blanco County, Colorado; the Town of Rangely, Colorado; the local school, hospital, park, sanitation and fire district; the regional library; and the Colorado Northwest Community Hospital. Western-Utah agreed to pay millions of dollars up front and to fund various hospital, housing, school, and other programs over the life of the project. In return Western-Utah received a special use permit from Rio Blanco County (Statement of Reasons (SOR) at 20).

Appellant notes that the mitigation agreement states that Western-Utah had to obtain a permit for the "underground coal mine and associated facilities" which expressly included the "mine and associated railroad transportation systems" (SOR, Exh. E, at 2). Western-Utah contends the agreement was written to address "in substantive detail * * * the impacts anticipated from construction and operation of Unit 1 of the Power Plant and the mining and transportation activity associated therewith." Id. at 11.

The MMS answer contends that the former regulations, while not specifically addressing socioeconomic impact costs, permitted allowances only for actual expenses to enhance the quality of the coal. Under the revised regulations, MMS asserts that the coal washing allowance is limited expressly to reasonable, actual costs incurred to wash the coal. Since the impact payments do not constitute actual expenses of coal transportation or washing, MMS argues that these costs are not allowable as a deduction.

[7] As noted above, the former regulation held to support allowance of transportation costs merely authorized consideration of "other relevant factors" and, thus, was silent regarding particular components of such expenses. 30 CFR 203.200(g)(vi) (1987). The former regulation cited by the Director as supporting the granting of coal washing allowances provided that "[i]f additional preparation of the coal is performed prior to sale, such costs shall be deducted from the gross value in determining value for Federal royalty purposes." 30 CFR 203.200(h) (1987). This regulation also placed limits on allowances by precluding deduction for "costs of primary crushing, storing, and loading; * * * and, other preparation of the coal which in the judgment of the District Mining Supervisor does not enhance the quality of the coal." *Id.* Although these regulations did not specifically address socioeconomic costs, the allowance of deduction of expenses was expressly limited to costs of preparation of coal which actually enhances the quality of the coal prior to sale. Specifically excluded were certain costs including primary crushing, storing, loading, and other "preparation of the coal which * * * does not enhance the quality of the coal." *Id.* We think that the disallowance of deductions for costs in the form of socioeconomic impact payments to local jurisdictions is consistent with the regulations regarding allowances for coal washing and transportation. The socioeconomic impact payments neither improve the quality of the coal nor pay for its transportation to the power plant. Rather, the Socioeconomic Impact Mitigation Agreement which obligates appellant to make the payments indicates that the reason for the compensation agreement is the decision of Deseret to "locate the major tax base associated with the project as a whole (the Power Plant) in the State of Utah" (Appellant's Brief, Exh. E at 5). 14/

[8] The revised regulations dealing with transportation allowances limit the deduction to "the reasonable, actual costs incurred" to transport coal from a Federal lease to a sales point which is remote from both the lease and the mine. 30 CFR 206.261(a). For non-arm's-length or no-contract situations, an allowance is to be "based upon the lessee's actual costs for

14/ The Socioeconomic Impact Mitigation Agreement provides in part:

"M. As a result of the decision by Deseret to locate the major tax base associated with the project as a whole (the Power Plant) in the State of Utah, the adverse fiscal impacts of the project as a whole upon the citizens of the County will be more difficult to mitigate than they would have been had the Power Plant been located in the County. Had the Power Plant been located in the County, the Governmental Entities would have received significant additional tax-based revenues which could have been applied to mitigate anticipated adverse socioeconomic impacts. With the location of the Power Plant in Utah, the governmental Entities will suffer project impacts disproportionate to the tax-based revenues to be generated by the Mine and associated facilities."

(Appellant's Brief, Exh. E, at 5).

transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment * * * or a cost equal to the depreciable investment in the transportation system multiplied by the rate of return * * *." 30 CFR 206.262(b)(2). Allowable operating expenses include: "Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document." 30 CFR 206.262(b)(2)(i). The allowance for coal washing expenses is similarly limited. 30 CFR 206.259(b)(2)(i). We find that socioeconomic impact payments to local governmental jurisdictions do not qualify as a "directly allocable and attributable operating expense."

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:

James L. Burski
Administrative Judge