EXXONMOBIL COAL AND MINERALS COMPANY

IBLA 97- 207 Decided May 21, 2003

Appeal from a decision of the Associate Director for Policy and Development, Minerals Management Service, requiring payment of additional royalty in connection with production from federal coal leases. (MMS-92-0674-MIN.)

Affirmed.

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

The pre-Mar. 1, 1989, regulations governing valuation of coal for royalty purposes prohibit the deduction of the costs of loading from gross value in determining value for Federal royalty purposes. Where the coal purchasers pay fees for loading coal, MMS properly requires the lessee to add those fees to the sales price of the coal to determine value for Federal royalty purposes.

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

The coal valuation regulations effective Mar. 1, 1989, provide that the term “gross proceeds” for royalty purposes includes payments for certain services, including loading coal, to the extent that the lessee is obligated to perform them at no cost to the lessor.


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OPINION BY ADMINISTRATIVE JUDGE ROBERTS

ExxonMobil Coal and Minerals Company (ExxonMobil or Exxon) has appealed an April 30, 1996, decision of the Associate Director for Policy and Development, Minerals Management Service (MMS), requiring payment of additional royalty in connection with production from Federal coal leases comprising the Rawhide and Caballo coal mines near Gillette, Wyoming. The Associate Director found that the fees ExxonMobil receives from coal purchasers for loading coal onto railroad cars must be included as part of the “gross proceeds” upon which royalty must be paid.

We affirm the Associate Director’s decision because the applicable regulations in effect prior to March 1, 1989, and those in effect thereafter, make it unarguably clear that the costs of loading are not deductible from gross value in determining value for royalty purposes and payments for loading received from coal purchasers must be included in determining the gross proceeds upon which royalty is based. See Peabody Coal Co., 139 IBLA 165, 171-72 (1997). Although appellant believes that the special nature of its “precision loading system” (PLS) is such that the fees it receives should not be included as part of the gross value of the coal or gross proceeds of its sale, we find nothing in the pertinent regulations that would justify excluding the fees appellant receives on that basis. If we were to hold that innovations in loading procedures provide a sufficient basis for excluding loading fees, as appellant suggests, the rule that makes those fees part of the gross proceeds for the sale of coal would soon be swallowed by its exceptions as loading systems evolve.

APPLICABLE LAW

[1] The history of this case and the merits of appellant’s specific arguments can be more fully appreciated if we set forth at the outset of this opinion the pertinent provisions of the applicable regulations. As indicated above, there are two sets of regulations applicable in this case: those in effect prior to March 1, 1989, and those in effect thereafter. The pertinent regulations in effect prior to March 1, 1989, provided in part as follows:

(f) Where Federal royalty is calculated on a percentage basis, the value of coal for Federal royalty purposes shall be the gross value at the point of sale, normally the mine, except as provided at 30 CFR 203.200(h).

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(h) If additional preparation of the coal is performed prior to sale, such costs shall be deducted from the gross value in determining

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value for Federal royalty purposes. * * * However, the following shall not be deducted from the gross value in determining value for Federal royalty purposes: costs of primary crushing, storing, and loading * * *


[2] Regulations that became effective on March 1, 1989, provide as follows:

Gross proceeds (for royalty payment purposes) means the total monies and other consideration accruing to a coal lessee for the production and disposition of the coal produced. Gross proceeds includes, but is not limited to, payments to the lessee for certain services such as crushing, sizing, screening, storing, mixing, loading, treatment with substances including chemicals or oils, and other preparation of the coal to the extent that the lessee is obligated to perform them at no cost to the Federal Government or Indian lessor.

30 CFR 206.251 (1994) (emphasis added). The regulations further provide:

[t]he lessee is required to place coal in marketable condition at no cost to the Federal Government or Indian lessor. Where the value established pursuant to this section is determined by a lessee's gross proceeds, that value shall be increased to the extent that the gross proceeds has been reduced because the purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the coal in marketable condition.

30 CFR 206.257(h) (1994) (emphasis added). The term “marketable condition” refers to “coal that is sufficiently free from impurities and otherwise in a condition that it will be accepted by a purchaser under a sales contract typical for that area.” 30 CFR 206.251 (1994) (emphasis added). MMS states that “typical sales contracts in the Gillette, Wyoming area provide for precision loading.” (Answer at 6.)

We agree with MMS that “[t]he preamble to the final rulemaking makes clear that loading coal for shipment is necessary to place coal into marketable condition and that loading costs cannot be deducted from royalty value.” Id. With regard to the marketable condition requirement, the preamble stated:

Marketable condition is the form and condition of leasehold production resulting from the application of normal mining processes. The
established market demands and expects that lease production be in such a condition that it can be accommodated by existing buyer facilities used for receipt, handling, and consumption of leasehold production. With respect to coal, processes commonly applied by mine operators (or lessees) to prepare coal for the market include all operations which extract, sever, or otherwise separate coal from its in-place position in the geologic strata: crushing (to limit upward size), storing, blending, and loading for shipment.

54 FR 1498, 1499 (Jan. 13, 1989) (emphasis added.)

Consideration of this appeal had been suspended at the request of the parties. During that time, the Board issued a decision in Peabody Coal Co., supra, in which we construed and applied the pre-1989 and post-1989 regulations in examining the relationship between the costs of coal loading facilities and the royalty due on the coal that was loaded. Although this decision was issued three years before appellant and MMS filed their pleadings in this case, neither party has referred to it. Nevertheless, it construes and applies the same regulations that govern the disposition of the instant appeal, and fairness is best achieved by reaching similar results in similar cases.

In Peabody, a “rapid load facility” was constructed at Peabody’s Big Sky Mine, and Peabody’s purchaser, Minnesota Power and Light Company, leased the loading facility from its owner, a financial institution. 139 IBLA at 166. Although the purchaser in Peabody did not pay loading fees directly to the coal lessee as occurred in the instant case, the Board nevertheless concluded that MMS correctly required the lessee to include the cash value of the loadout facility in its gross proceeds for the sale of coal. After analyzing the pre-March 1, 1989, regulations, we stated:

It is the obligation of the lessee to place the coal in marketable condition, and this duty generally entails placing the coal in a loadout facility where the buyer can readily take possession. Western Fuels-Utah, Inc., 130 IBLA 18, 31 (1994). Under the express terms of 30 C.F.R. § 203.200(h) (1986), the costs of loading are not deductible from gross value in determining value for royalty purposes. It is irrelevant who performs that activity. See Apache Corp., 127 IBLA 125, 134 (1993). By furnishing the coal loadout facility, Minnesota Power relieved Peabody of part of the expense of loading the coal. Those loading costs, however, are Peabody's responsibility, and the portion of those costs assumed by Minnesota Power may not be deducted from gross value. We find that MMS properly directed Peabody to add the value of these assumed costs to the sales price of the coal to determine
the royalty value of the coal sold to Minnesota Power prior to March 1, 1989.

139 IBLA at 171. The Board then referred to the post-March 1, 1989, regulations quoted above and found that they required the lessee to include the costs of loading the coal in the gross proceeds subject to royalty:

[I]f Peabody shouldered full responsibility for the expenses of loading the coal, those expenditures would be passed on to Minnesota Power in the form of a higher sales price. Since Minnesota Power provides the loadout facility and thereby assumes part of the costs of loading the coal, we conclude that MMS properly required Peabody to include the value of these assumed costs as part of its gross proceeds in determining the royalty value of the coal sold to Minnesota Power.

Id. at 172.

HISTORY

The coal produced from the Rawhide and Caballo mines was transported on the Burlington Northern Railroad (BN), which became concerned during the early 1980's that overloaded coal trains could damage its rails and bridges and that underloaded coal trains would underutilize its equipment. (Dec. 21, 1992, Affidavit of Richard S. Sandgren, Vice President Coal Marketing, BN (hereinafter referred to as Sandgren Affidavit).) In response to these concerns, Exxon installed a precision loading system (PLS) at each of the two mines in 1985.

Coal mined from the Rawhide and Caballo Mines is first loaded into rail cars directly from storage silos located at the mine sites. The precision loading systems at the Rawhide and Caballo mines are located away from the silo loadouts, and this top-off service is offered as a separate service to EXXON's rail carriers/coal purchasers as a way of equalizing the amount of coal in each rail car. The precision loading systems protect the rail carriers' rails and bridges from damage while providing for optimum utilization of the rail equipment.

(Dec. 3, 1992, Affidavit of Michael R. Rayphole, Transportation Coordinator, Exxon (hereinafter referred to as Rayphole Affidavit).)

Prior to the completion of the precision loading systems, BN and Exxon executed two precision loading agreements (one for each mine) under which BN would repay Exxon's cost of the facilities over a period of time on a “per ton” basis, rather than a lump sum payment, monthly payment, or “per rail car” payment.

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(Sandgren Affidavit.) Exxon also directly received fees for precision loading services from two of its customers. (Rayphole Affidavit.)

The events leading up to this appeal began with an MMS audit of royalty payments from October 1, 1983, through September 30, 1989, from coal lease M75-005630-0 which is part of the Rawhide Mine. Prior to the adoption of the Federal Coal Leasing Amendments Act of 1976 (FCLAA), as amended, 30 U.S.C. §§ 201-209 (1994), coal leases provided for royalty on a cents-per-ton basis, so that the loading fees received by Exxon for coal mined under such leases would not affect royalty payments. The amended legislation required payment of an ad valorem royalty, i.e., a royalty based on a percentage of the value of production. See 30 U.S.C. § 207 (1994). When appellant’s leases were readjusted in the 1980's, the cents-per-ton royalty was replaced with an ad valorem royalty. §

On the basis of its audit, MMS’s Houston Compliance Office (HCO) issued a June 30, 1992, decision finding that Exxon had erroneously excluded loading fees from the royalty valuation on the basis of regulations quoted above. HCO further stated:

We determined that a systemic deficiency exists since, as previously mentioned, Exxon Coal stated that it did not include the PLS fees it collected in its gross proceeds for royalty payment purposes. Also, Exxon Coal records the PLS fees collected as “other revenue” in its General Ledger. For six months examined, three in 1988, two in 1989, and one in 1990, we determined that the Rawhide and Caballo mines generated “other revenue” of $401,657.12. For these six months, royalties of $50,207.14 are due to MMS for the PLS fees collected.* * *

In order to bring its royalty payments into compliance with the regulations and lease terms, Exxon Coal is hereby directed to calculate and pay any royalties due through the most current production month on the proceeds received for the Rawhide and Caballo mines from the

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1/ Prior to 1987, BN had the only rail access to the two mines. In 1987, BN sold access rights to the Caballo Mine to two other railroad companies.

2/ Appellant refers to this lease as W-5036 (part of the Rawhide Mine), and states that the MMS decision also affects leases W-83394 (Caballo), W-83395 (Rawhide), W-3397 (Caballo), and W-49644 (Caballo). (Statement of Reasons (SOR), nn. 2, 4.)

3/ According to appellant, lease W-49644 was readjusted from a cents-per-ton lease to an ad valorem lease effective Sept. 1, 1985, and the other leases were readjusted effective Dec. 1, 1987. (SOR at 2 n.4.) Appellant sold its interest in the Rawhide and Caballo Mines and the leases in the mid-1990's. (SOR at 6 n.10.)
PLS. The royalties are due from the time the Federal leases were adjusted from royalty on a cents per ton basis to a percentage of value basis.

(HCO June 30, 1992, decision at 2.) On appeal to the Director, MMS granted the appeal with respect to loading fees paid by the railroads, but sustained HCO with respect to loading fees paid by purchasers of coal. 4

The Associate Director rejected ExxonMobil’s argument that the sophisticated nature of its loading system justified different treatment for royalty purposes:

4 The Associate Director offered three reasons for concluding that the fees collected from railroads should not be treated as royalty bearing. First, the Associate Director noted that the rail carriers are concerned with transportation rather than the marketing of coal and they are concerned about damage to their equipment. Second, the Associate Director noted that under the applicable regulations MMS looks to total consideration flowing from the buyer of the coal but not unaffiliated third parties. Third, the Director referred to 30 CFR 206.257(b)(5) which provides: “The value of production for royalty purposes shall not include payments received by the lessee pursuant to a contract which demonstrates, to MMS’s satisfaction, were not a part of the total consideration paid for the purchase of coal production.” The Associate Director found that the railroads were not involved in the purchase of the coal. (Decision at 3.)

Although appellant finds no support “by logic or the applicable regulations” for the distinction the Associate Director made between fees received from purchasers and those received from railroads, see SOR at 4-5, the reasons and regulations provided in the Associated Director’s decision clearly refute appellant’s assertion. However, the pertinent regulations and our precedents indicate that there may be circumstances in which fees paid by someone other than the purchaser must be included in gross proceeds if they affected the lessee in such a way that they affected part of the total consideration paid for the purchase of coal production. In Peabody, supra at 171, we referred to 30 CFR 203.200(h) (1986) and noted: “the costs of loading are not deductible from gross value in determining value for royalty purposes. It is irrelevant who performs that activity. See Apache Corp., 127 IBLA 125, 134 (1993).” (Emphasis added.) We also referred to 30 CFR 206.257(h)(1994) which requires gross proceeds to “be increased to the extent that the gross proceeds has been reduced because the purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the coal in marketable condition.” (Emphasis added.) In this case, the Associate Director concluded that, unlike the payments received from coal purchasers, the payments from the railroads “were not a part of the total consideration paid for the purchase of coal production” under 30 CFR 206.257(b)(5).
It is clear that the regulations do not distinguish between different types of loading, and I can find no basis for such a distinction. The facility at issue here is simply a two-stage loading system. There are other mines in the area that have single-stage batch loading systems that are arguably more sophisticated and do not receive, or are eligible for, such deductions. It is equally clear that the second-stage services referred to by Appellant are not performed after loading the coal; they are part of the process.

(Decision at 2.)

ANALYSIS OF ARGUMENTS ON APPEAL

Pointing out that issues such as those in the instant appeal did not arise when coal royalty was paid on a cents-per-ton basis rather than a percentage-of-value basis, appellant suggests that MMS’s regulations remain “flawed by the continued application in the coal context of certain inappropriate ‘value’ concepts borrowed from the oil and gas area.” (SOR at 9-10.) Nevertheless, the Secretary possesses considerable discretion in determining the value of production for royalty purposes. 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); Texaco, Inc., 104 IBLA 304, 308 (1988).

Furthermore, although it was not until appellant’s leases had been readjusted pursuant to the FCLAA that the royalty on the coal was subject to a percentage of value royalty, lessees of other solid minerals have long been required to pay royalty on the basis of the value of a product in marketable condition that includes certain processing costs. For example, when we held that a coal lessee must include the cost of crushing in determining the value of coal for royalty purposes in Trapper Mining, Inc., 144 IBLA 204 (1998), we referred to a court’s decision involving Federal potash leases, United States v. Southwest Potash Corp., 352 F.2d 113, 116-18 (10th Cir. 1965), cert. denied, 383 U.S. 911 (1966).

Appellant asserts that MMS “is not merely seeking a percentage share as its royalty; but, rather, is actively seeking to participate in ExxonMobil’s profits by insisting on a percentage of the total revenues that were in any way related to ExxonMobil’s coal mining operations” at the mines in question. (SOR at 12.) Appellant refers to cases involving payments by customers to reimburse lessees for severance tax payments as well as take-or-pay payments to suggest that there may be payments received by lessees that are not includable in gross value or gross proceeds. (SOR at 20-23.) For example, appellant cites Diamond Shamrock Exploration Corp. v. Hodel, 853 F.2d 1159, 1168 (5th Cir. 1988), where the court found that payments received by a lessee from a purchaser of gas pursuant to a take-or-pay clause in a gas
sales contract did not trigger an obligation to pay royalty because royalty is only due on production “which does not occur until the minerals are physically separated from the earth.”

In arguing that MMS is improperly seeking to participate in its profits, appellant misstates the issue. The lessor’s royalty share is to be free of the costs of production. Loading is a cost of production that the lessor does not bear, so payments by customers for that cost must be included in the royalty base. In this appeal, there is no question that the loading fees received by appellant were in connection with coal actually produced from the mine. It has been long recognized that MMS may properly include payments from purchasers for certain production-related costs in addition to the purchase price in determining the basis for royalty payments. E.g. Mesa Operating Ltd. v. U. S. Department of Interior, 931 F.2d 318, 323 (5th Cir. 1991), cert. denied, 502 U.S. 1058 (1992). Because the regulations make specific provision for the fees appellant receives for loading, the only basis for reversing MMS is to establish that the activity for which appellant receives the fee does not constitute “loading” under those regulations.

Appellant seeks to avoid the effect of the pertinent regulations by claiming that it has placed the coal in what it calls “first marketable condition” before the loading process is complete:

[Coal mined from the two Mines was first loaded into rail cars directly from storage silos located at the mine sites. Once the rail cars were loaded with coal from the silos, ExxonMobil could be said to have placed the coal in first marketable condition, and to have fulfilled its marketing obligations to its federal lessor.

(SOR at 6-7.) Appellant further states:

[When federal coal lessees do not offer a precision loading service, the MMS does not take the position that they have failed to place the coal in first marketable condition. Certainly, during the Audit Period, coal was not customarily sold in the Powder River Basin area of Wyoming utilizing precision loading systems similar to the ones then in use at the Rawhide and Caballo Mines.

(SOR at 19.) Pointing to the language of 30 CFR 206.251 of the post March 1, 1989, regulations providing that “gross proceeds” includes payments to the lessee for loading only “to the extent that the lessee is obligated to perform them at no cost to the Federal Government or Indian lessor,” appellant argues that this obligation is satisfied after the first stage of its loading process rather than when loading is complete.
Appellant states that the fees it received were not established in the coal purchase contracts but in “specific contracts with its coal purchasers* * * for the use of the precision loading systems.” (SOR at 7.) The loading fees, appellant contends, “were not part of the price established for the coal* * * by ExxonMobil’s coal sale and purchase agreements.” (SOR at 7-8.) Appellant points out that the pre-March 1, 1989, regulations defined “gross value” as “the unit sale or contract price,” see 30 CFR 203.200(g) (1987), 43 CFR 3485.2(g) (1987), and asserts that MMS may consider other factors only where a coal sales transaction was not a bona fide transaction between independent parties. (SOR at 14.) In Trapper Mining, Inc., supra at 209, we responded as follows to a similar argument from a coal lessee with respect to payments for crushing:

Regulation 30 C.F.R. § 203.250(h) (1988) precludes deduction of the cost of primary crushing of coal from gross value for royalty purposes, when such cost is incurred by the lessee in preparing the coal "prior to sale." Cf. Western Fuels-Utah, Inc., 130 IBLA 18, 30-31 (1994) (costs of transporting coal to off-lease loadout facility); FMC Corp., 54 IBLA 77, 81 (1981) (costs to produce finished soda ash). We conclude that the regulation is equally applicable to require the addition of those costs to the actual sales price when those costs are incurred after the sale. Cf. Texaco Inc., 134 IBLA 109, 113-15 (1995) (costs of removing hydrogen sulfide from natural gas). The cost of primary crushing is, because it is deemed necessary to place the coal in a marketable condition under 30 C.F.R. § 203.250(h) (1988), considered the sole responsibility of the lessee, regardless of whether the crushing is performed by the lessee or the lessee's buyer or whether the crushing occurred on or off the lease site. Cf. Texaco Inc., 134 IBLA at 114 (citing Apache Corp., 127 IBLA 125, 134 (1993)); R.E. Yarbrough & Co., 122 IBLA 217, 220-22 (1992) (costs of gathering and compressing natural gas). If the cost of primary crushing is not added to the contract sales price for royalty valuation purposes, such cost is effectively deducted from gross value. Peabody Coal Co., 139 IBLA 165, 171 (1997) (capital costs of loadout facility).

(Emphasis added.) The same logic applies to loading fees.

Although appellant asserts that “[r]evenue received from separate business transactions unrelated to the arm’s length coal sale and purchase agreements should not be included in the ‘value’ of coal for royalty purposes,” (SOR at 16) MMS responds that the precision loading contracts either amended or superseded the purchase contracts. (Answer at 7.) These arguments place form above substance, as our decision in Peabody makes clear. Regardless of the means by which a customer “assumes part of the costs of loading the coal,” we concluded in Peabody “that MMS properly required [the lessee] to include the value of these assumed costs as part of
its gross proceeds in determining the royalty value of the coal sold to the [customer].” Id. at 172.

Finally, citing a provision of the Administrative Procedure Act (APA), 5 U.S.C. § 552(a)(1) (1994), appellant argues that “MMS's interpretation of the vaguely-worded language of [the applicable regulations] to authorize the imposition of royalties on precision loading fees” violates the provisions of the APA that require publication of regulations in the Federal Register, as well as interpretive rules and statements of policy. (SOR at 27-29.) There is no merit in this argument. The simple fact of the matter is that the sale of the coal cannot be completed unless it is loaded, and the applicable regulations make it unarguably clear that the fees a lessee receives for loading the coal must be included in the gross proceeds upon which the royalty is calculated. The text of the regulations contain no provision for relieving a lessee of this responsibility on the basis of how the coal is loaded. Appellant has provided no convincing explanation why its loading fees are not payments for loading under existing regulations.

To the extent not expressly addressed herein, appellant’s arguments have been considered and rejected.

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.

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James F. Roberts
Administrative Judge

I concur:

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Bruce R. Harris
Deputy Chief Administrative Judge