DECKER COAL COMPANY

176 IBLA 277

Decided January 5, 2009

Editor’s Note: appeal filed Civ. No. 1:09-cv-26-BLG-RFC (D. Mt. March 6, 2009), vacated and remanded to MMS (Feb. 16, 2010), 2010 WL 555676
DECKER COAL COMPANY

IBLA 2008-146 Decided January 5, 2009

Appeal from a decision by the Associate Director, Minerals Management Service, affirming and modifying an Order to Report and Pay Additional Royalties. MMS-03-0106-COAL.

Affirmed.

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

To value coal sales at prices paid pursuant to an arm’s-length contract, a lessee must demonstrate that such contract is between independent, nonaffiliated persons. In determining whether a lessee has met this burden, MMS may consider facts and circumstances beyond the four corners of the contract.

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

In valuing coal sold pursuant to a non-arm’s-length contract, MMS determines royalty value based upon the first applicable criterion (or benchmark) identified in 30 C.F.R. § 206.257(c)(2). When MMS determines that the fourth benchmark applies, it is the lessee’s burden to demonstrate by a preponderance of the evidence that a more senior benchmark should have been applied by MMS.


176 IBLA 277
OPINION BY ADMINISTRATIVE JUDGE JACKSON

Decker Coal Company (Decker) appeals from a February 15, 2008, decision by the Associate Director, Minerals Management Service (Decision), affirming an Order to Report and Pay Additional Royalties of $7,529,456 issued on October 30, 2003 (Order).

BACKGROUND

This appeal involves actions by, transactions between, and agreements among Decker, Black Butte Coal Company (Black Butte), and Commonwealth Edison Company (ComEd). Decker owns and operates a coal mine in Big Horn County, Montana, on public lands under leases issued pursuant to the Mineral Leasing Act of 1920, as amended, 30 U.S.C. §§ 201-209 (2000); Black Butte owns and operates a coal mine on non-Federal lands in Sweetwater County, Wyoming. It is undisputed that Decker and Black Butte are affiliated (i.e., a 50% interest in each is owned by Kiewit Mining Group). ComEd is an electric utility with coal-fired generating facilities in and around Chicago, Illinois.


By the early-to-mid 1980s, ComEd realized that its coal needs were substantially less than what it was required to purchase under its Coal Purchase Agreements with Decker and Black Butte. To partially address this imbalance, ComEd entered into “Reserve Coal transactions” with both Black Butte and Decker. These Reserve Coal transactions have two parts, the purchase of an undivided interest of coal in the ground (Reserve Coal) under a Coal Lease Purchase Agreement and an agreement to mine Reserve Coal under a Coal Mining Agreement. Beginning in 1982 and continuing through 1992, ComEd acquired 15,933,005 tons of Reserve Coal at the Black Butte Mine under its Reserve Coal Lease Purchase Agreements with Black Butte. This tonnage apparently represents the difference between what ComEd was required to purchase under its 1976 Coal Purchase Agreement and what Black Butte supplied under that agreement, including coal from the Decker Mine under the Decker Contracts.

The Minerals Management Service (MMS) audited Decker for the period from 1985 through 1990, and by order dated October 2, 1992, determined that Decker’s
contracts with Black Butte (i.e., the Decker Contracts) were not arm’s-length because they were not between “independent, nonaffiliated persons with opposing economic interests,” as required by 30 C.F.R. § 206.251. MMS then directed Decker to pay additional royalties of $512,993.90. See Decker Coal, 172 IBLA at 3-7. Decker appealed that order. 1 Decker, Black Butte, and ComEd then restructured several of their transactions as follows:

- Effective January 1, 1993, Decker and ComEd agreed to combine, amend, and restate their 1974 Coal Purchase Agreement and the Decker Contracts (ComEd had replaced earlier Black Butte as the purchaser under the Decker Contracts).

- Effective January 1, 1993, Decker and ComEd entered into a Coal Purchase Contract in which Decker agreed to supply and ComEd agreed to purchase 15,933,006 tons of coal from the Decker Mine at a base price of $7.00 per ton (subject to adjustment).

- Effective January 1, 1993, ComEd assigned its interest in the Coal Purchase Contract to Black Butte.

- Effective January 1, 1993, Black Butte and ComEd entered into an Amended and Restated Coal Mining Agreement in which they agreed to combine, amend, and restate their Reserve Coal transactions so that Reserve Coal at the Black Butte Mine (15,933,006 tons) would be supplied from the Decker Mine under Decker’s Coal Purchase Contract with ComEd, which “has been assigned by [ComEd] to Black Butte.”

Decker’s coal sales to ComEd were again audited by MMS, this time for the period from 1993 through 2001. MMS auditors confirmed that 3,269,486 tons of “Reserve Coal” had been delivered to ComEd at the Decker Mine between 1993 and 1999 under the Coal Purchase Contract. Order at 8. The auditors determined that

---

1 This appeal was consolidated with its appeal of a 1997 order directing it to pay additional royalties of $5,238,321.13 for 1991 and 1992; both appeals were decided by the Associate Director on Apr. 18, 2003. Decker appealed, but while its appeal was pending, MMS identified an error in its application of royalty benchmarks and requested a remand to correct that error. We granted that request, and a modified decision on remand was issued by the Associate Director on Jan. 13, 2005. After Decker again appealed, we affirmed MMS’s determination that the Decker Contracts were not arm’s-length and concluded that coal sold thereunder should be valued at the price ComEd paid to Decker for similar coal under their 1974 Coal Purchase Agreement ($25 ± per ton), not the price later agreed to under the Decker Contracts ($8 ± per ton). Decker Coal, 172 IBLA at 20-22, 25-26.
these deliveries had been made to fulfill Black Butte’s Reserve Coal obligations to ComEd and that these sales by Decker were not pursuant to an arm’s-length contract with ComEd because that contract had been earlier assigned by ComEd to Black Butte.\textsuperscript{2} \textit{Id.} at 5, 7. They valued this coal sold by Decker under 30 C.F.R. § 206.257(c)(2),\textsuperscript{3} determining that Benchmark Two applied because ComEd reported the prices it paid for coal from the Decker Mine on FERC 423 reports. In applying

\textsuperscript{2} MMS defines “arm’s-length contract” in 30 C.F.R. § 206.251 as follows:

[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 . . . . 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 the production month as well as when the contract was executed.”

\textsuperscript{3} These rules identify criteria (benchmarks) for valuing coal not sold pursuant to an arm’s-length contract:

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 . . . , provided that those gross proceeds are 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. In evaluating the comparability of arm’s-length contracts for the 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 [Benchmark One];

(ii) Prices reported for that coal to a public utility commission [Benchmark Two];

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

(iv) Other relevant matters including, but not limited to, published or

(continued...)

176 IBLA 280
that criterion “to arrive at the price paid by ComEd for the Black Butte Reserve Coal mined at the Decker Mine,” MMS adjusted ComEd’s reported prices by deducting its annual average rail transportation rates and determined a royalty value of more than $30 per ton. Order at 11-12. MMS ordered that additional royalties of $7,529,456 be paid; Decker appealed to the Director under 30 C.F.R. § 290.105.

The Associate Director for Policy and Management Improvement, MMS, concluded that sales pursuant to the Coal Purchase Contract were not at arm’s-length because “ComEd subsequently assigned its interest in that contract to Black Butte [and b]y this assignment, the parties amended the terms of the contract so that it became a non-arm’s-length contract between affiliated parties.” Decision at 4. The Associate Director also concluded that these sales were “used to fulfill Black Butte Reserve Coal requirements [to ComEd].” Id. at 4-5. As in his decision that was affirmed in Decker Coal, 172 IBLA at 25-26, the Associate Director determined that neither Benchmark 2 nor Benchmark 3 applied. Decision at 6-7.4 The Associate Director found Benchmark Four, 30 C.F.R. § 206.257(c)(2)(iv) (“other relevant matters . . . concerning circumstances unique to a particular lease operation”), to be the first applicable criterion:

I find that the appropriate royalty value under this benchmark is the price Decker received for its coal under its own supply contract with ComEd. It makes sense that the coal at issue in this appeal is worth the same as the like quality coal that ComEd buys from Decker. As previously established and stated in the 2005 decision, “It is reasonable to expect that the coal is worth at least what ComEd pays Decker directly for the same quality coal produced from the same mine.” Modified 2005 Decision at 4. Again, this conclusion is consistent with and is mandated by Decker Coal Company, 172 IBLA 1, 25-26 (2007). Furthermore, the record indicates that this is a reasonable value. Pages eleven and twelve of the Order show that ComEd paid a price adjusted for rail transportation rates of between $31.19 and $36.75 per ton of

3 (...continued)

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 [Benchmark Four];

(v) If a reasonable value cannot be determined . . . , then a net-back method or any other reasonable method shall be used to determine value [Benchmark Five].

4 Decker does not claim that Benchmark Two or Three should have been applied by MMS; they are considered no further. See Statement of Reasons (SOR) at 28.
coal during the period 1993 - 1999. Thus, the valuing of Decker’s coal sales at a price near $25 per ton is proper.

Decision at 6-7. The Associate Director then ordered Decker to recalculate and pay additional royalties under Benchmark Four, as described above. *Id.* at 7. Decker timely appealed to this Board.

**DISCUSSION**

Decker advances two principle claims on appeal. It first claims that its Coal Purchase Contract with ComEd was an arm’s-length contract, arrived at in the marketplace between two independent entities with opposing economic interests, and that neither its assignment by ComEd to Black Butte nor its subsequent amendment by Black Butte are relevant in determining whether it is arm’s-length. SOR at 13-19; *see* n.2, *supra*. Second, even if not an arm’s-length contract, Decker claims that Benchmark One, 30 C.F.R. § 206.257(c)(2)(i), is the first applicable criterion. SOR at 23-28; *see* n.3, *supra*. For the reasons discussed below, we affirm the Associate Director’s Decision.

I. The Coal Purchase Contract is Not an Arm’s-Length Contract.

Decker argues that the form of its Coal Purchase Contract with ComEd is dispositive and that its simultaneous assignment to and subsequent amendment by Black Butte are irrelevant to a proper determination of whether it is arm’s-length. We disagree. The Coal Purchase Contract was effective on the same day it was assigned by ComEd to Black Butte, which was also the same day ComEd and Black Butte agreed that Reserve Coal at the Black Butte Mine would be supplied by Decker under the Coal Purchase Contract. Since both of these transactions were effective on the same date, it follows that Decker and Black Butte were parties to the Coal Purchase Contract in both fact and law. We are unpersuaded that we (or MMS) should put form over substance in determining whether this is an arm’s-length contract and ignore these circumstances or the affiliation of Decker with Black Butte.

[1] To value coal sales based on gross proceeds received pursuant to an arm’s-length contract, the burden was on Decker to demonstrate “its contract is arm’s-length.” 30 C.F.R. § 206.257(b)(1); *see, e.g.* Michael Voegele, 174 IBLA 313, 318 (2008). Although the form of the Coal Purchase Contract and the proffered affidavit of ComEd’s Manager of Fuel suggest it was arm’s-length, we find it consistent with applicable royalty rules for MMS to go beyond the four corners of that contract and consider its context and substance in determining whether it is arm’s-length. The record demonstrates that Decker and Black Butte were parties to the Coal Purchase Contract on and after its effective date and are neither independent
nor nonaffiliated, as required to meet the definition of an arm’s-length contract under 30 C.F.R. § 206.251. Even if this contract was arm’s-length when it was executed by ComEd and made effective on January 1, 1993, “[t]o be considered arm’s-length for any production month, a contract must meet the requirements of this definition for the production month as well as when the contract was executed.” 30 C.F.R. § 206.251. Decker has not met its burden to establish that the Coal Purchase Contract was arm’s-length when it sold coal pursuant to that contract on and after January 1, 1993. See Decker Coal, 172 IBLA at 21-22.

II. Benchmark One Was Not Applicable Under the Circumstances of This Case.

For Benchmark One to apply under rules applicable to sales pursuant to a non-arm’s-length contract, a lessee’s gross proceeds must be “within the range of the gross proceeds derived from, or paid under, comparable arm’s length contracts . . . [for] like-quality coal produced in the area.” 30 C.F.R. § 206.257(c)(2)(i). In Decker Coal, appellant claimed that Benchmark One applied, arguing that the price at which it sold coal to Black Butte under the Decker Contracts (approximately $7.50 per ton) was within the range of prices then paid for like-quality coal sold under arm’s-length contracts, as demonstrated by an expert report by Dr. Robert Sansom. 172 IBLA at 8, 18-19. We rejected that claim because the record was “devoid of any example of an arm’s-length contract comparable to, or even resembling the agreement between Kiewit affiliates by means of which Decker’s coal was sold to ComEd.” Id. at 25. Decker reasserts the same claim here, again relies upon an expert report by Sansom, and proffers a confirming affidavit to the same effect. SOR at 23-27; see SOR Attachments 2 and 5. We are unpersuaded that we should reach a different result in this case. See Decker Coal, 172 IBLA at 25.

[2] Decker challenges MMS’s determination that Benchmark Four applies, contending that Benchmark One should have been applied. To prevail, Decker must show by a preponderance of evidence that the gross proceeds it received under the Coal Purchase Contract are within the range of what others received under “comparable arm’s-length contracts.” 30 C.F.R. § 206.257(c)(2)(i). Thus, Decker must not only show that its gross proceeds are within the range of arm’s-length contracts, but that those contracts are also “comparable.” Decker expends considerable effort to show that prices under the Coal Purchase Contract (approximately $7 per ton) are within the range of certain arm’s-length contracts, SOR at 3-7, 25-27, but offers little to demonstrate that these contracts are comparable to the Coal Purchase Contract.

The Coal Purchase Contract was for a 15 year term and involved the sale of 15,933,009 tons of Decker coal. In evaluating comparability, MMS is directed to consider “duration, . . . terms, . . . quantity, and such other factors as may be
appropriate to reflect the value of the coal.” 30 C.F.R. § 206.257(c)(2)(i). Neither spot market data, sales under purchase order, nor contracts of substantially shorter duration and/or for substantially less coal are necessarily comparable to the Coal Purchase Contract. SOR Attachments 2 and 5; see Decker Coal, 172 IBLA at 24-25. Moreover, the potentially unique circumstances of the Coal Purchase Contract, including its relation to Black Butte meeting its Reserve Coal obligations to ComEd, are “other factors” affecting the value of coal sold by Decker and, as such, appropriately considered in determining whether the arm’s-length contracts identified by Decker are “comparable.”

The Coal Purchase Contract simply does not reflect the value of coal here at issue. Decker mined Reserve Coal for Black Butte and delivered it to ComEd under the Coal Purchase Contract to satisfy Black Butte’s Reserve Coal obligations to ComEd under their 1993 Coal Mining Agreement, just as Decker supplied coal to ComEd under the Decker Contracts to satisfy Black Butte’s obligations to ComEd under their 1976 Coal Purchase Agreement. See Decker Coal, 172 IBLA at 3, 16, 24-25. As there stated, “the best indicator of value . . . is the actual price paid for the coal in question, as determined by the long-term contracts underlying the transaction.” Id. at 25 (emphasis in original). The Associate Director determined royalty value based on what ComEd paid Decker for coal from the Decker Mine under their 1974 Coal Purchase Agreement (approximately $25 per ton). Decision at 6-7. We find no error in that determination but note that MMS could have determined royalty value based on what ComEd paid for Reserve Coal in the ground at the Decker Mine and for later mining and delivering that coal under its Reserve Coal transactions with Decker. Thus, even if Benchmark One could be applied in this case, we would reject Decker’s claim that its gross proceeds are only $7 per ton (i.e., the price paid to Decker under its 1993 Coal Purchase Contract for removing Reserve Coal from the ground so as to satisfy Black Butte’s Reserve Coal obligations to ComEd), without regard to what ComEd had earlier paid for Reserve Coal at the Decker Mine under its Coal Lease Purchase Agreements with Decker. See SOR at 19-23.

To the extent not expressly addressed herein, all other errors of fact or law raised by the appellants have been considered and rejected as contrary to the facts or law or as immaterial to a final resolution of this appeal.
Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the February 15, 2008, decision by the Associate Director, MMS, is affirmed.

/s/
James K. Jackson
Administrative Judge

I concur:

/s/
R. Bryan McDaniel
Administrative Judge