DECKER COAL COMPANY

172 IBLA 1 Decided July 17, 2007

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United States Department of the Interior
Office of Hearings and Appeals
Interior Board of Land Appeals
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DECKER COAL COMPANY

IBLA 2005-163 Decided July 17, 2007

Appeal from a decision of the Associate Director for Policy and Management Improvement, Minerals Management Service, denying appeals from orders of the Royalty Management Program, Minerals Management Service, that determined coal sales contracts to be non-arm's-length and ordered the payment of additional royalties. MMS-93-0403-MIN; MMS-97-0142-MIN.

Decision affirmed.

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

   A contract for the sale of coal from one affiliate to another, when the affiliates are under common control and do not have opposing economic interests, is not arm's-length under either the pre-1989 regulation, 30 C.F.R. § 203.250(g), or the current regulation, 30 C.F.R. § 206.251.

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

   Under the pre-1989 regulation governing coal valuation, 30 C.F.R. § 203.250(g), MMS may accept non-arm's-length contract prices when the lessee demonstrates independent indicia establishing that the contract price is one fairly derived from the marketplace. However, when the totality of the circumstances shows that the non-arm's-length contract prices result from an arrangement between affiliates and that the ultimate purchaser actually pays and reports substantially more for the coal in accordance with the contract, MMS properly values the coal at the prices actually paid for that coal.

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

In valuing coal for royalty purposes under a non-arm's-length contract, MMS properly applies the criteria of 30 C.F.R. § 206.257(c)(2)(i)-(iv) and determines coal value based upon the first applicable criterion. When MMS determines that the first three criteria of 30 C.F.R. § 206.257(c)(2) do not apply, it properly considers "[o]ther relevant matters" under subsection 206.257(c)(2)(iv), including information showing that the value of the coal claimed by the lessee was substantially less than what the ultimate purchaser actually paid for the same coal.

APPEARANCES: Joseph E. Jones, Esq., and Timothy J. Thalken, Esq., Denver, Colorado, for appellant; Triscilla P. Taylor, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ROBERTS

Decker Coal Company (Decker) has appealed from a modified decision of the Associate Director for Policy and Management Improvement, Minerals Management Service (MMS), dated January 13, 2005 (2005 Decision), determining that coal sales contracts between Decker and its affiliated entities, Black Butte Coal Company (Black Butte) and Big Horn Coal Company (Big Horn), do not qualify as arm's-length sales contracts and that Minerals Revenue Management (MRM) correctly determined that the appropriate royalty value, under benchmark four (iv) of 30 C.F.R. § 206.257(c)(2), is the price Decker received for the coal under its own supply contract with Commonwealth Edison (ComEd, Commonwealth, or Edison), an Illinois utility company.

I. FACTUAL BACKGROUND

Decker, Black Butte, and Big Horn are affiliated entities because of their corporate relationship with Peter Kiewit Sons', Inc. (Kiewit), which directly or indirectly has an ownership interest in those corporations through its subsidiary Kiewit Mining Group (KMG). KMG owns a 50% interest in Decker, and Western Minerals, Inc. (WMI), a wholly separate entity owned by NERCO, Inc. (NERCO), owns the other 50%. KMG owns a 50% interest in Black Butte, and Bitter Creek Coal Company, a wholly separate entity owned by Union Pacific Minerals (UPM), owns the other 50%. Big Horn is a wholly-owned subsidiary of KMG. Black Butte and Big Horn are Wyoming coal mines.

There are four coal sales contracts at issue in this appeal: (1) Coal Purchase Option Agreement dated January 1, 1986, between Decker and Big Horn; (2) Coal Purchase Option Agreement dated December 31, 1986, between Decker and Big Horn; (3) Coal Purchase Agreement dated December 1, 1987, between Decker and Big Horn; and (4) Coal Purchase Agreement dated January 1, 1988, between Decker and Black Butte. Collectively, these contracts are referred to as the "Decker Contracts."

In 1976, Black Butte and Big Horn entered into long-term coal supply contracts with ComEd to supply coal to ComEd through the 1980's and 1990's. These contracts are referred to as the "1976 Wyoming Contracts." The 1976 Wyoming Contracts provided that Black Butte and Big Horn could purchase coal from alternate sources to fulfill their obligations to ComEd under the 1976 Wyoming Contracts, and that Black Butte and Big Horn could supply those contracts with coal from another mine rather than mine the coal themselves.

From 1986 through 1992, Decker sold coal to Black Butte and Big Horn pursuant to the Decker Contracts. Black Butte and Big Horn then resold the coal to ComEd to fulfill Black Butte's and Big Horn's separate obligations under the 1976 Wyoming Contracts. Under the Decker Contracts, Black Butte and Big Horn paid Decker between $7.30 per ton and $9.70 per ton for the coal they purchased from 1986 through 1992. Black Butte and Big Horn, in turn, sold Decker's coal to ComEd for prices ranging between $25.00 and $31.72 per ton pursuant to Black Butte's and Big Horn's long-term 1976 Wyoming Contracts with ComEd. Decker based its Federal royalty payments on the price it received for coal sold to Black Butte and Big Horn.

II. PROCEDURAL HISTORY

MMS' MRM issued an order to Decker on October 2, 1992, and another on May 27, 1997, regarding Decker's valuation of production sold under its coal sales contracts with Black Butte and Big Horn.

A. The 1992 Order

On October 2, 1992, the Lakewood Area Compliance Office (LACO), MMS, issued an order directing Decker to pay additional royalty on coal sold pursuant to the Decker Contracts (1992 Order). Following an audit covering January 1985 through December 1990, LACO determined that the Decker Contracts with Black Butte and Big Horn were not at arm's-length. LACO concluded that the

Decker Contracts were devised to facilitate sales from Decker's mine directly to ComEd, with Decker paying royalty "on the basis of the price contained in these selling arrangements rather than on the sales prices contained in the selling arrangements between Decker and [ComEd]." 1992 Order at 2. MMS concluded that the Decker Contracts are not arm's length agreements within the meaning of 30 C.F.R. § 206.251 (1991)[1] and as formerly defined at 30 C.F.R. § 203.200(g) (1987).[2] Further, MMS concluded that the "price established under the non-arm's-

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[1] The current regulations governing valuation of coal produced for royalty purposes became effective Mar. 1, 1989. 54 Fed. Reg. 1492 (Jan. 13, 1989), codified at 30 C.F.R. §§ 206.250 through 206.265. The former regulations governing coal royalty were codified at 30 C.F.R. § 203.200. In this opinion, we cite to the present or former version of the applicable coal royalty regulation, only referring to the year when pertinent to the discussion.

Regulation 30 C.F.R. § 206.251 provides:

> *Arm's-length contract"* means a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. For purposes of this subpart, based on the instruments of ownership of the voting securities of an entity, or based on other forms of ownership:
>
> (a) Ownership in excess of 50 percent constitutes control;
>
> (b) Ownership of 10 through 50 percent creates a presumption of control; and
>
> (c) Ownership of less than 10 percent creates a presumption of noncontrol which MMS may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates.
>
> . . . The MMS may require the lessee to certify ownership control. To be considered arm's length for any production month, a contract must meet the requirements of this definition for that production month as well as when the contract was executed.

30 C.F.R. § 206.251 (1991).

In addition, 30 C.F.R. § 206.263(c) provides: "A lessee's or other payor's determination that its contract is arm's-length is subject to future audit to verify that the contract meets the criteria of the arm's length contract definition in § 206.251 of this subpart."

[2] This regulation provides:

> The gross value shall be the unit sale or contract price times the number of units sold, unless MMS determines that:

(continued...)

length agreements does not represent the proper value for royalty payment purposes." *Id.* at 2.

LACO stated that the Decker Contracts were for the "sole purpose of resale to Commonwealth Edison, which has long-term coal supply agreements with Black Butte and Big Horn as well as Decker." *Id.* at 3. LACO deemed the purpose to be "clear from the explicit language of the coal sale contract dated December 1, 1987, between Decker and Big Horn and the coal sale contract dated January 1, 1988, between Decker and Black Butte." *Id.* The "explicit language" to which LACO refers is found in Section 1 of both contracts. Section 1.02 provides that "[t]hese broker sales are based solely on Big Horn and Black Butte's ability to resell this same coal under their existing contracts with Commonwealth," and Section 1.03 provides that "if Commonwealth breaches its contract to purchase coal from Big Horn or Black Butte then under the Decker and Big Horn and Black Butte contracts, Decker's rights to remedies cannot exceed the amount of damages, settlement payments, or other consideration paid Big Horn or Black Butte by Commonwealth." Relying upon *Stauffer Chemical Company of Wyoming*, 54 IBLA 85 (1981), LACO determined that "[t]he conditioning of sales based upon the resale of the same production cannot be considered a bona fide transaction based only on the value of the coal." 1992 Order at 3. LACO deemed the key to receipt of payment by Decker to be the resale of the coal by Black Butte and Big Horn to ComEd. LACO's reasoning for determining that the Decker Contracts were non-arm's-length, which was not modified in MMS' subsequent 2005 Modified Decision, is set forth below:

> Big Horn and Black Butte are not truly buying for their own account, and there is no duty for either producer to pay Decker unless resale occurs to Commonwealth Edison. The MMS concludes that the substance of the transaction is that Big Horn and Black Butte are acting as brokers for the sale of coal from Decker, and they assume no risk as sale and title transfer are conditioned upon Commonwealth Edison's purchase from Big Horn and Black Butte. Moreover, in the event of Commonwealth Edison's breach of contract to repurchase, Decker's rights and remedies under its Big Horn and Black Butte contracts are limited to whatever is recovered from Commonwealth Edison by Big Horn and Black Butte. The MMS concludes that Decker's selling

[2] (...continued)

> (1) A contract of sale or other business arrangement between the operator/lessee and a purchaser of some or all of the coal produced from the Federal lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the coal. . . .

30 C.F.R. § 203.200(g) (1987).

> arrangements with Big Horn and Black Butte are not arm's-length contracts. The tenets set forth in *Stauffer, supra*, clearly require that in order to be a bona fide broker sale, the distributor or jobber must be purchasing for its own account and payment to the lessee (producer) cannot be contingent upon resale by the distributor. Furthermore, MMS finds that Decker's agreement to limit its remedy to that of breach-of-contract payments recovered by Big Horn or Black Butte is an indication of lack of economic adversity between Decker and Big Horn and Black Butte because there is no assurance that such a recovery would make Decker whole. Lack of economic adversity has been found to be an indication of dealing at less than arm's-length circumstances.

1992 Order at 4, *citing AMAX Lead Company of Missouri*, 84 IBLA 102 (1984) ("Overlapping ownership and control are indicators of the lack of adversity.")

Having determined that the Decker Contracts were non-arm's-length, LACO applied 30 C.F.R. § 203.200(g)(2) (1987),[3] as construed by *Lone Star Steel Co.*, 117 IBLA 96 (1990), in measuring the value of coal sold pursuant to the Decker Contracts:

> The MMS concludes that the proper value of Decker's brokered sales to Big Horn and Black Butte is the gross value that would have accrued under its own arm's-length contract with Commonwealth Edison. This valuation determination most closely comports with the substance of the transaction, namely, that Decker is selling its production to Commonwealth Edison using Big Horn's and Black Butte's contracts with Commonwealth Edison as a conduit to facilitate

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[3] This regulation provided that where MMS determines that the sale of Federal coal is non-arm's-length, MMS is required to determine the 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 and 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) Such other relevant factors as the District Mining Supervisor may deem appropriate.

30 C.F.R. § 203.200(g) (1987).

> those sales. Big Horn and Black Butte are not transacting business with Commonwealth Edison since neither has any risk of loss in the event that Commonwealth fails to make payment. Since only Decker incurred cost to produce the coal, it would be Decker that incurred actual losses through Commonwealth Edison's failure to pay. Because it is Decker which is at risk for incurring production costs based on Commonwealth Edison's promise to purchase and pay, Decker should correctly receive the full benefits from the sale of its production. The best measure of the benefits is its long-term contract with Commonwealth Edison. This valuation procedure is authorized under 30 C.F.R. § 203.200(g)(2) (1987) which specifically authorizes that the value for royalty purposes be determined recognizing other relevant factors.

1992 Order at 5-6. LACO directed Decker to pay $512,993.90 in additional royalty for the 9 sample months audited, based on the prices in its contract with ComEd, and to pay additional royalty for the period August 1986 through December 1990, excluding the 9 sample months subject to MMS' audit. Decker appealed the 1992 order.

B. The 1997 Order

On May 27, 1997, MMS' Royalty Management Program (RMP) issued a second order concerning the Decker Contracts (1997 Order). The Montana Department of Revenue (DOR or MDOR), under authority granted by MMS, had reviewed Decker's records and determined that Decker had underpaid royalties for the months January 1991 through December 1992 by $5,238,321.13. RMP applied 30 C.F.R. § 206.257,[4] effective March 1, 1989, which governs valuation of non-arm's-

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[4] This regulation provides:

> (c)(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, then the value shall be determined through application of other valuation criteria. The criteria shall be considered in the following order, and the value shall be based upon the first applicable criterion:
>
> (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 the gross proceeds derived from, or

(continued...)

length sales of Federal coal for royalty purposes. RMP stated that since the value of the coal sold under the Decker Contracts cannot be determined pursuant to 30 C.F.R. § 206.257(b), *i.e.*, the Contracts are not arm's-length, such value should be determined through application of other valuation criteria set forth in 30 C.F.R. § 206.257(c)(2), with the "value . . . based upon the first applicable criterion." RMP deemed the first three criteria to be inapplicable, stating that "[t]he fourth criterion is the first benchmark that is applicable." 1987 Order at 3. RMP explained its application of this criterion as follows:

> The substance of the transactions at issue is that the first bona fide sales take place when Edison purchases Decker coal f.o.b. railroad car at the Decker Mine. The price Edison pays for this coal under the Big Horn and Black Butte contracts (mid-1970's vintage) is approximately $30 per ton . . . while the value reported for royalty purposes is the non-arm's-length Big Horn/Decker and Black Butte/Decker contract price of approximately $7.50 per ton. The price paid by Edison under the Decker arm's-length long-term contract, also negotiated in the mid-1970's, is approximately $25 per ton.

1997 Order at 3-4. RMP concluded "that the value of the coal under question is established by coal taken from the same mine under the same physical conditions and

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[4] (...continued)

> 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 purposes of these regulations, the following factors shall 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;
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> (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 saleability 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.

30 C.F.R. § 206.257.

sold to the same consumer (Edison)." *Id.* at 4. RMP directed Decker to pay additional royalties of $5,238,321.13, as calculated by MDOR, in order to bring its royalty payments into compliance with the regulations and lease terms. Decker appealed this 1997 Order also.

C. The Associate Director's 2003 Decision

By decision dated April 18, 2003, the Associate Director for Policy and Management Improvement, MMS, consolidated Decker's appeals from the 1992 and 1997 Orders, noting that the legal and factual bases are the same, and denied both appeals (the 2003 Decision).

1. The Decker Contracts are not Arm's Length

a. Transactions Prior to March 1, 1989

The pre-1989 regulations distinguished between those transactions that are "arm's length" and those that are "other than arm's length," *i.e.*, "not bona fide transactions between independent parties." 30 C.F.R. §§ 203.250(f), (g). Under the pre-1989 rule, when MMS finds that a transaction is not arm's length, the coal is valued taking into account a number of factors, such as prices reported to a public utility commission or comparable sales of like-quality coal in the area of supply, listed in order of preference. The test for determining whether a transaction was arm's-length was found in opinions of the Board and reviewing courts. To be deemed arm's-length, a transaction must be between parties with adverse economic interests. As stated by Decker, "each party to the transaction must be in a position to distinguish his economic interest from that of the other party, and where they conflict, always choose that to his individual benefit." 2003 Decision at 10, *citing Campana Corp. v. Harrison*, 114 F.2d 400, 408 (7th Cir. 1940), *overruled on other grounds*, *F.W. Fitch Co. v. United States*, 323 U.S. 582 (1945). Further, "evidence of overlapping ownership and control between transacting parties is also generally considered to be an indicator of the lack of adverse economic interests." SOR at 10, *citing Creme Manufacturing Co. v. United States*, 492 F.2d 515, 520 (5th Cir. 1974). The Associate Director rejected Decker's contention that the Decker Contracts were arm's-length under these tests, as discussed more fully *infra*.

b. Transactions Under Current Regulatory Definition

The Associate Director noted that the current regulations specifically define an "arm's-length contract" as "a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract," and provide that "two persons are affiliated if one person controls, is controlled by, or is under common control with another person."

30 C.F.R. § 206.251.[5] The Associate Director stated that "[u]nder the current regulations, to establish that the contracts between the Kiewit subsidiaries are arm's length, the Appellant must show that the transactions are between independent, non-affiliated entities having opposing economic interests with regard to these transactions." 2003 Decision at 11.

The Associate Director rejected Decker's position that the Decker Contracts were the result of arm's-length bargaining and therefore qualify as arm's-length transactions. He concluded that "Decker, Big Horn and Black Butte, are not independent of one another, but rather are affiliated entities, each owned in whole or in part by parent company Kiewit." *Id.* at 12. In looking at the Decker/Black Butte contract, he noted that Kiewit owns 50% of Decker (the seller) and 50% of Black Butte (the buyer), and that in the Decker/Big Horn contract, Kiewit owns half of Decker and all of Big Horn. He observed that "Kiewit itself considered the contracts to be non-arm's-length," noting that "Kiewit filed a combined Montana Corporation License Tax Return for all three entities indicating that they were engaged in a unitary business." 2003 Decision at 12-13 (footnote omitted). He noted further that Kiewit's "Federal partnership tax returns in the record show that Kiewit recognized the coal sales from Decker to Big Horn and Black Butte as sales to affiliates"; and that

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[5] The Associate Director noted that, with respect to the issue of "control," the current regulations provide a set of presumptions based on the percentage of ownership between persons:

> . . . For purposes of this subpart, based on the instruments of ownership of the voting securities of any entity, or based on other forms of ownership:
>
> (a) Ownership in excess of 50 percent constitutes control;
>
> (b) Ownership of 10 through 50 percent create a presumption of control; and
>
> (c) Ownership of less than 10 percent creates a presumption of noncontrol which MMS may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates.

30 C.F.R. § 206.251. The Associate Director stated that in light of the decision in *National Mining Ass'n v. United States Dep't of the Interior*, 177 F.3d 1 (D.C. Cir. 1999), MMS had "not relied on the presumption of control based on 10 through 50 percent ownership to reach a determination regarding the arm's-length status of the coal sales contracts in this case." SOR at 10. In *National Mining*, the D.C. Circuit held invalid an analogous presumption of control, based on 10 to 50 percent ownership of an entity that was part of an Interim Final Rule issued by the Office of Surface Mining (OSM). *See* 62 Fed. Reg. 19,450 (1997). That presumption was subsequently omitted from OSM's final rule (65 Fed. Reg. 79,663 (2000)) and replaced by a requirement that the regulatory authority make a finding of actual ownership or control. *See* 30 C.F.R. § 773.12 (2001).

"Kiewit treated these sales as non-arm's-length, and calculated the representative market price for Federal tax purposes using its own arm's-length sales under existing long-term contracts." *Id.* at 13 (footnotes omitted). He stated that "Kiewit was unquestionably positioned to influence both sides of the bargaining table and indeed stood to gain from both sides of the Montana contracts at issue." *Id.* His conclusion is set forth below:

> [W]e find insufficient assurance that the contract terms negotiated between the affiliated parties are necessarily the product of uninhibited bargaining between independent parties intent upon maximizing their own economic return. The contracts at issue were not arrived at in the marketplace between independent parties with opposing economic interests. Accordingly, we find that the Decker-Big Horn and Decker-Black Butte contracts do not qualify as arm's length under either (prior to or after 1989) set of regulations. The Appellant has failed to show that these transactions were between independent, nonaffiliated entities with opposing economic interests. The MRM's determination on this point is affirmed.

Id.

2. Royalty Valuation

Having determined that the Decker Contracts represent non-arm's-length transactions under both the pre-1989 and current regulations, the Associate Director considered MRM's position that the arm's length Decker/ComEd prices represent the most comparable values, and then Decker's argument that the prices received from Black Butte and Big Horn pursuant to the Decker Contracts should be accepted as the value for royalty purposes. He addressed these arguments in the context of the pre-1989 and current regulations governing non-arm's-length coal sales.

a. Pre-1989 Valuation for Non-Arm's-Length Sales

In valuing coal sold in non-arm's-length transactions under 30 C.F.R. § 203.250(g),[6] the pre-1989 regulation, the Associate Director applied the Board's

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[6] This regulation provided:

> (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 form the same general area during the Federal lease month.
>
> (iii) Contracts or other business arrangements, between coal

(continued...)

ruling in *Getty Oil Co.*, 51 IBLA 47, 51 (1980), that MMS may value production for royalty purposes on the basis of prices derived from non-arm's-length transactions where such prices are reflective of the fair market value of the production. However, the corollary of this rule is that where such prices are not reflective of the fair market value of the production, they may not be used to value coal for royalty purposes. He cited subsequent cases in which the Board "emphasized that MMS may accept non-arm's-length contract prices for royalty valuation purposes only when the lessee demonstrates 'independent indicia establishing that the contract price is one fairly derived from the marketplace.'" 2003 Decision at 15, *quoting AMAX Lead Company of Missouri (On Reconsideration)*, 99 IBLA 313 (1987), and *Transco Exploration Co.*, 110 IBLA 282, 286 (1989).

The Associate Director rejected Decker's contention that the proceeds from sales under the Decker Contracts "are well within the range of comparable nonaffiliated arm's-length coal sales within the area," and that "at the time the contracts were executed between Decker, Big Horn and Black Butte, no buyer would purchase coal at the 1970's Decker-ComEd contract prices." 2003 Decision at 15 (footnote omitted). He observed that "[t]he original contracts between Decker, Black Butte, Big Horn, and ComEd are interrelated, allowing for flexibility among the three mines in supplying coal to ComEd," and that "the Black Butte and Big Horn purchase agreements should not be viewed as separate, newly derived contracts." *Id.* at 16. He stated: "To the contrary, the Decker-Black Butte and Decker-Big Horn contracts exist for the sole purpose of resale to ComEd." *Id.* Finding the absence of "independent indicia establishing that its contract price is one fairly derived from the marketplace, as required by the rules in effect prior to 1989," he concluded that "Decker may not use its sale prices to Black Butte and Big Horn as the basis for royalty valuation." *Id.*

The Associate Director further followed the analysis in *Lone Star Steel Co.*, 117 IBLA at 105, in which the Board construed and applied the pre-1989 regulation in valuing coal for royalty purposes:

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6 (...continued)

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

30 C.F.R. § 203.250(g).

> 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 Associate Director rejected MRM's position that the Decker/ComEd prices (roughly $17-$20) are the most comparable values for the Decker sales to Black Butte and Big Horn. Rather, in "consider[ing] the totality of the circumstances, the appropriate value is the price that ComEd pays for the coal (that is, the higher $25-$31 figures)." 2003 Decision at 17. His analysis is set forth below:

> In its filings with the Federal Energy Regulatory Commission ("FERC") and the State public utility commission, ComEd reported the value of the coal at the prices it paid to Decker's affiliated companies under the long-term supply contacts. Only the purchasing utility company (in this case, ComEd) makes such a report to FERC and the utility commission. Accordingly, these records indicate only one price – the price ComEd pays for the coal it receives. Consideration of such reported prices is specifically prescribed under the pre-1989 regulations at 30 C.F.R. § 203.250(g)(v) (1988). Given the interrelated nature of the parties to the various contracts, and the fact that $25-31 per ton was actually paid for the coal from the Decker mine, we find that these values more fully satisfy the requirements of 30 C.F.R. § 203.250(g) than the Decker-ComEd contract prices. Thus, the appropriate valuation for Federal royalty purposes in this case is the price ComEd actually paid and reported for coal it purchased through its long-term agreements with Black Butte and Big Horn.

2003 Decision at 17.

b. <u>Decker Coal Co. v. MDOR</u>

The Associate Director acknowledged that "Decker [had] litigated and won a case involving similar issues with the State of Montana." *See Decker Coal Co. v. The Dep't. of Revenue of the State of Montana (Decker v. MDOR)*, 2 P.3d 245 (Mont. 2000). At issue was the very valuation method employed by Decker in the present case for the coal sales to Black Butte and Big Horn. MDOR had assessed additional coal taxes against Decker for periods covering 1986 through 1988, and Decker's appeals eventually reached the Montana Supreme Court. Under MCA § 15-35-107, MDOR had the authority to impute a value to coal sales rather than relying on contract prices if (1) it determines the contract price does not represent an arm's length agreement; and (2) the imputed value approximates market value. Thus, the Montana Supreme Court accordingly addressed two issues: (1) "Whether Decker has an arm's length relationship with Wyoming coal producers, Big Horn and Black Butte?" and (2) "Whether the $24-$28 per ton value that DOR imputed to the contracts approximates market value?" 2 P.3d at 248.

The Montana Supreme Court determined that Decker had shown that MDOR's imputed value does not "approximate" market value under the market and economic conditions pertaining in 1986-1988, and therefore deemed it unnecessary to address the question of whether the sales were arm's-length. The District Court, however, had concluded that "substantial evidence supported MDOR's decision that the transactions were not arm's length." The Montana Supreme Court agreed with Decker's contention that "[a]bsent Decker's sales of coal to Big Horn and Black Butte under the Montana Contracts [the Decker Contracts], the coal in question would have been sold in the same market at the same or lower prices to another consumer, or perhaps it would have remained in the ground for lack of another buyer," and concluded that the "prices paid to Decker by Black Butte and Big Horn under the Montana Contracts met or exceeded market value, in other words, the price that a willing buyer would pay to a willing seller under market and economic conditions *at the time of the sale.*" *Id.* at 249. It viewed as "incorrect" MDOR's "conclusion that the 1974 ComEd Contract price represents the price that a willing buyer would pay to a willing seller under the market and economic conditions at the time of the 1980s sales." *Id.* at 252.[7]

c. Valuation of Non-Arm's-Length Sales under Current Regulations

In applying the benchmarks established in 30 C.F.R. § 206.257(c)(2), *see* n.4 *supra*, the Associate Director framed "[t]he appropriate question [as] whether the gross proceeds under the Decker-Big Horn and the Decker-Black Butte contracts are similar to proceeds received under comparable arm's-length contracts (not the 1970's vintage contracts per se)." 2003 Decision at 19. He rejected Decker's argument "that the prices it received from its affiliates should be used as the royalty value because those proceeds meet or exceed the fair market value of like quality coal produced in the area under contracts between unrelated parties executed during the mid-1980's time period." *Id.* at 19-20. He found determinative the fact that "Decker's sales to

[7] A dissenting opinion was filed in *Decker v. MDOR*, 2 P.3d at 252-57. Judge Hunt concluded that the Montana (Decker) Contracts were non-arm's-length and that considering all relevant factors the price ComEd actually paid Black Butte and Big Horn represented the value of the coal for royalty purposes. We consider his analysis *infra* in the context of our affirming the Associate Director's 2005 Remand Decision.

Black Butte and Big Horn were solely contingent upon resale of the coal to ComEd under the long term supply contracts." *Id.* at 20.

The Associate Director proceeded to consider the remaining regulatory benchmarks. He disagreed with MRM's view that "where sales are made to affiliates for subsequent resale, the 'other relevant matters' criterion of benchmark four (§ 206.257(c)(2)(iv)) is the first applicable criterion for valuing the coal." *Id.* at 21 (footnote omitted). He determined rather, in the following fashion, that benchmark two applied to the Decker Contracts:

> . . . Having determined that benchmark one (§ 206.257(c)(2)(i)) does not apply, the analysis turns to benchmark two (§ 206.257(c)(2)(ii)): prices reported for that coal to a public utility commission. For the coal ComEd received from Decker pursuant to the non-arm's-length arrangements with Black Butte and Big Horn, ComEd reported to FERC and the State public utility commission the prices it paid to Black Butte and Big Horn under their long-term supply contracts. These values are unmistakably specified by benchmark two as the appropriate basis for calculating royalties. As we have indicated, because the benchmarks are prioritized, the first applicable provision is the prescribed legal valuation. MRM has provided no explanation as to why benchmark two should be ignored. Thus, valuation in this case is properly based on the prices ComEd pays for the coal pursuant [to] its long-term contracts with Big Horn and Black Butte.

Id.

Decker appealed MMS' 2003 Decision to this Board. While Decker's appeal was pending before the Board, MMS identified an error in the 2003 Decision involving application of the regulatory benchmarks and requested that the Board remand the 2003 Decision to allow MMS to correct the error. By order dated February 4, 2004, the Board granted MMS' request.

C. The Associate Director's 2005 Modified Decision

On January 13, 2005, the Associate Director issued his decision on remand, modifying his valuation of the disputed coal sales under the regulatory benchmarks (2005 Decision). He stated that "[w]ith respect to whether the coal sales contracts are arm's-length under the royalty valuation regulations, our finding in the 2003 decision stands unaltered," *i.e.*, that "[t]he Decker-Big Horn and Decker-Black Butte contracts do not qualify as arm's-length." 2005 Decision at 2.

The Associate Director further left "unaltered our finding in the 2003 Decision that the first benchmark is inapplicable," guided by the fact that "Decker's coal sales to Big Horn and Black Butte were solely contingent upon resale of the coal to ComEd under long term supply contracts." *Id.*

He "modified [his] earlier ruling that the next applicable benchmark is benchmark two." *Id.* at 3 (footnote omitted). He ruled that the second benchmark does not apply to the Decker Contracts, given that, as MMS has learned, "the public utility commission in this instance, the Illinois Commerce Commission, does not require ComEd (the purchasing utility company) to report the prices it pays for the coal at issue." *Id.*

He rejected benchmark three, which provides, in valuing non-arm's-length sales of coal, for the use of "[p]rices reported for that coal to the Energy Information Administration of the Department of Energy," as the next applicable benchmark. *Id., quoting* 30 C.F.R. § 206.257(c)(2)(ii) (1994); *see* 2003 Decision at 20-21. He stated that "ComEd does not distinguish the coal purchased by way of the various contracts, with Decker, Black Butte, and Big Horn," but "simply reports the price it pays for the coal itself." 2005 Decision at 3.

The Associate Director then turned to the fourth benchmark, which directs that MMS consider "[o]ther relevant matters . . . concerning circumstances unique to a particular lease operation . . . ." 30 C.F.R. § 206.257(c)(2)(iv). MRM had applied benchmark four in the 1992 and 1997 orders on appeal. The Associate Director now found "MRM's valuation to be a reasonable application of the fourth benchmark." *Id.* at 4. He stated: "It is reasonable to expect that the coal is worth at least what ComEd pays Decker for the same quality coal produced from the same mine. The Decker-ComEd prices represent the base measure of value because they were negotiated for the sale of significant quantities of the same source coal, to the same ultimate purchaser, under contracts entered into in the same time frame." *Id.*

III. ARGUMENTS OF THE PARTIES

A. Decker's SOR

1. The Decker Contracts were Arm's-Length

Decker contends that "[t]he Decker Contracts were entered into at arm's length," and that MMS erred in finding otherwise.[8] SOR at 13. Decker points out

[8] Decker presents its argument that the Decker Contracts are arm's-length near the end of its SOR, following its argument that the first benchmark of 30 C.F.R. (continued...)

that under 30 C.F.R. § 206.257(b)(1) "[t]he value of coal that is sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee . . . ." Decker states that "[t]he purpose of the gross proceeds standard is to approximate the market value of the coal." SOR at 14. According to Decker, "[t]he prices received by Decker from Black Butte and Big Horn under the Decker Contracts met or exceeded the market price for coal at the time of the sales," and "Decker has paid all royalties due based on these contract prices." *Id.* Decker emphasizes that "[i]n promulgating the regulations regarding federal coal royalties in 1989, the MMS recognized that the gross proceeds standard should approximate market value." *Id.* at 15; *see* 54 Fed. Reg. 1492 (Jan. 13, 1989) ("[I]n deference to the market concept, MMS accepts the principle that the most effective and efficient value-setting mechanism is the value set by competition in the free market.") In arm's-length transactions, such as reflected in the Decker Contracts, "the contract price is presumed to approximate the gross proceeds because it reflects the true market value of the coal." SOR at 15.

Decker's maintains that the Decker Contracts were arm's-length transactions under both the pre-1989 and current regulatory schemes. Decker asserts that, regarding pre-1989 arm's-length contracts, under 30 C.F.R. § 203.250(g) "the burden is on the MMS to establish that the questioned contract does not constitute a bona fide transaction," and that "MMS has failed to meet its burden by failing to present any evidence demonstrating that the Decker Contracts are not bona fide contracts between independent parties." SOR at 32-33.

Decker states that "[t]here is no dispute that Decker, Black Butte, and Big Horn are independent legal entities." *Id.* at 33. Decker acknowledges that Kiewit held an ownership interest in all three companies, but claims that "Kiewit relied on its non-Kiewit business partners to negotiate each of the Decker Contracts to prevent Kiewit representatives from negotiating with other Kiewit representatives." *Id.* As evidence of this independence, Decker states that the Decker Contracts were negotiated "principally between Donald Sturm of Kiewit (on behalf of Big Horn and Black Butte) and Gerald Drummond of NERCO (on behalf of Decker)." *Id.* According to Decker, "NERCO had every interest in maximizing the price that Decker received from Big Horn and Black Butte," and that "[t]here can be no better evidence that the Decker Contract prices were derived from arm's-length transactions than the fact that the prices were at or above market value." *Id.* at 34.

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[8] (...continued)
§ 206.257(c)(2) applies. For purposes of organizational symmetry in this opinion, we will first give our reasons for affirming the Associate Director's ruling that the Decker Contracts were not entered into at arm's-length, and then for affirming his ruling that the first applicable benchmark under 30 C.F.R. § 206.257(c)(2) is benchmark four.

Decker further claims that the Decker Contracts qualify as arm's-length contracts under the current regulation, 30 C.F.R. § 206.251, since they "were arrived at in the marketplace between independent parties, whose non-affiliated partners negotiated the contracts and controlled the final decision to approve the contracts," and since "[t]he parties that actually negotiated and approved the contracts had opposing economic interests, wherein each sought to maximize their profit and minimize their costs." SOR at 35.

2. Benchmark One--Gross Proceeds Should Approximate Market Value

Decker states that coal value under the 1989 "regulations is determined by prices set by individuals of opposing economic interests transacting business between themselves." *Id., quoting* 54 Fed. Reg. at 1493. Decker states further, regarding non-arm's-length coal sales, that the "list of benchmarks . . . are to be used to determine the price to be imputed for the coal" and "are designed to approximate the market value of the coal when the transaction is not made at arm's length." *Id.* at 16. Decker asserts that, in determining whether the Decker Contracts reflect market value under benchmark one, 30 C.F.R. § 206.257(c)(2)(i), "MMS must compare the sales to arm's length sales," something that MMS failed to do. SOR at 17.[9]

Decker argues that "[b]ecause the purpose of the gross proceeds standard is to approximate market value, the first step is to determine whether the Decker Contract prices were comparable to other arm's length sales, i.e., market value." *Id.* at 19. Decker maintains that "[t]he evidence in the record establishes that the prices that Decker received from Black Butte and Big Horn under the Decker Contracts were at or above the market price of coal under comparable contracts." *Id.* In support of this argument, Decker quotes *Decker v. MDOR*, in which Decker claims the Montana Supreme Court rejected MMS' position herein, as stating: "There being no evidence to the contrary, we conclude that the prices paid to Decker by Black Butte and Big Horn under the Montana Contracts met or exceeded market value, in other words, the price that a willing buyer would pay to a willing seller under market and economic conditions *at the time of the sale.*" 2 P.3d at 250 (emphasis in original). Because the Decker Contract prices were "within the range of gross proceeds" derived from comparable sales, "MMS is required to accept those prices as the gross proceeds accruing to Decker." SOR at 21; *see* 30 C.F.R. § 206.257(c)(2)(i).

Decker asserts that "MMS offered no evidence of market value and ignored the evidence submitted by Decker," which "overwhelmingly establishes that the

[9] Decker cites *Fina Oil and Chemical Co. v. Norton*, 332 F.3d 372, 678-79 (D.C. Cir. 2003), and *Creme Manufacturing Co. v. United States*, 492 F.2d at 520, in support of its argument that the purpose of the gross proceeds standard is to approximate market value.

Decker Contract prices were at or above the existing market value of coal from 1986 through 1992." SOR at 21. Decker relies heavily upon a report prepared by Dr. Robert L. Sansom (the Sansom Report), in which Sansom examined comparable sales of coal during the late 1980's and compared them to the Decker Contracts utilizing the seven factors set forth in benchmark one. Sansom Report at 1-1; *see* 30 C.F.R. § 206.257(c)(2)(i). According to Decker, the Sansom Report "establishes that the Decker Contract prices were well within the 'range of the gross proceeds' paid under comparable arm's length contracts from 1986 through 1992." SOR at 22. In addition, Decker relies upon the deposition of Donny Hoffman, the Bureau Chief of the Natural Resources Bureau of MDOR during the audit years at issue in this appeal, who stated that he was "unaware of ***any*** coal contracts that yielded higher prices than the price range received by Decker from Black Butte and Big Horn under the Decker Contracts." *Id.* at 23. Decker concludes that "MMS erred in failing to apply the first benchmark and in failing to accept the Decker Contract prices as the gross proceeds accruing to Decker." *Id.* at 23-24.

Decker disagrees with MMS' conclusion that because the Decker Contracts were "solely contingent upon resale of the coal to ComEd under long term supply contracts" they were "encumbered" (2005 Decision at 2-3), transforming them from "comparable to incomparable sales." SOR at 24. Decker finds persuasive the following analysis by the Montana Supreme Court in *Decker v. MDOR*: "[T]he fact that the parties made the sale of coal under the 'Montana Contracts' contingent upon the contemporaneous sale of the coal to ComEd does not change the fact (shown by the Sansom Report) that there was a market for the sale of coal to buyers other than Black Butte or Big Horn. This was not a 'closed market' situation where the customers could not turn elsewhere to purchase or outsource the coal." 2 P.3d at 250. Decker reiterates that "MMS should have applied the first benchmark and accepted the Decker Contract prices as the gross proceeds accruing to Decker." SOR at 25.

Next, Decker views as "misplaced" MMS' ruling that the fourth benchmark is the first applicable benchmark of 30 C.F.R. § 206.257(c)(2). The fourth benchmark allows MMS to value gross proceeds based on "[o]ther 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 saleability of certain types of coal." 30 C.F.R. § 206.257(c)(2)(iv). Decker claims that "[w]ith this broad authority to look at all 'relevant matters' to determine market price, the MMS chose to examine a single contract between Decker and ComEd in 1974–a decade before the Decker Contracts, and ignored the other evidence in the record such as spot sales, the market analysis in the Sansom Report, and the testimony of the Bureau Chief of the MDOR." SOR at 26.

Decker asserts that "MMS is flatly wrong in its assertion that the 1974 Decker-ComEd Contract was entered into 'in the same time frame' as the Decker Contracts which were entered into in 1986, 1987, and 1988." *Id.* at 27. Decker again relies upon *Decker v. MDOR,* in which the Montana Supreme Court stated that it found "unpersuasive DOR's arguments that Decker's 1974 contract with ComEd should determine the market value of coal sold under the Montana Contracts," and that "DOR's imputed price is erroneously pegged to the 1974 ComEd contracts rather than to any market factors extant 'at the time of the sale.'" 2 F.3d at 251. Decker contends that "recent sales are the best indicator of market value," and that "the 1974 Decker-ComEd Contract prices do not reflect market value." SOR at 28, *citing, e.g., United States v. 5139.5 Acres of Land,* 200 F.2d 659, 662 (4th Cir. 1952), and *Onego Corp. v. United States*, 295 F.2d 461, 463 (10th Cir. 1961). Decker concludes that "[w]hether applying the first benchmark or the fourth, the result is the same--the Decker Contract prices were at or above the market price of coal from 1986 through 1992," and "MMS should have accepted the Decker Contract prices for purposes of calculating coal royalties." SOR at 31.

B. MMS' Answer

MMS argues that the Associate Director correctly ruled that the Decker Contracts do not qualify as arm's-length because "Decker, Black Butte, and Big Horn were under the common control of their parent corporation" (Answer at 10), and because "Decker did not have opposing economic interests with Black Butte and Big Horn. Answer at 13. MMS responds further that the fourth benchmark is the first applicable benchmark under 30 C.F.R. § 206.257(c)(2)(iv), and that as an "other relevant matter" the Associate Director properly concluded that "ComEd's purchases of Decker coal is the best measure of the coal because at the time of Decker's sales to Black Butte and Big Horn, ComEd continued to pay the prices it agreed to in its 1974 contract with Decker." Answer at 22-23. For the reasons that follow, we affirm the Associate Director's 2005 Decision.

III. ANALYSIS

A. The Decker Contracts Are Non-Arm's Length

[1] We agree with MMS that the first step in determining the proper valuation of coal for royalty purposes is to determine whether the sales agreement at issue is an arm's-length contract. As noted, the Decker Contracts were in force during two regulatory periods. Before 1989, the regulations did not define arm's-length contracts, instead providing that "gross value shall be the unit sale or contract price times the number of units sold, unless MMS determines that . . . [a] contract or other business arrangement . . . is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of

the coal." 30 C.F.R. § 203.250(g).[10] The Board interpreted the pre-1989 regulations to mean that for a contract to be arm's-length, the contract must be between parties with adverse economic interests. *See, e.g., Amax Lead Company of Missouri,* 84 IBLA at 107.

The current coal royalty valuation regulations, promulgated in 1989, do define "arm's-length contract." A contract or agreement qualities as arm's-length if it "has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract." 30 C.F.R. § 206.251. The regulation further provides that "two persons are affiliated if one person controls, is controlled by, or is under common control with another person." *Id.*

We have noted that Decker, Black Butte, and Big Horn were under the common control of their parent corporation, Kiewit, with Kiewit having a 50 percent ownership interest in Decker and Black Butte and owning Big Horn entirely. In its Answer, MMS emphasizes that "[a]s part of its ownership responsibilities, Kiewit managed the day-to-day operations of both Decker and Black Butte," and further "Kiewit also comprised one half of each company's management committee." Answer at 10. MMS states that "Kiewit's state and federal tax returns are even more revealing of Kiewit's control over Decker, Black Butte, and Big Horn," with "Kiewit fil[ing] a combined Montana Corporation License Tax Return for all three subsidiary entities indicating that they were engaged in a unitary business," and with "Kiewit recogniz[ing] the coal sales from Decker to Big Horn and Black Butte as sales to affiliates" on its Federal Partnership Tax Return. *Id.* MMS finds it evident that "Kiewit did not treat these sales as arm's-length . . . ." *Id.*

Moreover, as MMS points out, the Kiewit and NERCO representatives, Sturm and Drummond, were both members of the Decker Management Committee, the "sort of overlapping control [that] is strongly indicative of a lack of adverse economic interest." *Id.* at 11, *citing Creme Manufacturing Co. v. United States*, 492 F.2d at 520. In his dissent in *Decker v. MDOR*, Judge Hunt described the negotiations as follows: "In other words, a member of the Decker Management Committee 'negotiated' with another member of the Decker Management Committee to sell Decker coal. These 'negotiations' were nothing more than Decker negotiating with itself for the sale of Decker coal with Decker approving what was 'negotiated.'" 2 P.3d at 253.[11] As

[10] *See* note 2 *supra* for text of pre-1989 regulation defining "gross value."

[11] In concluding that "the Kiewit Companies did not have opposing economic interests," Judge Hunt stated:

> Although Decker claims that NERCO's participation in the negotiation of the Montana Contracts ensured that Decker received the highest

(continued...)

observed by MMS, "Kiewit and NERCO stood to gain by switching coal production from Black Butte and Big Horn's Wyoming mines to Decker's Montana mine," with Kiewit and NERCO having a "common interest in switching coal from Black Butte and Big Horn's Wyoming mines to Decker's Montana mine to maximize tax credits in Montana . . . ." *Id.* at 11-12.

MMS finds the terms of the Decker Contracts "[e]ven more telling of the lack of opposing economic interests between Decker, Black Butte, and Big Horn . . . ." *Id.* at 12. Most pertinent, in MMS' view, is the fact that the Contracts "provide that in the event ComEd breaches its obligation to purchase substitute coal from Black Butte and Big Horn, Decker's rights and remedies under its contracts with Big Horn and Black Butte are limited to whatever Black Butte and Big Horn can recover from ComEd." *Id.* MMS finds unpersuasive Decker's argument that there were contract prices below those Kiewit and NERCO agreed to during contract negotiations, as identified in the Sansom Report. MMS states:

> If lower prices were available, Kiewit and UPM would have at least attempted to negotiate with other available coal suppliers for the lower prices if in fact Decker's interest were opposed to the interest of Black Butte and Big Horn. The fact that neither party sought the lower prices indicates that the parties did not have opposing economic interests and they had a common goal to only buy coal from Decker for resale to ComEd.

Id.

We are persuaded, for the reasons given by MMS, that the Decker Contracts are not arm's-length because the parties did not have opposing economic interests.

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[11] (...continued)

> price for its coal, this fact does not magically render the transactions the result of opposing economic interests. It is too simple a point to belabor here, but all of the parties to the Montana Contracts, including NERCO, had the same economic interest of selling more Decker coal. Put simply, everyone stood to profit by the Montana Contracts. This was especially true of Kiewit: not only would ComEd pay Kiewit under the lucrative long-term Big Horn and Black Butte contracts without diminution by the Wyoming coal severance tax, but Kiewit would also be paid for the additional Decker coal that was mined with Decker, as it turns out, being taxed only on the lower face value of the Montana contracts.

Id. at 253-54.

MMS rightly concludes that the Decker Contracts were not the result of arm's-length negotiations.

B. Royalty Valuation of Coal Sold Pursuant to Non-Arm's-Length Contracts

1. "Other Relevant Matters" under 30 C.F.R. § 203.250(g)

As discussed *supra*, Decker's primary argument is that MMS incorrectly applied the regulatory benchmarks for determining the royalty value of coal sold under a non-arm's-length contract. Decker contends that the gross proceeds rule is designed to approximate market value. The approximate market value standard, argues Decker, applies under the pre-1989 regulation (30 C.F.R. § 203.250(g)), and requires application of the first benchmark under the current regulation (30 C.F.R. § 206.257(c)(2)).

[2] In his 2003 Decision, in applying the pre-1989 regulation, the Associate Director stated that MMS may accept non-arm's-length contract prices for royalty valuation purposes only when the lessee demonstrates "independent indicia establishing that the contract price is one fairly derived from the marketplace," citing *AMAX Lead Company of Missouri*, 84 IBLA at 107; *AMAX Lead Company of Missouri (On Reconsideration)*, 99 IBLA at 313; and *Transco Exploration Co. & TXP Operating Co.*, 110 IBLA at 286. He stated that "the record . . . contains no evidence or documentation of arm's-length sales to support Decker's statements regarding the market value of similar coal by similar producers in the area," and that "contrary to Decker's assertion, spot sale prices effective during the audit period are not indicative of the proper value for the coal at issue." 2003 Decision at 16. He concluded that Decker "has failed to demonstrate independent indicia establishing that its non-arm's-length contract price is one fairly derived from the marketplace, as required by the rules in effect prior to 1989." *Id.* In considering the totality of the circumstances, *i.e.*, the "other relevant factors" referred to in 30 C.F.R. § 203.250(g), the Associate Director found the appropriate valuation for the coal to be the price ComEd actually paid for the coal, *i.e.*, the $25 to $31 figures, rather than the Decker-ComEd prices as MRM had concluded.

2. "Other Relevant Matters" Under Benchmark Four (30 C.F.R. § 206.257(c)(2)(iv))

[3] In his 2005 Decision, the Associate Director rejected Decker's argument that the first benchmark applied to the valuation of coal sold pursuant to the Decker Contracts, concluding rather that MRM's valuation under the fourth benchmark of 30 C.F.R. § 206.257(c)(2) was applicable. He stated that "the coal is worth at least what ComEd pays Decker directly for the same quality coal produced from the same mine." 2005 Decision at 4.

MMS characterizes as flawed Decker's contention that "since its contract prices with Black Butte and Big Horn met or exceeded what it asserts was the market value, the first benchmark applies." Answer at 14. The correct analysis, according to MMS, is as follows:

> The gross proceeds rule requires that the value of coal for royalty purposes be no less than the gross proceeds accruing to the lessee. 30 C.F.R. § 206.257(g) (2004). When the lessee sells its coal production under an arm's-length contract, MMS may accept the lessee's contract price, minus certain allowances, as the gross proceeds. 30 C.F.R. § 206.257(b)(1) (2004). When the lessee sells its coal production under a non arm's-length contract, MMS accepts a lessee's gross proceeds only if the gross proceeds are equal to or within the range of the value determined by the first applicable of five valuation criteria, known as "benchmarks." Since the gross proceeds rule establishes a threshold and not a cap, value determined under the regulatory benchmarks may in some circumstances exceed a lessee's purported gross proceeds.

Id.

In its consideration of the Decker Contracts within the terms of the first benchmark, 30 C.F.R. § 206.257(c)(2)(i), MMS states that it "requires that Decker's gross proceeds fall within the range of gross proceeds paid or received by parties not affiliated with the lessee under comparable arm's-length contracts for like-quality coal produced in the area." Answer at 15. MMS states that the "focus of the first benchmark is comparability and not whether the gross proceeds reflect market value," as Decker contends, and that "without evidence of comparable contracts, MMS cannot apply the first benchmark." *Id.* MMS states that it "carefully and objectively reviewed the Sansom Report," the primary source of evidence of comparable contracts, and concluded that it "did not provide adequate evidence of comparable contracts which is necessary to establish that Decker's contract prices were representative of the gross proceeds others received under comparable arm's-length transactions." *Id.* at 16. MMS asserts that "[t]he record is absent any example of any arm's-length contract between parties not affiliated with Decker that is comparable to or resembles the agreements between Decker and Black Butte and Big Horn." *Id.* at 17. "Accordingly," concludes MMS, "the first regulatory benchmark for determining the value of coal disposed of under non-arm's length sales contracts involved here is inapplicable." *Id.* at 18.

MMS proceeds to explain its position that the fourth benchmark provides the proper valuation of the coal sold to Black Butte and Big Horn and resold to ComEd pursuant to the Decker Contracts. MMS viewed as "other relevant matters" under 30 C.F.R. § 206.257(c)(2)(iv) the prices ComEd was paying for Decker's coal through direct purchases pursuant to the 1974 Decker-ComEd coal sales contracts. MMS had reasoned in its 1992 and 1997 orders, as did the Associate Director in his 2005 Decision, that "the coal is worth at least what ComEd pays Decker directly for the same quality coal produced from the same mine." 2005 Decision at 4. Thus, "since Decker continued to sell its coal to ComEd under the 1974 contract, the 1974 contract establishes the proper royalty value of any Decker coal sold to ComEd, whether in a direct sale between ComEd and Decker or through an indirect sale by Black Butte or Big Horn." Answer at 22. MMS finds pertinent the fact that on its 1987 and 1988 Federal Partnership Tax Returns Decker indicated that the average selling prices of Decker's coal were "more than double Decker's non-arm's-length sales prices to Black Butte and Big Horn." *Id.*

We find MMS' reasoning persuasive. Simply put, the record is devoid of any example of an arm's-length contract comparable to, or even resembling, the agreement between the Kiewit affiliates by means of which Decker's coal was sold to ComEd. In his dissenting opinion, Judge Hunt begins with the question, as "ironically" framed by MDOR: "How can this coal be worth the values of $7 to $10/ton claimed by Decker and its expert when it is *simultaneously* sold to Commonwealth for $24 to $29/ton?" 2 P.3d at 252-53. Judge Hunt underscores a point that reinforces the analysis provided by MMS in 2005 Decision and Answer, *i.e.*, "the 1970s long-term contracts between ComEd and the Kiewit Companies were arms-length agreements negotiated between a willing buyer and seller," and that "[t]herefore, nothing should prevent the DOR from piercing the sham Montana Contracts and reaching the true value of the underlying, arms-length transactions." *Id.* at 254. The reason Judge Hunt agreed with MDOR that the value of the Decker coal actually paid by ComEd should be imputed to the coal applies to our application of 30 C.F.R. § 206.257(c)(2) and to our rejection of benchmark one as the appropriate benchmark in valuing the Decker coal. The necessary predicates for applying benchmark one are simply absent from the record, in that the gross proceeds cannot be said to be within the range of the 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." 30 C.F.R. § 206.257(c)(2)(i). As Judge Hunt so aptly concluded, at the beginning of his opinion: "I agree with DOR that artificial prices between companies that share common management and ownership do not accurately reflect the true value of coal upon which coal production taxes are based. Rather, the best indicator of value of the Montana coal production for tax purposes is the *actual price paid* for the coal in question, as determined by the long-term contracts underlying the transactions." *Id.* This reasoning serves as a succinct summary of why we now hold that MMS correctly determined that the proper benchmark to use in calculating royalty on the Decker coal is benchmark four and not one.

IV. CONCLUSION

Our review of this record leaves us with no doubt that the Associate Director correctly ruled that the Decker Contracts were non-arm's-length contracts under both the pre-1989 regulation, 30 C.F.R. § 203.250(g), and the current regulation, 30 C.F.R. § 206.251. We further conclude that under 30 C.F.R. § 203.250(g), as applied by this Board, the Associate Director properly determined that the coal sold pursuant to the Decker Contracts should be valued at what ComEd in fact paid for the coal. Under the current regulation on valuing coal subject to a non-arm's-length contract, 30 C.F.R. § 206.257(c)(2), the Associate Director properly determined that the first applicable criterion was benchmark four and, again, that royalty should be calculated on the prices ComEd actually paid to Black Butte and Big Horn, Decker's affiliates, for the coal. We accordingly affirm the Associate Director's 2005 Decision.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is affirmed.

/s/
James F. Roberts
Administrative Judge

I concur:

/s/
Lisa Hemmer
Administrative Judge