

# **federal register**

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**Friday  
July 15, 1988**

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**Part III**

## **Department of the Interior**

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**Minerals Management Service  
Bureau of Land Management**

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**30 CFR Parts 202 et al.**

**43 CFR Part 3480**

**Revision of Coal Product Valuation  
Regulations and Related Products;  
Further Proposed Rulemaking**

**DEPARTMENT OF THE INTERIOR****Minerals Management Service****Bureau of Land Management****30 CFR Parts 202, 203, 206, and 212****43 CFR Part 3480****Revision of Coal Product Valuation Regulations and Related Topics****AGENCY:** Minerals Management Service (MMS), Bureau of Land Management, Interior.**ACTION:** Further notice of proposed rulemaking.

**SUMMARY:** This proposed rulemaking provides for the amendment and clarification of regulations governing the valuation of coal for royalty purposes. The regulations being amended affect Federal coal leases and Indian (Tribal and allotted) coal leases (except leases on the Osage Indian Reservation, Osage County, Oklahoma).

The purpose of this proposed rulemaking is to update, consolidate, and clarify existing regulations in order to provide industry and the public with a comprehensive and consistent coal valuation policy. The revised regulations will result in consistent and uniform guidance to industry relative to the valuation of coal for royalty computation purposes.

**DATE:** Written comments must be received on or before September 13, 1988. A hearing will be held on September 7, 1988, 8:30 a.m. to 4:00 p.m. in Lakewood, Colorado.

**ADDRESS:** Written comments may be mailed to Minerals Management Service, Royalty Management Program, Rules and Procedures Branch, Denver Federal Center, Building 85, P.O. Box 25165, Mail Stop 662, Denver, Colorado 80225. Attention: Dennis C. Whitcomb.

The hearing will be held in the auditorium, Building 25, Denver Federal Center, 6th and Kipling Streets, Lakewood, Colorado.

**FOR FURTHER INFORMATION CONTACT:** Dennis C. Whitcomb (303) 231-3432, (FTS) 326-3432.

**SUPPLEMENTARY INFORMATION:** The principal authors of this rule are Earl Cox, Herbert B. Wincentzen, Thomas J. Blair, and Stanley J. Brown of the Royalty Valuation and Standards Division of the Minerals Management Service (MMS), Lakewood, Colorado; Donald T. Sant, Deputy Associate Director for Valuation and Audit, MMS; and Peter J. Schaumberg of the Office of the Solicitor, Washington DC.

**I. Introduction**

A notice of proposed rulemaking for coal product valuation regulations was published in the *Federal Register* on January 15, 1987 (52 FR 1840), with a 90-day comment period. The public comment period was reopened on July 9, 1987. Additional comments were accepted through July 23, 1987 (52 FR 25887). A total of 82 comments were received from industry representatives, State governments, local governments, Indian Tribes, Indian organizations, and other persons.

During the initial comment period, a public hearing on the proposed rulemaking was held on March 3, 1987, in Denver, Colorado. The Royalty Management Advisory Committee (RMAC) also held a meeting on April 1, 1987, in Denver, Colorado, on the proposed coal valuation rulemaking. Industry, State, and Indian representatives also met with MMS and Department of the Interior (Department) officials during the comment period to discuss issues pertaining to the proposed rulemaking. Minutes from these meetings were included in the record and were incorporated as comments on the proposed rulemaking along with the transcripts from the public hearing and RMAC meeting, and written comments received by MMS.

On August 12, 1987, MMS published a notice in the *Federal Register* (52 FR 29868) reopening the public comment period for 60 days primarily to obtain public comments on a proposal submitted jointly on behalf of the coal and electric utility industries. This proposal included a comprehensive, section-by-section set of revisions to the January 1987 proposed rulemaking. The MMS received 46 comments on the industry proposal which are discussed in more detail below.

The MMS also recently completed two rulemakings to adopt new product valuation regulations for oil (53 FR 1184, January 15, 1988) and gas (53 FR 1230, January 15, 1988). The rulemaking process for oil and gas included draft rules, proposed rules, and two further notices of proposed rulemaking with draft final rules appended. (Citations are included in the preamble to the final rules.)

On June 7, 8, and 9, 1988, MMS held open meetings with representatives of the Western States, Indian Tribes, and the coal and electric utility industries to discuss a draft of this proposed rule. Several suggested changes and additions offered at those meetings have been incorporated in this proposed rule.

In this preamble, MMS will note some of the principal comments received thus

far on the coal rules. Most comments will be addressed in the final rule. The MMS will include in the rulemaking record all comments received to date plus the comments on this further notice of proposed rulemaking.

To the extent that the regulatory provisions in this notice have not changed significantly from the January 1987 proposal, we are not repeating the preamble discussion in this notice. Commenters should refer to the January 15, 1987, notice of proposed rulemaking (52 FR 1840).

Sections 206.254, 206.257, 206.259, 206.262, and 206.263 of the proposed rule contain information collection requirements. Public reporting burden for this collection of information is estimated to vary from one half hour to 3 hours per response with an average of 1.5 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Due to the complexity of the information requested, applications for allowances, using Forms MMS-4292 and MMS-4293 in non-arm's-length or no-contract situations may require up to an estimated 40 hours per response. Send comments regarding the burden estimate or any other aspect of this collection of information including suggestions for reducing this burden, to the Information Collection Clearance Officer, Mail Stop 631, Minerals Management Service, 12203 Sunrise Valley Drive, Reston, VA 22091; and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503.

**II. Purpose and Background**

These rules would supersede all currently effective coal royalty valuation directives, such as those contained in numerous Secretarial, MMS, and U.S. Geological Survey Conservation Division (now Bureau of Land Management Onshore Operations) decisions and orders. These rules would apply to production on or after the effective date of the final rule for all leases including coal from existing leases, except for certain proposed grandfather provisions which are addressed later in this preamble.

Structurally, these rules add sections to 30 CFR Parts 202, 203, and 206, revise subpart titles in Part 212, and remove paragraphs from 30 CFR 203.250 and 43 CFR 3485.2. Paragraph (b) of § 203.250 is redesignated to Part 202 as § 202.250. Also, §§ 206.250, 206.251, 206.252, 206.253, 206.254, 206.255, 206.256, 206.257,

206.258, 206.259, 206.260, 206.261, 206.262, 206.263, 206.264, and 206.265 are added to Subpart F of Part 206.

For the convenience of coal lessees, payors, and the public, the following chart summarizes the effects of the

proposed rule:

Regulation Changes (all from 30 CFR, except as noted)	Descriptions
<b>I. Redesignations:</b>	
1. Paragraph (b) of § 203.250 is designated to Part 202 as § 202.250	This administrative action more appropriately locates within 30 CFR the information contained in this paragraph.
2. Paragraph (a) of § 203.250 is redesignated as § 203.250	This administrative action removes the paragraph designation.
3. Paragraph 3485.2(j) is redesignated to 3485.2(d)	This action resulted from the deletion of paragraphs 3485.2(d) through 3485.2(i).
<b>II. Deletions</b>	
1. Paragraphs (c), (d), (e), (f), (g), (h), (i), (j), and (k) of § 203.250 are removed.	This action eliminates the existing coal product valuation regulations.
2. Paragraphs (d), (e), (f), (g), (h), (i), and (k) of § 3485.2 are removed	This action eliminates the existing coal product valuation regulations found at Subpart 3485 of 43 CFR. These regulations are redundant with those at § 203.200, of 30 CFR Part 203, and would conflict with the new regulations intended to replace those in § 203.200.
<b>III. Additions:</b>	
1. Sections 206.250, 206.251, 206.252, 206.253, 206.254, 206.255, 206.256, 206.257, 206.258, 206.259, 206.260, 206.261, 206.262, 206.263, 206.264, and 206.265 are to be added to Subpart F of Part 206.	The addition of these sections provides new coal valuation regulations to replace those currently found at § 203.200 of 30 CFR and § 3485.2 of 43 CFR.
2. Subpart H—Geothermal Resources—[Reserved] and Subpart I—"OCS Sulfur (Reserved)" are added to Part 212.	This administrative action creates new subparts for future rulemaking requirements.
<b>IV. Amendments:</b>	
1. Section 206.10 is amended to add information collection requirements for coal product valuation.	This administrative action places all information collection in Subpart A—General Provisions.
2. The titles of Subparts C, D, F, and G under Part 212 are revised to read: Subpart C—Federal and Indian Oil—[Reserved] Subpart D—Federal and Indian Gas—[Reserved] Subpart F—Coal—[Reserved] Subpart G—Other Solid Minerals—[Reserved]	This administrative action creates new subparts for future rulemaking requirements.
3. Section 212.200 under Part 212 is amended	This technical amendment deletes the obsolete reference to the "District Mining Supervisor" and replaces the word "Associate Director for Royalty Management" with the word "MMS" for consistency with other parts.

These rules generally would apply the same valuation standards to coal from Indian lands and coal from Federal lands. Except for Indian cents-per-ton leases (which currently have specific royalty provisions in Title 25 of the Code of Federal Regulations, see 25 CFR 211.15(c), 212.18(c), 213.23(c), and 214.10(b)), this is a continuation of the practices under existing regulations.

These rules expressly recognize, however, that where the provisions of any Indian lease, or any statute or treaty affecting Indian leases, are inconsistent with the regulations, then the lease, statute, or treaty shall govern to the extent of the inconsistency. This same principle applies to Federal leases.

The mineral leasing laws require that the Secretary receive a royalty on the "value of production" or the "value of coal" from minerals produced from Federal lands, but value is a word without precise definition. "Men have all but driven themselves mad in an effort to definitize its meaning." *Andrews v. Commissioner of Internal Revenue*, 135 F.2d 314, 317 (2nd Cir. 1943). The word "value" has sometimes been modified by the words "fair market," although the mineral leasing law provisions on "value of production" do not include these words. But, these adjectives do not really clarify the word value. The word "fair" can modify the word value as in "fair value" or it can

modify the word market as in "fair market." The term "fair value" may not be interpreted the same as the "fair market" value. The term fair market value, however, has been generally accepted to be the price received by a willing and knowledgeable seller, not obligated to sell, from a willing and knowledgeable buyer not obligated to buy. Willing, knowledgeable, and obligated are again adjectives which are not terms of precise definition. These general concepts, however, were still the general principles which were followed in drafting these regulations on valuation of production for the purpose of calculating royalties. The general presumption is that persons buying or selling products from Federal and Indian leases are willing, knowledgeable, and not obligated to buy or sell. Because the U.S. economy is built upon a system whereby individuals are provided the opportunity to advance their individual self interest, this seems to be a reasonable presumption. This system and its reliance on self-motivated individuals to engage in transactions that are to their own best interest, therefore, is a cornerstone of the regulations.

The purpose of the regulations is to define the value of production, for royalty purposes, for production from Federal and Indian lands. Value can be determined in different ways, and these

rules explain how value is to be established in different circumstances. Value in these regulations generally is determined by prices set by individuals of opposing economic interests transacting business between themselves. Prices received for the sale of products from Federal and Indian leases pursuant to arm's-length contracts are often accepted as value for royalty purposes. However, even for some arm's-length contracts, contract prices may not be used for value purposes if the lease terms provide for other measures of value (such as Indian leases) or when there is a reason to suspect the bona fide nature of a particular transaction. Even the alternative valuation methods, however, are determined by reference to prices received by individuals buying or selling like-quality products in the same general area and having opposing economic interests. Also, in no instance can value be less than the amount received by a lessee in a particular transaction.

### III. Response to General Comments on the First Notice of Proposed Rulemaking

*Comment:* One issue that permeated many of the comments, but which is unrelated to coal valuation, concerns the royalty rate. Several comments submitted by industry and several States stated that the 12½-percent

royalty rate was too high thus placing an unfair financial burden on lessees, which in turn places them at an economic disadvantage. One State commented that royalty rates, in concert with valuation of deep-mined coal, place underground mines at a disadvantage and the 8-percent royalty rate "should be lowered accordingly to a maximum rate of 5 percent, but more equitably, a lower rate should be adopted by legislative action."

**MMS Response:** The royalty rate is not a valuation issue. The 12½-percent royalty rate imposed on surface coal operations is required by statute. The Mineral Leasing Act of 1920 (MLA), as amended specifically by the Federal Coal Leasing Amendments Act of 1976 (FCLAA), requires the Secretary of the Interior to determine a royalty "of not less than 12½-per centum . . . except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations." The Bureau of Land Management (BLM) regulations at 43 CFR 3473.3-2 require a royalty rate of 8 percent for coal from underground mines, with the provision to determine a lesser rate if conditions warrant, but in no case less than 5 percent. The MLA at 30 U.S.C. 209 provides statutory authority to reduce royalty rates for those lessees that cannot successfully operate their leases under the prevailing terms and conditions.

**Comment:** Several commenters expressed concern that deletion of redundant royalty provisions from 43 CFR 3485.2 would create confusion because of cross-references found in other sections of 43 CFR Part 3480. The MMS agrees that some potential confusion could result if certain sections of 43 CFR 3480 continue to refer to portions of 43 CFR 3485.2 which would be deleted under a final rulemaking. The BLM will, as part of its normal ongoing housekeeping duties, ensure that 43 CFR 3480 is appropriately modified to eliminate cross-references to nonexistent sections.

**Comment:** Some commenters stated that in the January 1987 proposed rulemaking, MMS neither acknowledged nor adopted the Royalty Management Advisory Committee's (RMAC's) recommendations concerning coal product valuation. These commenters also stated that MMS did not provide its reasoning for not accepting RMAC's recommendations.

**MMS Response:** These comments are without merit. The January 15, 1987, Federal Register notice states that "MMS also has considered the written and oral comments from the public on the draft rules and the resolution

presented to the Secretary by RMAC." (52 FR 1840) The MMS also noted with appreciation the dedicated efforts of all participants who worked on the problems of coal valuation. The MMS considered the section-by-section analysis that preceded the proposed rules adequate explanation and notice to the public, including RMAC, of the substantive reasoning and motivation that guided the formulation of the proposed rules.

**Comment:** Several industry commenters claimed that MMS's proposed regulations were destroying the longstanding past practice of royalty valuation which is supported by administrative and judicial decisions. Some commenters stated that MMS's regulations represented an attempt to broaden, not clarify, regulations pertaining to royalty valuation. One commenter stated that, "The Minerals Management Service has demonstrated an attitude which borders on the rapacious. The proposed rules are nothing more than a naked attempt to maximize revenues from federal and Indian coal leaseholds." One commenter stated that MMS's use of longstanding policy to support these regulations was untenable, because there is no longstanding policy for coal product valuation.

**MMS Response:** The MMS disagrees with the commenter's categorization of MMS's attitude as bordering on the "rapacious." On the contrary, MMS believes the proposed rules appropriately update and clarify existing policies regarding coal royalty valuation. The MMS and its predecessor agency, the Conservation Division, U.S. Geological Survey, have always required royalty to be paid on the full value of the coal. This policy was established in the early 1970's in order to uniformly administer the first Federal coal leases that carried ad valorem royalty rates. Many of the original underlying principles of coal royalty valuation were cloned from existing valuation practices for noncoal leasable minerals, notably phosphate, potassium, and sodium, which, since the enactment of the MLA, have always required ad valorem royalty rates. The MMS considers royalty valuation principles dating back to the 1920's and 1930's as longstanding.

**Comment:** State and Indian commenters stated that the manner in which the proposed regulations were constructed essentially eliminates the protection of the existing regulations, and the self-implementing aspects of the proposed regulations invite industry abuse. These commenters further charged that MMS was abrogating its

monitoring, review, and audit responsibilities with respect to coal product valuation. On the other hand, one industry commenter stated an objection to the "subjective determination elements [which] indicate a significant distrust by the government of the coal industry's past practices of valuation and accounting for royalty purposes."

**MMS Response:** The MMS believes that no derogatory connotation of industry accounting or valuation practices should be attributed to the first proposed rules. These rules should also not be viewed as delegating valuation responsibilities and duties to industry. The report entitled "Fiscal Accountability of the Nation's Energy Resources" written by the Linowes Commission and published in January 1982 (p. xvi) stated "The Federal government should perform an oversight role. It must not waste its limited resources on tasks that are industry's responsibility. In managing royalty collection, it should not remain mired in bookkeeping details that rightly belong to the lessee. Instead, it should develop systematic, independent cross checks of royalties paid and reports submitted by companies, and it should impose meaningful penalties for false statements or gross errors." The MMS considers these rules to carry out that recommendation.

**Comment:** Many industry commenters stated that the proposed regulations do not promote development of Federal coal resources. An area of concern to these commenters is that these regulations discourage conservation of Federal coal. Some industry commenters stated that the proposed regulations would influence the economic behavior of the coal industry. One commenter's rationale for this position was that "The economic forces of the marketplace would move mine plans away from high-royalty/high-cost coal to lower-royalty/lower-cost coal or would hasten the closure or cessation of the mining of such Federal coal reserves." One commenter also stated "that MMS or BLM, is party to the ups and downs of the coal business and as such should work with the industry to improve market share as well as profitability." One commenter stated that MMS failed to take into consideration the Mining and Minerals Policy Act of 1970, which states that in part that: "The Congress declares that it is the continuing policy of the Federal Government . . . to foster and encourage private enterprise in (1) the development of economically sound and stable domestic mining . . ." One State commenter and one Indian

commenter suggested that MMS should ignore any potential economic impacts that may result from the final coal valuation regulations. Opposing this viewpoint, one industry commenter stated that MMS should consider the plight of the electric utility rate payer who ultimately bears the full burden of any royalty increase.

**MMS Response:** The MMS disagrees with the statement that these regulations do not promote development of coal resources. The MMS considers these regulations to promote development to the extent that they would better communicate MMS's coal valuation policy to lessees. In this respect, the informed judgment of lessees, who are also prudent businessmen, is enhanced, thus providing increased certainty regarding the economic consequences of Federal or Indian coal lease production. The MMS has no mandate to promulgate coal valuation rules that are expressly designed to preserve or improve the Federal or Indian lessor's overall nationwide market share of coal production.

**Comment:** Some industry commenters stated that all existing coal sales contracts or supply agreements should be "grandfathered" under any new royalty scheme. Under this approach, any such coal sales contracts would be subject to the royalty requirements in effect at the time the coal supply contract was executed. One of these comments cited the Interior Board of Land Appeals (IBLA) support for this position by quoting *Kanawha & Hocking Coal & Coke Co.*, 93 IBLA 179, at 183 as follows: "The method of calculating the value of coal for royalty purposes shall be that method set forth in the regulation on the effective date of readjustment, and any subsequent regulatory change will not alter that method." Similarly, two industry commenters requested that only leases readjusted after these rules become effective should be subject to these regulatory requirements. Other respondents raised this issue again in comments submitted specific to § 206.250(b).

**MMS Response:** It is MMS's intent that absent specific lease terms that set forth specific valuation criteria, the proposed rules, when final, would govern the valuation of coal from Federal and Indian leases. However, there are some lessees with contracts that pre-date the Federal Coal Leasing Amendments Act (FCLAA) of 1976 and that do not have reimbursement provisions common to contracts after FCLAA's enactment. The MMS would like comments on whether there is a

way to grandfather these contracts that would be consistent with the requirements of FCLAA and the Mineral Leasing Act.

With regard to the comments that MMS should not make the new regulations applicable to existing pre-FCLAA contracts because the new rules would require royalty to be paid on payments which the commenters said are not royalty bearing under existing rules, MMS would like further comments, specifically identifying the type of payments that are involved.

**Comment:** Two industry commenters stated that the proposed royalty valuation instructions are unclear when there is mixed mineral ownership at a single mine. One commenter requested that MMS provide guidance for the calculation of royalties "when an operator is producing coal from both Federal and non-Federal [lands] . . . ." This commenter also stated that this issue becomes even more critical with respect to payments for insurance compensation, coal recovered from waste piles or slurry ponds, take-or-pay payments, and purchaser reimbursements for certain costs items. Another industry commenter claimed that it is "entirely possible that the definition of gross proceeds will be significantly different on the Federal and non-Federal leases."

**MMS Response:** The MMS agrees that royalty terms in leases between private land owners and coal operators, or between States and coal operators, may differ significantly from Federal lease royalty terms. However, the applicability of these proposed rules is limited to Federal and Indian Tribal and allotted coal leases. See § 206.250. Similarly, valuation procedures or instruction contained in private or State leases do not pertain to Federal or Indian leases.

**Comment:** Two State commenters argued that MMS's attempt to provide certainty to coal valuation in the regulations has resulted in the elimination of necessary agency discretion. One commenter explained, "Flexibility in the regulations that allows for some discretion on the part of the auditing agency is necessary."

**MMS Response:** The MMS disagrees that the rules eliminate necessary agency discretion. For example, §§ 206.259(b) (now designated § 206.257(d)) and 206.259(d) (now designated § 206.257(d)) provide for MMS to establish a value for royalty purposes if a determination is made that the lessee's reported value is inconsistent with the requirements of the regulations. Similar provisions for

MMS's adjustment of coal washing and transportation allowances are provided §§ 206.260 and 206.262 [now designated §§ 206.259 and 206.262]. Also, in response to these comments, additional language has been added to § 206.259(b) [now designated—§ 206.257(b)] which now allows MMS to determine if the sales contract reflects the total consideration actually transferred, either directly or indirectly, from the buyer to seller and also to determine if certain factors would render the sales contract to be deemed non-arm's-length.

#### IV. Section-by-Section Analysis

Many of the sections have not changed significantly from the January 1987 notice of proposed rulemaking. This preamble primarily will focus on the significant changed sections.

##### *Proposed § 206.250 Purpose and Scope.*

This section would provide that if the provisions of any statute, treaty, lease, or settlement agreement (resulting from administrative or judicial litigation) are inconsistent with any of the regulations, then the statute, treaty, lease, or settlement agreement provision governs to the extent of the inconsistency.

Paragraph (d) has been revised so that it would specifically refer to the trust responsibility of the United States with respect to the administration of Indian coal leases.

##### *Proposed § 206.251 Definitions.*

**Comment:** Some industry respondents recommended deletion of the words "amount or" from the proposed definition of "ad valorem lease." One commenter explained: "Amount of production is only relevant in a take-in-kind royalty provisions [sic]. There is no authorization for such a provision in the MLA [Minerals Leasing Act of 1920, as amended]."

**MMS Response:** The phrase "based upon a percentage of the amount or value of the production" is appropriate because Indian leases may be designated to include a royalty-in-kind proviso. Because these rules would be equally applicable to Federal and Indian coal production, it is proper to include regulatory language that provides for this possibility.

**Comment:** The phrase "Coal washing allowance" appears in these proposed rules as an integral part of the definition of "Allowance." Many industry respondents recommended expanding the scope of the definition and changing the term "coal washing allowance" to "coal processing allowance." One commenter stated this change was necessary to be consistent with the

proposed revisions to § 206.260 [now designated §§ 206.258 and 206.259]. Many other commenters supported the proposed expansion for various similar reasons including the suggestions that "an allowance should be extended to all processing costs incurred downstream from the point or royalty determination" and to "other methods of beneficiation which may increase the value of coal . . ." Examples provided as other forms of processing included pelletizing, treatment with chemicals or oil, drying, crushing, and sizing.

**MMS Response:** The MMS acknowledges the existence of developing coal quality enhancement techniques other than the commercially available coal washing process. However, rather than transplant coal washing allowance procedures to other coal beneficiation technologies, MMS believes it is preferable to provide a rule that recognizes coal beneficiation processes other than coal washing for royalty valuation purposes. A new § 206.265 has been added to these proposed rules to address these comments. The discussion of § 260.265 appears later in this preamble.

**Comment:** One Indian commenter recommended deleting "all references to washing allowances," and maintained that the basic premise of the regulations is that the lessee "is obligated to place the mineral in its first marketable condition." In support of this position, this commenter stated: "The incorporation of a practice which is primarily a conservation measure does not belong in regulations to value the product for royalty purposes." This commenter concluded that such decisions as approving washing allowances be the responsibility of "the agency leasing the minerals."

**MMS Response:** Coal washing is not necessarily practiced as an exclusive conservation measure. It is feasible for coal operators to wash coal to upgrade a first marketable product. Because the net effect of coal washing is to increase heat content and to provide a cleaner burning product by removal of ash and sulfur, an operator may desire to wash coal to extend its market reach or expand its potential customer base. The MMS considers any attempt to differentiate between washing as a conservation measure (to develop a first marketable product) and washing as a marketing tactic to be a needless expenditure of MMS's limited manpower resources. Allowances have been provided to coal lessees that wash Federal or Indian coal since the inception of ad valorem royalty rates. These rules increase the level of detail

necessary to obtain coal washing allowances but otherwise would continue existing policy.

**Comment:** Some industry comments recommended deleting the "reasonableness" standard. The proposed definition provided for a coal washing allowance based on the "reasonable, actual costs." One commenter explained that "there is no indication of what would be considered reasonable or unreasonable. We believe that the concept of 'reasonableness' is inherent in all of the lessee's obligations under these regulations."

**MMS Response:** The MMS normally considers any cost incurred for coal washing or transportation that is out of proportion to standard industry practices to be unreasonable. However, this statement may be tempered by the specific situation that created the unusual and unreasonable costs. In any event, because the commenter acknowledges that the concept of reasonableness is present in all lessee's obligations, it seems no greater an imposition to explicitly state the term in the regulation.

The phrase "Transportation allowance" also appears in these rules as an integral part of the definition of "Allowance." Several industry respondents provided comments on this proposed definition. Many of the same comments were received as discussed above with respect to the phrase "coal washing allowance." These will not be addressed again.

**Comment:** One industry commenter recommended "that the final regulations should be amended to provide an allowance for all transportation costs." No elaboration or explanation was provided.

**MMS Response:** The MMS has no intent to provide transportation allowances for routine in-mine transportation costs, which every mining operation encounters to some degree. In-mine transportation is an integral part of the total mining process, the cost of which the Federal or Indian owner has historically not shared. Additional discussion of transportation allowances appears later in this preamble. The MMS notes, however, that under the definition of "mine," no allowance would be approved for coal transported between mine facilities, including, for instance, transportation between the pit (or portals, in the case of an underground mine) and the crusher, or for transfer from the crusher to other mine surface facilities, including the storage and loadout facility.

**Comment:** The MMS received numerous comments on the definition of

"arm's-length contract." "Arm's-length contract" would be defined as a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. Affiliation essentially would be a control test: ownership in excess of 50 percent constitutes control; ownership of 10 through 50 percent creates a presumption of control; and ownership of less than 10 percent creates a presumption of noncontrol which MMS can rebut. Contracts between relatives would not be arm's-length contracts. To be considered arm's-length for any production month, a contract must meet the requirements of the definition for that month as well as when the contract was executed. Thus, if two contracting parties were not affiliated when the contract was executed, but are affiliated now, the contract would be non-arm's-length.

The definition of gross proceeds received more comments than any other section of the proposed regulations. Thirty-nine respondents, consisting of industry representatives, one local government association, and one State, specifically supported MMS's proposed deletion of reimbursements for Black Lung Excise Taxes and Abandoned Mine Land Reclamation Fees (AML) from the gross proceeds definition. One industry respondent explained: "The exclusion of Abandoned Mine Reclamation (AML) fees and Black Lung (BL) taxes is appropriate as they add no enhancement to the real value of the coal." Another industry commenter noted support for "Secretary Hodel's proposal to exclude those reimbursables [Federal Black Lung Taxes and Abandoned Mine Lands Fees] from gross proceeds on the grounds that it is inequitable to require lessees to pay royalties on levies imposed by Federal, state, or local governments solely to mine coal." Many other respondents repeated this rationale. One industry respondent offered a somewhat different reasoning by stating that it was appropriate for MMS to take action to "enhance the competitiveness of Federal and Tribal coal, and hence the viability of the domestic coal industry."

Eighteen respondents, consisting of 14 State organizations and 4 Indian groups, opposed the exclusion of any reimbursed taxes or fees from gross proceeds. Most respondents maintained that MMS's explanation of why Black Lung Excise Taxes and AML fees are excluded from gross proceeds was not sufficient or acceptable. One Indian respondent specifically commented that MMS's justification for exclusion was

not true with respect to Indians, who do not get the rate of either the Black Lung Excise Tax or the AML fee. The respondent further noted that AML fees have not been made available to Indian lands. A State respondent commented: "These fees are essentially a pass-through, the lessee does receive the benefit of the purchaser reimbursing him . . ." These costs would otherwise be borne by the lessee. Another State respondent claimed: "The MMS proposal would have the effect of reducing royalties on coal without going through the findings required under the Minerals Leasing Act, 30 U.S.C. 209." One other State respondent concurred with this statement. Several other State respondents objected to the exclusion of Black Lung Excise Taxes and AML fees on the grounds that it sets a precedent and "opens the door for the exclusion of other items . . ."

Over 50 industry and 2 States respondents submitted comments requesting that MMS extend the exclusion of Black Lung Excise Taxes and AML fees to other similar taxes and fees that are normally assessed at the State and local levels. One particular industry commenter explained that "The lessee receives no additional value from these payments which are only incidentally related to the value of the coal through the tax structure. In fact, by adding these taxes to the value of coal, the government is directly placing taxes on taxes and improperly inflating the royalty payment." Many other industry comments concurred with the "taxes on taxes" objection and stated that this royalty practice was not the intent of the MLA. Three industry respondents stated that MMS's proposed definition was inconsistent with the recommendation contained in the Linowes Commission report entitled "Fair Market Value Policy for Federal Coal Leasing." As noted by one commenter, "The Commission recommended that 'the base for calculating Federal royalty payments should be f.o.b. price minus all State and local severance and similar taxes.'"

*MMS Response:* The MMS has considered both the comments calling for the reinstatement of reimbursements for the Black Lung Excise Tax and AML fees into the value basis for royalty computation, and all comments requesting the further exclusion of all other reimbursements for State and local imposed taxes and fees from the value basis of Federal and Indian coal. The MMS has determined that the definition of gross proceeds is not the place to address issues as to whether certain payments are royalty-bearing.

There is no doubt that when the purchaser pays \$10/ton for coal, that is the lessee's gross proceeds. Whether all of that \$10 is royalty-bearing is a separate issue and is addressed below in § 208.257(b).

*Comment:* Many commenters, including States, Indians, and industry, commented that they favored recognizing all forms of consideration received by the lessee for purposes of valuing Federal and Indian coal. Some industry respondents opposed the concept of including all forms of consideration, other than the sales price, as part of gross proceeds. One industry commenter stated that its firm "provides substantial water to power plant customers buying coal, without separate consideration for the water." Another industry commenter stated that the concept of collecting royalty on all consideration was logical, but that MMS was carrying the idea to an extreme. The commenter maintained: "There may be occasions when there truly is significant consideration given to the seller which is not included in the actual sales price of the coal. When that is the case, then there is justification to collect royalty on such consideration." This commenter concluded, however, that the proposed rules do not define what is significant.

*MMS Response:* The MMS has always required royalty to be paid on all components of coal value, including those components of a coal sales agreement that are not in the form of cash and imbedded in the price. As stated in the January 15, 1987, proposed rulemaking, "The definition of gross proceeds is intended to be expansive to ensure that it includes all the benefits flowing from the purchaser to, or on behalf of, the seller for the disposition of the coal, . . ."

*Comment:* Eleven industry commenters stated that the use of "gross proceeds valuation" does not have a basis in law. One commenter supported this position by stating that, "The words 'gross proceeds' do not appear in the Mineral Leasing Act of 1920. Section 7 of the Act, as amended in 1976, established a royalty based on coal's value." This reasoning was expressed as support in other comments.

*MMS Response:* Section 7 of the MLA, as amended by FCLAA, requires royalty to be paid on "the value of coal as defined by regulation." The regulations in effect since 1976 have required royalty to be based on "gross value." Although the "gross proceeds" term herein is new, it is not forwarding a new concept. The selection of the term "gross proceeds" is to assure regulatory

consistency within MMS and is an exercise of discretion provided by statute. However, as discussed further below with regard to § 208.157, MMS is proposing certain adjustments to the value of coal.

*Comment:* Some industry commenters stated that MMS should not use the gross proceeds established under contracts signed in the 1970's. One respondent commented that "These negotiated coal prices are over-inflated and not indicative of fair market value. They were contracted during the 'oil crisis' and the moratoriums on federal coal leasing." The commenter advocates that MMS "should develop a method that takes into account the average coal price at each mine and does not consider these 1970's contracts as indicative of fair market value." Another industry commenter offered an alternative proposal where royalty would be based on the average price of a geographic area if "the current 'arm's-length' price exceeds the average price for coal sold in the same geographic area by 20 percent or more . . ."

*MMS Response:* For arm's-length contracts, MMS does not believe that there is any justification for receiving a royalty based on less than a contract sales price. The lessee receives the benefit of a higher price and the royalty owner is entitled to share in that benefit. For non-arm's-length situations, a possible exception is addressed later in this preamble.

*Comment:* The MMS received many comments from industry respondents stating that all preparation costs should be excluded from the royalty value. One commenter stated that the value should include "payments to the lessee for the extraction, primary crushing, storing, mixing, and loading coal . . ." We recommend the exclusion of reimbursements for secondary processing and beneficiation, such as oiling to suppress dust or freeze prevention chemical treatment . . ." Several commenters recommended excluding from the value for royalty purposes "processing in excess of that which is necessary to bring coal to the first point of marketability." Other commenters stated that coal should be valued "from where it's taken off, the mine at the face . . ." One commenter continued to explain that "various forms of cleaning or other treatment do not add to the value of the product at the mine." Other commenters suggested a similar approach with one stating that it was inappropriate for MMS "to collect a royalty on the increased value . . . from . . . crushing, storing, mixing loading [sic], treatment

with substances including chemicals or oil, and other preparation of the coal . . . ."

*MMS Response:* The proposed rulemaking would maintain the status quo of MMS policy. Standard mining and preparation costs would be considered as part of the mine operation and not be deductible from royalty. Hence, under the approach of the rules, expenses arising from separating the coal from the seam, hauling coal from the surface pit or underground face to other mine facilities, crushing coal, sizing or screening coal, storing coal while awaiting shipment, spraying with oil or with coal antifreeze treatment chemicals, and loading coal at the point of shipment to market would be borne 100 percent by the lessee and could not be deducted from royalties.

*Comment:* One industry commenter stated that it was more reasonable to maintain MMS's current gross value requirement, which is the unit sale or contract price times the number of units sold.

*MMS Response:* The MMS noted earlier that the concept of coal valuation remains unchanged. The term "gross proceeds" has been selected for purposes of regulatory consistency.

*Comment:* The MMS received many comments concerning the inclusion of take-or-pay payments in the proposed gross proceeds definition. Four commenters, two Indian and two States, expressed support for the inclusion of take-or-pay payments as part of gross proceeds. One commenter reasoned that the inclusion was proper "since the other contractual terms may be affected by inclusion of such language in the selling agreement." Another commenter stated that gross proceeds "does not simply mean the amount received by the lessee. Rather, it must have an expansive definition to include any consideration . . . including any minimum payments, stand-by fees, or take-or-pay payments." Other commenters recommended that the gross proceeds definition stand as proposed with respect to including take-or-pay payments, but offered no additional reasoning or support.

Industry commenters generally opposed the collection of royalty on take-or-pay payments. Several commenters specifically stated that royalty is due only on production; others specifically stated that MMS lacked statutory support to collect royalty on take-or-pay payments; and some commenters stated that royalty should be collected on take-or-pay payments only under certain circumstances. With respect to the issue that royalty is only due on production, one commenter

explained that "if no coal is produced, there is no diminution in the value of the coal reserve and therefore no royalty should be payable." Several other commenters took the same position. Another commenter stated that the "assessment of royalties on take-or-pay payments is inconsistent with the traditional framework for royalty payments . . . . The royalty becomes due only when coal is mined." Many commenters urged that the take-or-pay payment serves as a mechanism to cover the producer's investment risk and as such does not constitute a prepayment for Federal coal. Several commenters continued by stating that the Government has no right to share in the rewards resulting from risk of the capital investment. Several commenters declared that the proposed regulations were internally inconsistent, with certain parts requiring royalties to be paid on take-or-pay payments not related to coal production, while other parts such as §§ 206.259, 206.255, and 206.257 [now designated §§ 206.257, 206.253, and 206.255, respectively] required royalty to be paid on coal produced and sold or otherwise finally disposed of. One commenter also suggested that MMS adopt a wait-and-see position and let the courts decide the legality of collecting royalty or take-or-pay issues.

With regard to the comments citing MMS's lack of statutory support to collect royalties on take-or-pay payments, one commenter noted that "The plain language of FCLAA (30 U.S.C. 207) ties royalty assessment to the value of recovered coal." Other commenters echoed this view. Another commenter stated that the MLA does not allow royalty collection "on coal not mined, produced and sold." Another commenter stated that "The statutory authority to include in production royalties payments made on 'take-or-pay' provisions as if they were 'advance royalties' is certainly subject to question." The commenter further noted that payment of advance royalties is controlled by 30 U.S.C. 207(b). The commenter concluded: "Since advance royalties can only be accepted in lieu of continued operation—one percent of commercial quantities of recoverable coal reserves . . . if an operator is producing the required one percent, section 8 [of FCLAA] would prohibit the lessee from reducing his production royalty payment by the amount of his 'take-or-pay' payment, since these payments are not, by statute, considered 'advance royalties.'"

As noted earlier, several commenters agreed that under certain conditions royalty should be collected on take-or-

pay payments. One industry commenter stated: "Some payments received under 'take-or-pay' clauses may well constitute payments for the disposition of coal produced by the lessee, and in such cases we agree that they should be subject to royalty."

Other industry commenters objected to collecting royalty on any other contractually required compensatory payments, other than take-or-pay, which are not based on coal production. The commenters referred to such payments as assignment payments, prepaid reserve payments, damages awarded by courts, by-outs, bonuses, and capacity charges.

*MMS Response:* By collecting royalties on "take-or-pay" payments, MMS is not departing from existing coal royalty valuation policy. The collection of royalty has always been based on the total value of coal sold. The MMS and its predecessor agency, Conservation Division, U.S. Geological Survey, have never permitted royalty to be paid on values reduced by prior take-or-pay payments. The proposed regulation's definition of gross proceeds represented a clarification of existing policy and practice. However, MMS does agree that no royalty should be paid on a payment which is not for production. See discussion below related to § 206.157(b)(6).

The proposed definition of "gross proceeds" has been modified to include the total monies and other consideration "accruing" to the lessee. Because the definition of arm's-length contract does not include any provisions which address the concept that such contracts must reflect the entirety of the agreement between the parties, MMS concluded that the definition of gross proceeds should be sufficiently broad to encompass all consideration to which the lessee is entitled. The term "accruing" would be intended to accomplish that purpose.

*Comment:* Several industry respondents provided comments regarding the proposed definition of "marketable condition." One commenter described the definition as being so subjective that it was meaningless. Four commenters stated that MMS should regard coal as being in marketable condition if sold and accepted by the purchaser. One commenter requested clarification of the meaning of the phrase "typical sales contract," stating "there is no such thing as a typical sales contract for an area . . . ." One commenter requested that the entire definition, as proposed, be deleted. Two commenters suggested an alternative definition seeking to define coal as

being in marketable condition when it has been extracted, crushed, and screened. No other processing of coal would be deemed necessary before being considered marketable.

*MMS Response:* The proposed definition was modified for purposes of clarity. The thrust of the definition is unchanged, as an explicit notice that MMS will not accept, as an appropriate value for royalty purposes, any value paid for coal which has not been conditioned to meet the minimum recognized market standard.

Finally, the definition of "net-back method" has been revised in the proposed rules so that it would be clear that the net-back procedure is to begin from the first downstream point at which value could be ascertained by reference to arm's-length contracts or other comparable sales.

*Proposed § 206.253 Coal subject to royalty—general provisions.*

This section has not been changed significantly from the first proposed rulemaking.

*Proposed § 206.254 Quality and quantity measurement standards for reporting and paying royalties.*

This section has not been changed significantly.

*Proposed § 206.255 Point of royalty determination.*

This section has not been changed significantly from the first proposed rulemaking. The term "used" has been added to make it clear that use of coal by the lessee triggers the royalty payment obligation.

*Proposed § 206.256 Valuation standards for cents-per-ton leases.*

This section has not been changed significantly from the first proposed rulemaking.

*Proposed § 206.257 Valuation Standards for ad valorem leases.*

The fundamental approach of this section is the same as in the first proposed rulemaking. However, several changes have been incorporated.

Paragraph (a) has been modified slightly. It would continue to provide that value for royalty purposes is the value determined pursuant to this section less applicable coal washing and transportation allowances, or any other applicable allowances for beneficiation. See discussion of § 206.255, above. The paragraph would clarify that the royalty due is equal to the value for royalty purposes multiplied by the royalty rate in the lease.

Paragraph (b) still would provide that the value of coal which is sold pursuant to an arm's-length contract will be the gross proceeds accruing to the lessee. Under MMS's existing regulations in 30 CFR 203.250, the lessee's gross proceeds pursuant to an arm's-length contract are acceptable as the value for royalty purposes. The MMS believes that the gross proceeds standard should be applied to arm's-length sales for several reasons. The MMS typically accepts this value because it is well grounded in the realities of the marketplace where, in most instances, the  $\frac{1}{2}$ ths owner will strive to obtain the highest attainable price for the coal production for its own benefit. The royalty owner benefits from this incentive.

It also adds more certainty to the valuation process for payors and provides them with a clear and logical value on which to base royalties. Under the proposed regulations, in most instances, the lessee will not need to be concerned that several years after the production has been sold MMS will establish royalty value in excess of the arm's-length contract proceeds, thereby imposing a potential hardship on the lessee. This is particularly a concern for lessees who have long-term arm's-length contracts where sales prices under newer contracts may be higher. If MMS were to establish royalty value based on prices under those newer contracts, (i.e., prices which the lessee cannot obtain under its contract), the resulting royalty obligation could consume a larger percentage of the lessee's proceeds.

Establishing gross proceeds under an arm's-length contract as the royalty value also has benefits for MMS and those States that assist MMS in the audit and enforcement efforts. The gross proceeds standard would give auditors an objective basis for measuring lessee compliance. It would reduce audit workload and reduce the administrative appeal burden that results when valuation standards are too subjective, particularly when values are determined to be in excess of a lessee's arm's-length contract gross proceeds.

The MMS recognizes, however, that there must be exceptions to the general rule that the lessee's arm's-length contract price should be accepted without question as the value for royalty purposes. One such situation is where the contract does not reflect all of the consideration flowing either directly or indirectly from the buyer to the seller. For example, in return for Seller's reduced price for coal production from a Federal lease, Buyer may agree to reduce the price of coal it sells to Seller's affiliate from a non-Federal lease. This agreement is not reflected in

the coal sales contract for the Federal coal. In the event that MMS becomes aware of consideration that exists outside the contract, MMS would adjust the lessee's gross proceeds to reflect the additional consideration. However, in some circumstances the additional consideration may not be easily calculable. Thus, even if the parties are not affiliated and the contract is "arm's-length," MMS could require in paragraph (b)(2) that the coal production be valued in accordance with paragraph (c), the standards used to value coal disposed of under non-arm's-length contracts. Under these standards, the lessee's gross proceeds still may determine value, but the lessee will be required to demonstrate comparability to other arm's-length contracts.

The MMS recognizes that some parties may have multiple contracts with one another. This fact alone would not cause a contract to be treated as non-arm's-length. Rather, there must be some indication that the contract in question does not reflect the full agreement between the parties. The proposed regulations also include a provision in paragraph (b)(4) whereby MMS may require a lessee to certify that the terms of its arm's-length contract reflect all the consideration flowing from the buyer to the seller for the coal. The MMS is proposing to include this provision because there may be circumstances where an auditor could not reasonably be expected to find other consideration, yet there is good reason to believe it exists. Because of the potentially severe penalties for a false certification, this will assure that no other consideration exists when the certification is received.

In other situations it may not be apparent why an arm's-length contract price is unusually low, yet the lessor should not accept the arm's-length contract proceeds as value. It may be because of collusion between the buyer and seller or improper conduct by the seller, or it could be the result of a patently imprudent contract. Even if the contract is between unaffiliated persons and thus "arm's-length," pursuant to paragraph (b)(3), if MMS determines that the gross proceeds do not reflect the reasonable value of the production because of misconduct by the contracting parties or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS could require that the coal production be valued pursuant to paragraphs (c)(2) (ii) through (v). Thus, MMS first must determine that a price is unreasonable; for example, by looking at

comparable contracts and sales. Then MMS must determine that the unreasonably low price was the result of misconduct or a breach by the lessee of its duty to market its production for the mutual benefit of itself and the lessor.

A breach of the lessee's duty to market production to the mutual benefit of the lessor would include, but is not limited to, collusion between the producer/seller and buyer, pricing practices found by a court or regulatory authority to be incorrect or fraudulently manipulated, or negligence in negotiating contracts. The MMS would give a lessee an opportunity to comment when it determines the lessee has breached its duty to market the coal for the mutual benefit of the lessee and the lessor.

The suggestion that the Secretary should determine whether each contract is arm's-length or non-arm's-length was implied in the rules. However, the MMS has added a clarifying provision to paragraph (b)(1) of the proposed rule which would provide that the lessee will have the burden of demonstrating that its contract is arm's-length. This includes overcoming presumptions of control where two parties are possibly affiliated.

The MMS has determined that the phrase "or which could accrue" should be deleted in reference to gross proceeds in paragraph (b)(1). Many commenters on other product value rules thought that this phrase would allow MMS to second-guess the price which the lessee agreed to in its contract by arguing that other persons selling the same product may have received higher prices—thus, more proceeds "could have accrued" to the lessee. This was not MMS's purpose in including the "or which could accrue" language in the proposed rule. Rather, MMS's intent is to ensure that royalties are paid on the full amount to which the lessee is entitled under its contract, not just on the amount of money it may actually receive from its purchaser. However, MMS is satisfied that the phrase "the gross proceeds accruing to the lessee" properly includes all consideration to which the lessee is entitled under its contract, not necessarily just what it actually receives from the buyer. Therefore, the "or which could accrue" phrase was unnecessary. Because it caused confusion as to MMS's intent, it is being deleted from the proposed rule.

**Comment:** Many industry and State respondents provided comments on alternative valuation methods other than gross proceeds. Several commenters from industry advocated adopting some form of a cents-per-million British thermal units (Btu)

valuation procedure. This valuation procedure would establish a value for Federal and Indian coal based exclusively on the coal's heating value and would be expressed in cents-per-million Btu. The actual sale price would not be relevant, nor would other factors such as distance to market or other quality parameters. In general, these commenters claimed that this valuation method was simple and fair and that the value would be based on the intrinsic heating value of the coal. One commenter stated that the cents-per-million Btu valuation method "would eliminate the unfairness, inequities and disparities created by an *ad valorem* rate." A number of variations on the theme of cents-per-million Btu valuation were offered. Some commenters recommended initially fixing the dollar amount per million Btu and then adjusting "for inflation or deflation at regular intervals" by use of an "appropriate index." One commenter specified that whatever index was used "could be set nationally." One commenter stated that MMS should use a cents-per-million Btu base value, but "this value should reflect the 'value of the coal at the mine mouth.'" One industry and one State respondent opposed using a cents-per-million Btu royalty valuation method. The State commenter noted that the concept was not simple, because to make the method fair "you would have to bring some other quality factors into the coal that are going to have an effect on the value of it at the burner." The industry commenter expressed concern about abandoning the free market concept. One other industry commenter suggested that the first sentence of paragraph (b) be rewritten to read: "The value of coal for royalty purposes shall be determined by the MMS on the basis of Btus per ton on a regional basis through regulation that sets fair and reasonable values." The commenter elaborated, stating that value should be independent of factors such as time of contract execution, contract provisions, unit taxes, and transportation competitiveness.

**MMS Response:** The basic premise of MMS's royalty calculation methods is that royalty should be based on the value received by the lessee under an arm's-length contract for selling the coal (less allowances). The Btu-based royalty concept is neither easy to implement nor conducive to equitable administration. It is not easy to implement because MMS would be charged with the responsibility to establish, using some rational method, an initial value per million Btu. The MMS believes such an undertaking could easily consume all

the limited manpower resources of MMS without achieving an initial credible and tenable value. The Btu-based royalty concept would be inequitable to many lessees because the royalty value would be unresponsive to the sulfur content or other quality parameters affecting the value of Federal or Indian coal. The MMS maintains that the free market value established by an arm's-length sale is the best measure of coal value for royalty purposes.

As discussed above, MMS is proposing as an option for public comment a paragraph (b)(5) which would provide that notwithstanding the provisions of any other regulations in Subpart F, the value of coal would be reduced by the amounts of Federal Black Lung Excise Taxes and Abandoned Mine Lands Fees (AML fees) authorized by the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 *et seq.*), which are paid for the coal. Thus, if a coal contract provides that the purchaser is to reimburse the lessee for Black Lung and AML fees, those amounts would be part of gross proceeds, but paragraph (b)(5) nevertheless would not require the payment of royalty on those amounts. Similarly, even if a coal contract does not have a separate reimbursement clause, the lessee could reduce the value of coal for royalty payment purposes by the amount of Black Lung and AML fees the lessee is required to pay for the coal production. For example, if the lessee's arm's-length contract requires a flat payment of \$5.00 per ton, then \$5.00 is the lessee's gross proceeds. However, if the lessee is required to pay \$0.57 in Black Lung and AML fees, then the effect of paragraph (b)(5) would be to reduce the value of the coal to \$4.43.

While it is well-established that the lessee's gross proceeds include all payments for coal production, including reimbursements received either directly or indirectly by the lessee (*see, e.g., Knife River Coal Mining Co.*, 29 IBLA 28 (Feb. 8, 1977); *Knife River Coal Mining Co.*, 43 IBLA 104 (Sept. 24, 1979); and *Hoover & Bracken Energies, Inc. v. DOI*, 723 F.2d 1488 (10th Cir. 1983), *cert. denied*, 469 U.S. 821 (1984)), payments for Black Lung and AML fees are distinguishable from other types of fees or costs imposed on coal producers or on coal production because these are fees imposed by the Federal Government, the lessor. Thus, the lessor could raise its royalty revenues by imposing or increasing such fees. For this reason, MMS would like comment on whether it would be appropriate to reduce the value of coal for royalty payment purposes by the amounts the

lessee must pay for such fees and, therefore, pass on to its purchaser.

The MMS also is proposing that the provisions of paragraph (b)(5) would not be applicable to Indian tribal and allotted leases. It is MMS's intention that these rules be revenue neutral for Indian leases. Also, since the Indian lessor does not impose the AML and Black Lung taxes, the above-stated rationale for excluding these fees from royalty value (i.e., that the lessor can increase royalties by imposing or increasing these taxes) does not apply to Indian leases. The MMS specifically would like comment whether the proposed exclusion language will be sufficient to ensure that the exception provided by paragraph (b)(5) will not be applicable to existing Indian leases.

The MMS received many comments that the value of coal also should be reduced by amounts for State severance taxes. Most of the arguments were similar to those for the AML fee and Black Lung Tax exclusion. Although excluding severance taxes from value would be a departure from long established Departmental policy, MMS would like further comment on whether it should add a deduction for State severance taxes to paragraph (b)(5). It would be MMS's intent not to grant a deduction for State severance taxes from the value applicable to coal production from Indian leases.

The MMS received many comments from industry that it is inappropriate to impose a royalty burden on that portion of the value of coal which becomes the royalty payment; i.e., industry claims that a royalty on royalty is unfair. This issue can best be understood by an example. Assume a lease with a 12.5 percent royalty rate. Assume that the lessee sells 100,000 tons of coal under an arm's-length contract at \$10 per ton for a total of \$1,000,000. Historically, MMS would consider the value for royalty purposes to be the \$1,000,000 and would require a royalty payment of 12.5 percent or \$125,000.

Those who advocate that it is unfair to pay royalty on royalty first would divide the proceeds by 1.125 to remove the royalty portion of the proceeds (\$1,000,000 divided by 1.125 = \$888,888.88). The result then would be multiplied by the royalty rate to determine the royalty payment (\$888,888.88 × .125 = \$111,111.11). The MMS is not proposing regulatory language on this suggested exclusion but, in view of the many comments received, MMS would like public comment on whether it should include in the final rule a provision which would reduce the value of coal by an amount equal to the difference between: (1) the

value of the coal; and (2) the value of the coal divided by (1 + the royalty rate). This provision also would result in reduced royalty values in situations where the lessee has a royalty reimbursement provision in its contract.

As discussed above, the definition of gross proceeds includes payments made under take-or-pay clauses in contracts and similar clauses which MMS considers to be consideration for production. Paragraph (b)(6) would reflect the fact that the purchaser may make certain payments to a lessee under the contract that are not part of the total amount or consideration which the purchaser pays for the purchase of the product. For example, payments made for lessee provided services that are totally unrelated to the production and sale of coal would not be regarded as part of the total effective price paid for coal purchases under the contract. By way of contrast, if the contract required the purchaser to continue to make payments for certain mine operation costs, such payments would be royalty-bearing.

The MMS recognizes that coal sales contracts may contain provisions that are unique in form to that contract and the effect of which must be examined on the specific facts of the transaction. Ordinarily, payments made under contract clauses that allocate the risk of production and the risk of market demand and ensure a minimum return to the seller for the sale of the product (i.e., take-or-pay clauses and similar clauses) are part of the total consideration paid for the product and are royalty-bearing. In all instances, the substance of the contract clause or payment involved, and not its form, will control.

In the comments received from industry, many different types of payments were identified and questions raised as to whether they would be royalty bearing. These include:

1. Damages recovered under a court judgment for the purchaser's breach of the sales contract;
2. Payments made under a force majeure clause;
3. "Settlement" payments made to terminate a sales contract before the contractually-specified termination date; this includes situations where there may or may not be a follow-on contract;
4. Payments for assignment of an interest in the lease;
5. Payments not designated as part of the purchase price but made on a periodic or regularly scheduled basis under the contract;
6. Payments not designated as part of the purchase price, which may or may not vary with the amount of coal delivered, and paid on a one-time or not

regularly scheduled basis under the contract in a specific sum or calculated under a prescribed formula;

7. Payments or reimbursements for services or processing costs customarily the responsibility of the lessee, including that required to put the product in marketable condition;

8. Minimum payment obligations, price guarantees, or deficiency charges; and

9. Payments which are accepted by public service commissions as made for purposes other than for coal received.

The MMS specifically solicits comment on whether payments or reimbursements in these categories constitute part of the total consideration paid for the purchase of the product. Under the proposed provision, the lessee would have the opportunity to demonstrate that, under the terms of its contract, the payment made was not part of the consideration for production. However, unless MMS concurs with the lessee's position, royalty payment will be due on that payment.

Paragraph (c) would apply to coal production that is not sold pursuant to an arm's-length contract. Valuation benchmarks would have to be considered in the prescribed order with the value based upon the first applicable benchmark. The first benchmark is still based upon the lessee's gross proceeds from the disposition of the coal. However, the proposed rule has been modified so that, before the lessee's gross proceeds would be acceptable as value, they must be equivalent not just to the gross proceeds under the lessee's other arm's-length contracts, but they must be equivalent to the gross proceeds under arm's-length contracts involving other buyers and sellers in the area. The effect of this change is to combine what previously were the first and second benchmarks and broaden the base of comparability in the first benchmark. The other provisions of the first benchmark, including the comparability criteria, are not changed.

Where value is determined based on the benchmarks, the adjustments from §§ 206.257(b) (5) and (6), if adopted, would apply. These adjustments, which have been proposed for comment, relate to amounts for such costs as AML fees, Black Lung Taxes, State severance taxes, and the royalty-on-royalty issue. This would apply both where there is a reimbursement clause for these costs and where the cost is embedded in a net price. In some cases it may not be appropriate to make any further deduction for these items, for example, where the value determined under the

benchmarks already does not include a state severance tax component.

The MMS received many comments on the benchmarks. However, there was no one issue that received considerable comment. The MMS will address the comments in the final rulemaking.

The remaining benchmarks for valuing coal disposed of under non-arm's-length contracts were not changed.

It has come to MMS's attention that there may exist a disparity between the current market value of coal and the prices for coal paid under contracts between affiliates (e.g., a coal mining company owned by an electric utility) which, in many instances, are based on mining costs. In today's environment, mining costs often exceed the price for which coal can be sold in the marketplace. Some coal industry members have questioned whether it is reasonable to use these "gross proceeds" as a royalty value, or whether value should be based upon factors that more contemporaneously reflect the coal's value in the open market.

For mine-mouth or captive mine situations, the coal industry has commented that in today's weak market MMS should not receive a royalty computed on a cost-based contract that exists between affiliates. Therefore, MMS specifically requests comments on whether the final rules should include a provision whereby royalty value for non-arm's-length sales in mine mouth or captive mine situations should be based principally on current market determinants (such as spot prices) which several coal industry commenters advocated.

Paragraph (d) has been modified from the first proposal. Paragraph (d)(1) still would provide that value determinations under paragraph (c) do not require MMS's prior approval. However, the lessee would be required to retain all data that would be subject to review and audit. The MMS could direct a lessee to use a different value if it determines that the lessee's reported value is inconsistent with the requirements of the regulations.

Paragraph (d)(2) would require a lessee to make sales and sales quantity data available to authorized MMS, State, and Indian representatives, to the Inspector General of the Department of the Interior, and to other authorized persons.

Paragraph (d)(3) would continue to provide a notification requirement if a lessee determined value using the second through fifth benchmarks.

Paragraph (e) has been added to clarify that if a lessee improperly determines value, it would be liable for

both the additional royalties and interest.

The first proposed rule included a provision in paragraph (h) that lessees could request value determinations from MMS. That provision now is in paragraph (i).

Proposed paragraph (g) establishes gross proceeds as a minimum value. This provision is unchanged from the first proposal except that the specific reference to gross proceeds "which could accrue" was deleted. The reason for this change was discussed above with regard to paragraph (b)(1).

Paragraph (h), which requires the lessee to place coal in marketable condition at no cost to the lessor, is unchanged from the first proposal. The MMS specifically requests comments on whether or not this section, plus the definition of marketable condition, requires further development in these coal regulations to provide better guidance for the lessee. Commenters are requested to provide specific suggestions for changes to the regulatory language.

Paragraph (i) imposes a diligence requirement on lessees. This section would require a lessee to pay royalty in accordance with its contract price, but also expressly would recognize that contract prices may be amended retroactively. Retroactive price adjustments would be limited to 2 years. The MMS is aware that often there is a process of negotiation that occurs before the contract is formally amended and that lower payments may be received in the interim. Royalties may be paid on the gross proceeds received by the lessee until all reasonable attempts to force the purchaser to renegotiate the contract or to comply with the existing contract are exhausted, provided the lessee takes proper and timely action to receive prices or benefits to which it is entitled, or to revise the contract retroactively. Thus, the MMS will accept a renegotiated or a revised contract price if the main reason for renegotiating or revising the contract is not solely to reduce royalties. However, if a higher price can be legally enforceable under a contract and the lessee is not diligent in obtaining that price, royalties will be due on that higher price.

The MMS has added a new paragraph (j) to the proposed rules which would provide that, in those situations where MMS may make a preliminary value determination in the course of monitoring compliance with these regulations, the determination will not be binding until MMS has done an audit and the audit formally is closed. The MMS intends to issue further guidelines on when an audit is closed.

Paragraph (k) includes some minor changes to the paragraph originally proposed as paragraph (i).

*Proposed § 206.258 Washing allowances—general.*

The MMS received many comments on the limitations on washing allowances contained in the first proposed rule. Industry generally objected to any limit on allowances. Most State and Indian commenters thought the limits were not sufficiently restrictive. In this further notice of proposed rulemaking, MMS is not proposing a threshold requiring MMS approval to exceed that threshold. The purpose of a threshold is to assist MMS in monitoring allowances. Because there are few coal leases, and only a small number of those coal leases involve washing allowances, MMS does not believe that a threshold would be necessary to monitor the reasonableness of allowances. In fact, MMS is aware of only one instance where a washing allowance would have exceeded the threshold. The rules would continue to provide that a washing allowance could not reduce the value for royalty purposes to zero.

The MMS also has added a paragraph which would clarify that, if a lessee improperly determines a washing allowance, the lessee would be liable for any additional royalties plus interest.

*Proposed § 206.259 Determination of washing allowances.*

If a lessee has an arm's-length contract for coal washing under paragraph (a), the allowance would be the reasonable actual costs incurred by the lessee. This paragraph was not changed from the first proposal, but MMS has added two new paragraphs to address situations where a contract, though arm's-length, should be treated as non-arm's-length pursuant to paragraph (b). The first situation is where MMS determines that the coal washing contract reflects more than the consideration transferred from the lessee to the wash plant operator for the washing; i.e., the washing cost has been inflated. The second situation is where the MMS determines that there has been misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor. The types of misconduct or breach of duty that would trigger application of these provisions are essentially the same as those discussed above in the valuation section.

Paragraph (b), which is applicable to non-arm's-length coal washing situations, has not been changed significantly from the first proposal. It would continue to be a cost-based determination. The MMS has made some changes to the provisions relating to reporting of allowances in response to comments that the first proposal was somewhat unclear. Under paragraph (b)(1), no washing allowance may be taken before a Form MMS-4292 is filed. Washing allowances may be claimed retroactively for a period of 3 months prior to the month the form is filed. Thus, if a lessee takes an allowance for January, February, and March but does not file the form until April 15, the lessee will be entitled to the allowance but will owe interest for the time period that it was taken before it was authorized.

The MMS received many comments on the rate of return to be used in the cost computation. Paragraph (b)(2)(v) now would provide that the rate of return will be the industrial rate associated with Standard and Poor's BBB rating. This is the same rate adopted in the oil and gas rules, and the preambles provide an extensive explanation of this issue (Oil—53 FR 1212-1214; Gas—53 FR 1262-1263). However, as noted in those preambles, MMS is preparing a notice of proposed rulemaking to again address the rate of return issue.

In the gas processing regulations, MMS provided an exception to the cost-based approach in certain circumstances where the plant operator provides services under arm's-length contracts. See 30 CFR 206.159(b)(4). The MMS requests comments on whether or not a similar provision should be included for coal washing.

As noted above, MMS has modified the reporting requirements in paragraph (c). This paragraph generally is self-explanatory. One change is that washing allowances in effect on the effective date of the regulations would be allowed to continue until their termination date.

#### *Section 206.260 Allocation of washed coal.*

This section was not changed from the first proposal.

#### *Proposed § 206.261 Transportation allowances—general.*

This section would provide generally for a transportation allowance when coal is not sold at the mine or wash plant near the mine. The MMS received many comments on transportation allowances from industry, States and Indians.

*Comment:* Indian commenters recommended that paragraph (a) provide for a negotiated allowance for Indian lessors. One of these commenters explained that "certain transportation costs, unless cited in the lease, are a matter of negotiated settlement between the lessor and lessee and not subject to an arbitrary allowance." The other Indian commenter stated that transportation allowances were a reversal of past MMS practice and would be difficult to administer. This commenter stated, "Transportation costs should simply not be deducted from the value on which a company pays royalties to the Tribes."

*MMS Response:* The MMS and its predecessor agency, the Conservation Division, U.S. Geological Survey, have maintained a policy of providing coal transportation allowances to lessees that transport coal to distant points of sale at their own expense. As a matter of policy, MMS considers the assessment of ad valorem royalty on sale prices inclusive of value added by transportation to be an improper royalty practice leading to disincentives for the lessee to seek out and exploit all available markets. Unless specifically prohibited by lease terms, these rules would continue the past practice of allowing deductions for those selling arrangements that specify remote points of sale.

*Comment:* Paragraph (b)(1) of the original proposed rules, which establishes thresholds on transportation allowances, received numerous comments. Many industry commenters objected to any limit for transportation allowances. One industry commenter maintained that "Any standard other than actual transportation costs is arbitrary and places the burden on industry to then apply for a full deduction." Another industry commenter characterized the limit "to be an arbitrary amount intended for the sole purpose of increasing royalties." One industry commenter stated that "The coal mine operator should have the freedom to be able to market its product wherever possible without the requirement to obtain the approval of the Director when transportation costs exceed the value of the coal." Over 20 commenters offered similar rationales, most stating there was no justification to any limit.

One industry commenter suggested the 50- and 75-percent limits of the proposed rules "should be established as a guideline only so that MMS can freely exercise its authority to allow charges in excess of these amounts."

State and Indian respondents opposed the limits of paragraph (b)(1) citing that

the limits are too high. A State commenter recommended reducing allowance limits to 33-35 percent and explained, "It has been our experience that published acceptable allowances or deductible expenses often become self fulfilling [sic] prophecies providing targets to be attained by some lessees." The Indian commenter maintained that the 75-percent limit for combined washing and transportation was too high and recommended that the limit not exceed 50 percent of the value of the coal.

*MMS Response:* The 50- and 75-percent transportation allowance thresholds that were initially proposed are not retained in these proposed rules. The purpose of a threshold is to assist MMS in monitoring the reasonableness of allowances. Because there are few coal leases, and only a few of those involve significant transportation allowances, MMS does not believe that a threshold or limit is necessary. The rules would provide that the allowances cannot reduce the value for royalty purposes to zero.

*Comment:* One Indian commenter stated the proposed regulations did not clearly prohibit leases with cents-per-ton royalty terms from receiving transportation allowances.

*MMS Response:* Allowances for cents-per-ton leases are specifically prohibited by the regulations at § 206.256(c).

Section 206.261(c) would provide that lessees would not be required to allocate costs between coal and waste products. Allowances would be permitted for the total tonnage transported, even for coal that is transported to a wash plant for washing.

The MMS has reviewed all the comments received to date. Section 206.262 is being proposed again with only minor modifications from the first proposal.

#### *Proposed § 206.262 Determination of transportation allowances.*

This section was proposed initially as paragraph (d) of the transportation allowance section. The MMS has added a separate section for clarity and to simplify numbering.

This section has not been changed significantly from the first proposed rules. Some changes were made to the reporting requirements and effective date mechanisms for ease of understanding. These and other changes are similar to those made to the washing allowance rules that were discussed above. Likewise, many of the comments received on this section were similar to those received for washing allowances.

such as comments addressing rate of return.

Pursuant to this section, MMS generally would accept arm's-length transportation costs. The MMS also has added two new paragraphs to address situations where a contract, though arm's-length, should be treated as non-arm's-length pursuant to paragraph (b). The first situation is where MMS determines that the transportation contract reflects more than the consideration transferred from the lessee to the transporter for the transportation; i.e., the transportation cost has been inflated. The second situation is where MMS determines that there has been misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor. The types of misconduct or breach of duty that would trigger application of these provisions are essentially the same as those discussed above in the valuation section.

For non-arm's-length contracts, the allowance generally would be based upon the lessee's reasonable actual costs for transportation. The cost calculation procedure has not been changed from the initial proposal. The MMS also is proposing to add a new paragraph (b)(3) whereby the lessee could apply to MMS for an exception from the requirement that it compute actual costs if the lessee has a transportation rate approved by a regulatory authority and the rate is not excessive as compared to other arm's-length contracts. If there are no other arm's-length contracts to use for comparison, other criteria apply.

The MMS also received some comments that provision should be made for new technology transportation systems which may justify a different type of allowance procedure or a means for modifying the proposed procedure, such as allowing for a greater rate of return on investment for the increased risk. The MMS would like comment on this issue, describing the new technology and what provisions should be added to the rules.

#### *Discussion of the Coal and Electric Utility Industries' Proposal for Valuing Federal and Indian Coal.*

On July 9, 1987, the Department reopened the coal comment period for 14 days. During this second comment period, the Department received additional significant comments from principal interested parties raising issues that merited further consideration and response from the public. To allow

for this further consideration, the Department, once again, reopened the comment period on August 12, 1987, for 60 days to give interested persons an opportunity to obtain from DOI copies of three specific comments received from industry, State, and Indian representatives and then to provide a response for DOI to consider in developing a final rulemaking.

*Comment:* The industry comments were submitted as a joint proposal by six groups representing the coal producers and electric utilities. This proposal included a comprehensive, section-by-section set of revisions to the January proposed rulemaking, including a justification for the suggested modifications. The most significant revision in the joint industry proposal is to set aside the valuation standards contained in MMS's January 15, 1987, proposed rulemaking and substitute, instead, the concepts of "gross royalty value" and "net royalty value." Industry stated the basis for their proposal is the Internal Revenue Code's (IRC) concept of "gross income from property" as used for depletion allowance calculations (IRC 613). This "gross royalty value" would be increased by amounts for non-Federal royalties and reduced by processing allowances and amounts based on Federal Black Lung excise taxes, Abandoned Mine Land fees, and State and local taxes (such as severance taxes). The resulting figure would be the "net royalty value" upon which royalties would be paid. The "gross royalty value" would exclude outbound (long-distance) transportation costs incurred with f.o.b. destination sales. "Gross royalty value" would also exclude take-or-pay payments for royalty assessment.

The Department has received considerable comments on the joint industry proposal. A letter from Governor Schwinden of Montana, representing his views and those of the Governors of Colorado, New Mexico, and Wyoming, generally opposed the joint industry proposal and supported continued reliance on the proposed valuation procedures. Several Governors subsequently wrote individual letters to express personal opinions where their views differed from that of the consensus view. Governor Sullivan of Wyoming and Governor Romer of Colorado indicated they could support exclusion of royalty reimbursements from gross proceeds to address the "royalty on royalty" issue.

Governor Sinner of North Dakota urged the Department to continue the ongoing review of product valuation and expressed specific concerns regarding the production of lignite in his State.

Numerous comments were submitted by electric utility firms and from Governors of States that consume substantial quantities of western coal production. These commenters urged adoption of the joint industry proposal, stating that the joint industry proposal would reduce fuel costs, which in turn would reduce consumer electricity costs. Some commenters supported the valuation proposal by rationalizing that a reduced valuation basis would compensate for the increased ad valorem royalty rates now required under the MLA.

No Indian Tribe or allottee submitted written comments concerning the joint industry proposal. However, Mr. Donald R. Wharton, Assistant Attorney General for Natural Resources, The Navajo Nation, offered comments to the Subcommittee on Mineral Resources Development and Production during the Oversight Hearing on Proposed Coal Product Valuation Rules on November 16, 1987. Mr. Wharton opposed the joint industry proposal, stating: "Industry's deletion of the concept of 'gross proceeds' for royalty payment purposes is inconsistent with the concept underlying the present valuation regulations—that royalties from *ad valorem* leases be based on a percentage of gross proceeds. We urge MMS to retain the 'gross proceeds' methodology for valuation."

*MMS Response:* The Department expended considerable effort in reviewing the joint industry proposal. Representatives from MMS and from the Department met separately with representatives of the Internal Revenue Service (IRS) to discuss the operation of the "gross income from property" rules and the computation of the percentage depletion allowance. Also, analysts in the MMS reviewed the potential advantages and disadvantages of revenue problems that could arise if the joint industry proposal were adopted as the basis of coal royalty valuation. The MMS analysts solicited input from States and coordinated with principal industry representatives to arrive at a mutually agreed upon range of royalty revenue amounts that would, in the collective judgment of the States, MMS, and industry, most likely occur if the joint industry proposal were accepted.

Following this extensive review, MMS decided not to adopt the joint industry proposal. The following reasoning is provided to explain MMS's decision.

#### *1. The Joint Industry Proposal is not Readily Adaptable to Lease Accounting.*

The MMS is required to collect and account for royalties on a lease basis. Royalty rates may vary from lease to

lease; prices will vary from contract to contract; and contracts may dedicate specific reserves. The IRS determination is made on a taxpayer basis, which would be an aggregate, at least, of all leases and contracts for a single mine, and could conceivably encompass more than one mining operation. Thus, the industry proposal seems to be inconsistent with the basis on which MMS must collect and account for royalties. Making the proposal consistent with MMS needs would require that MMS develop an allocation procedure to convert depletable income to a lease basis. Such a procedure would likely be expensive and require the use of simplifying assumptions to the extent of being unacceptable.

#### 2. Joint Industry Proposal Has No Relation to Historical Federal Royalty Valuation Practices.

The Joint Industry Proposal introduces a royalty valuation concept that has never been used in the valuation of any leasable mineral. The Joint Industry Proposal valuation concept is not consistent with the Department of the Interior's current valuation procedure for coal. Also, the Joint Industry Proposal is inconsistent with existing royalty valuation procedures for noncoal solid minerals; e.g., sodium and potassium, which have not been substantially revised since 1978.

#### 3. Joint Industry Proposal Has No Relation to Prior Statutory Interpretation.

The Mineral Leasing Act of 1920 (Act), as amended specifically by the Federal Coal Leasing Amendments Act of 1978, requires that:

A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12½ per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations.

The Act and leases issued under the Act do not define value, gross value, gross proceeds, or value of production, or how to arrive at those values.

However, a long history of royalty valuation rulemaking for all leasable minerals shows a consistent adherence to common principles of valuation. The Joint Industry Proposal departs from previous administrative interpretations of legislation and in this regard strays from "original intent" that has been established by longstanding practice.

#### 4. The Joint Industry Proposal Creates New Auditing Problems.

The Joint Industry Proposal would be a new and complex approach to coal royalty value determinations. It is significantly different from the existing valuation methodology used for coal and

other minerals. As a result, MMS (as well as State and Indian) auditors would be required to relearn an entirely new system. This necessarily would delay many audits.

#### Proposed § 206.263 Contract submission.

*Comment:* Section 206.263(a), which requires sales contract submittal upon MMS request, received many industry comments and one Indian comment. All comments except the one Indian comment opposed the submittal requirement. The Indian commenter recommended "No changes" to the language of this section. Most industry commenters stated that MMS should have free access for review of contracts at the lessee's place of business. In objecting to the requirement of possible contract submittal, one industry commenter stated that "Coal supply agreements contain extremely proprietary information, which, if divulged to the public and/or competitors, can have a significantly negative impact upon both the coal buyer and the coal seller." Another industry commenter expressed the same concern, stating that if contracts are sent to MMS, it would "unnecessarily increase the risk of unwarranted disclosure of highly confidential, proprietary information \* \* \*." Again, another industry commenter addressed similar fears of contract disclosure by MMS and recommended that the entire section be deleted from the regulations. One industry commenter stated that the "Royalty Management Advisory Committee recommended that contracts be reviewed on site." One industry commenter questioned the need for contract submittal, stating that "it is our understanding that MMS is developing its own financial audit team, through which all necessary contractual information could be obtained."

*MMS Response:* The MMS intends to review contracts during on-site audits. However, the MMS must retain the right to obtain sales contracts or other agreements from Federal or Indian lessees. The MMS will take all necessary precautions to safeguard contracts from unauthorized disclosure. The section has not been changed from the first proposal, except for some wording changes.

*Comment:* Section 206.263(b), which requires lessees to designate each submitted contract as arm's-length or non-arm's-length, received six comments. Industry commenters recommended deleting the phrase "submitted pursuant to this section" in order to be consistent with similar recommendations for paragraph (a). An

Indian commenter stated that "Any contract submitted should be available to the [Indian] lessors also under paragraph (b)." The same Indian respondent maintained that "there should be some prior determination by MMS as to whether a contract is arm's-length or not instead of leaving the matter up to the lessee subject to audit to verify that the contract meets the criteria." One industry commenter recommended revising paragraph (b) to read: "Lessees and other payors shall designate each contract that is non-arm's-length." No rationale was supplied to support this recommendation.

*MMS Response:* When warranted, the MMS will make submitted contracts available to Indian lessors who certify that proprietary industry information in the contracts will be safeguarded. Regarding the issue of a lessee determining whether or not a contract is arm's-length, the MMS stresses that a lessee's determination of the arm's-length nature of a contract is not conclusive. Under paragraph (c), MMS may audit any contract to determine its character under the definition at § 206.251.

#### Proposed § 206.264 In-situ and surface gasification and liquefaction operations.

This section is changed only slightly from the first proposed rule.

#### Proposed § 206.265 Value enhancement of marketable coal.

The MMS is proposing to add a section which provides guidance to royalty valuation involving beneficiation beyond marketable condition by the lessee. This section would not be applicable in situations where a lessee sells its coal, in marketable condition, pursuant to an arm's-length contract and the purchaser performs the enhancement. In that circumstance, value would be determined by the lessee's gross proceeds pursuant to § 206.257(b).

This new section would provide generally that, if a lessee further processes coal (after placing it in marketable condition) to enhance its value prior to use, sale, or other disposition, royalties would be based on the value of the coal in marketable condition prior to enhancement.

The MMS received many industry comments that any valuation procedure for beneficiated coal must allow the lessee to recover the full costs of its activities. The focus of most concerns was that in the usual situation where MMS determines value based upon the sales price of the product less a

processing allowance, the typical MMS-allowed rate of return does not permit the lessee to fully recover its investment, hence the MMS benefits from the beneficiated coal without having made any investment. The MMS has revised its proposal to address this concern and would like further comment on this issue.

As stated above, this section would apply to situations where the value of the coal is enhanced beyond the point of marketable condition prior to use, sale, or other disposition by the lessee. The purpose of the proposal is to attempt to establish royalty value at the point when the coal has been placed in marketable condition but prior to its enhancement.

The first method to be applied would be to determine the value of the feedstock coal in marketable condition by application of the valuation benchmarks in § 206.257(c). Thus, MMS would consider the royalty value reported by the lessee and compare it to the values identified under the applicable benchmarks to determine the reasonableness of the value assigned by the lessee.

If the first four benchmarks cannot be applied, then MMS would use § 206.257(c)(v), or the net-back method. However, MMS would permit an allowance that is different than the normal net-back approach. This approach, to be seen as a last resort, determines royalty value after the marketable coal has been enhanced and is subsequently used, sold, or otherwise transferred. Under this net-back procedure, the MMS would begin with the gross proceeds accruing to the lessee from sales of the beneficiated coal. This amount would be reduced by MMS-approved processing costs. In recognition of the greater risk associated with coal beneficiation technologies and so as not to discourage their development, MMS is proposing to use a rate of return on investment (in doing the net-back procedure) that would be equal to two times the Standard and Poor's BBB bond rate applicable under § 206.259(b)(2)(v). The MMS specifically requests comments on the appropriateness of the proposed rate of return.

The MMS believes that using the approach described above for royalty purposes will accomplish MMS's goal of receiving the value of production in this circumstance, while assuring that the benefits associated with investments in beneficiation activities remain solely with the lessee. By first using the benchmarks to value feedstock coal in these situations, MMS ensures that market conditions are reflected in the

royalty determination, thus minimizing the use of non-market approaches.

## V. Public Comment Procedures

### A. Written Comments

The public is invited to participate in this proceeding by submitting data, views, or arguments with respect to this notice. All comments should be submitted by 4:30 p.m. of the day specified in the "DATES" section to the appropriate address indicated in the "ADDRESS" section of this preamble and should be identified on the outside envelope and on documents submitted with the designation "Revision of Coal Royalty Valuation Regulations and Related Topics." All comments received by MMS will be available for public inspection in Room C420, Building 85, Denver Federal Center, Lakewood, Colorado, between the hours of 8:00 a.m. and 4:00 p.m., Monday through Friday.

Any information or data submitted which is considered to be confidential must be so identified and submitted in writing, one copy only. The MMS reserves the right to determine the confidential status of the information or data and to treat it according to its independent determination.

### B. Public Hearing

1. *Procedure for requests to make oral presentations:* The time and place for the hearing are indicated in the "DATES" and "ADDRESSES" sections of the preamble. If necessary to present all testimony, the hearing will resume at 9:30 a.m. on the next business day following the first day of the hearing.

You may make a written request for an opportunity to make an oral presentation. The request should contain a business telephone number and also a telephone number where you may be contacted during the day prior to the hearing. If you are selected to be heard at the hearing you will be notified. You will be required to submit 50 copies of your statement to MMS at the address indicated in the "ADDRESS" section of the preamble.

2. *Conduct of the hearing:* The MMS reserves the right to select the persons to be heard at the hearing (in the event there are more requests to be heard than time allows), to schedule their respective presentations, and to establish the procedures governing the conduct of the hearing. The length of each presentation may be limited, based upon the number of persons requesting to be heard.

A Department of the Interior official will be designated to preside at the hearing. This will not be a judicial-type hearing. Questions may be asked only

by those conducting the hearing. At the conclusion of all initial oral statements, each person who has made an oral statement will be given the opportunity, if he or she so desires, to make a rebuttal statement. The rebuttal statements will be given in the order in which the initial statements were made and will be subject to time limitations.

If you wish to ask a question at the hearing, you may submit the question, in writing, to the presiding officer. The presiding officer will determine whether the question is relevant, and whether time limitations permit it to be presented for answer at the hearing.

Any further procedural rules needed for the proper conduct of the hearing will be announced by the presiding officer at the opening of the hearing.

A transcript of the hearing will be made. The entire record of the hearing, including the transcript, will be retained by MMS and made available for inspection in Room C420, Building 85, Denver Federal Center, Lakewood, Colorado, between the hours 8:00 a.m. and 4:00 p.m., Monday through Friday. You may purchase a copy of the transcript from the reporter.

## VI. Procedural Matters

### Executive Order 12291

The Department of the Interior (DOI) has determined that this document is not a major rule and does not require a regulatory analysis under Executive Order 12291. This rulemaking consolidates Federal and Indian coal royalty valuation regulations; clarifies DOI coal royalty valuation and coal transportation and coal washing allowance policy; and provides for consistent royalty valuation policy among all leasable minerals.

### Regulatory Flexibility Act

Because this rule primarily consolidates and streamlines existing regulations into a single part for consistent application, there are no significant additional requirements or burdens placed upon small business entities as a result of implementation of this rule. Therefore, the DOI has determined that this rulemaking will not have a significant economic effect on a substantial number of small entities and does not require a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.).

### Paperwork Reduction Act of 1980

The information collection requirements contained in §§ 206.254, 206.257, 206.259, 206.262, and 206.263 of this rule have been approved by the Office of Management and Budget

(OMB) under 44 U.S.C. 3501 et seq. and assigned clearance numbers 1010-0040, -0063, -0064, and -0074.

*National Environmental Policy Act of 1969*

It is hereby determined that this rulemaking does not constitute a major Federal action significantly affecting the quality of the human environment and that a detailed statement pursuant to Section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)) is not required.

List of Subjects

*30 CFR Part 202*

Coal, Continental shelf, Geothermal energy, Government contracts, Indian lands, Mineral royalties, Natural gas, Petroleum, Public lands-mineral resources, Reporting and recordkeeping requirements.

*30 CFR Part 203*

Coal, Continental shelf, Geothermal energy, Government contracts, Indian lands, Mineral royalties, Natural gas, Petroleum, Public lands-mineral resources, Reporting and recordkeeping requirements.

*30 CFR Part 208*

Coal, Continental shelf, Geothermal energy, Government contracts, Indian lands, Mineral royalties, Natural gas, Petroleum, Public lands-mineral resources, Reporting and recordkeeping requirements.

*30 CFR Part 212*

Coal, Continental shelf, Geothermal energy, Government contracts, Indian lands, Mineral royalties, Natural gas, Petroleum, Public lands-mineral resources, Reporting and recordkeeping requirements.

*43 CFR Part 3480*

Government contracts, Intergovernmental relations, Land Management Bureau, Mineral royalties, Mines, Public lands-mineral resources, Reporting and recordkeeping requirements.

Date: June 28, 1988.

James E. Coon,

Acting Assistant Secretary—Land and Minerals Management.

For the reasons set out in the preamble, 30 CFR Parts 202, 203, 208, and 212 are proposed to be amended as follows:

**TITLE 30—MINERAL RESOURCES**

**PART 202—ROYALTIES**

1. The authority citation for Part 202 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. Paragraph (b) of § 203.250 under Subpart F of Part 203 is redesignated as a new § 202.250 under Subpart F of Part 202.

3. 30 CFR Part 202 is amended by revising newly redesignated § 202.250 to read as follows:

**§ 202.250 Overriding royalty interest.**

The regulations governing overriding royalty interests, production payments, or similar interests created under Federal coal leases are in 43 CFR Group 3400.

**PART 203—RELIEF OR REDUCTION IN ROYALTY RATE**

1. The authority citation for Part 203 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1601 et seq.

2. Paragraphs (c), (d), (e), (f), (g), (h), (i), (j), and (k) of § 203.250 under Subpart F are removed.

3. Paragraph (b) of § 203.250 is redesignated as a new § 202.250 under Subpart F of Part 202.

4. In § 202.250, paragraph (a) designation is removed and the section heading is revised to read as follows:

**§ 202.250 Advance royalty.**

5. A new § 203.251 is added in Subpart F to read as follows:

**§ 203.251 Reduction in royalty rate or rental.**

An application for reduction in coal royalty rate or rental shall be filed and processed in accordance with 43 CFR Group 3400.

**PART 208—PRODUCT VALUATION**

30 CFR Part 208 is amended as follows:

1. The authority citation for Part 208 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 208 is amended by revising § 208.10 of Subpart A to read as follows:

**Subpart A—General Provisions**

**§ 208.10 Information collection.**

The information collection requirements contained in 30 CFR Part 208 have been approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3501 et seq. The forms and approved OMB clearance numbers are as follows:

Form No., name and filing date	OMB No.
MMS-4014—Report of sales and royalty remittance—solid minerals—due by end of month following sales or production month (unless lease terms specify a different frequency for royalty payments) and for rentals no later than the date specified in the lease terms.....	1010-0064
MMS-4030—Solid Minerals Payor Information form—due 30 days after issuance of a new lease or change to an existing account established by an earlier form.....	1010-0064
MMS-4050—Mine Information Report—due at the request of MMS during the initial conversion of the mine/lease to the Production Accounting and Auditing System (PAAS).....	1010-0063
MMS-4051—Facility and Measurement Information Form and Supplement—due at the request of MMS during the initial conversion of the facility and measurement device operators to the PAAS.....	1010-0040
MMS-4059—Solid Minerals Operation Report—due by the 15th day of the second month following the production month.....	1010-0063
MMS-4060—Solid Minerals Facility Report—due by the 15th day of the second month following the production month.....	1010-0063
MMS-4109—Gas Processing Allowance Summary Report—due within 3 months following the last day of the month for which an allowance is claimed, unless a longer period is approved by MMS.....	1010-0075
MMS-4110—Oil Transportation Allowance Report—due within 3 months following the last day of the month for which an allowance is claimed, unless a longer period is approved by MMS.....	1010-0061
MMS-4292—Coal Washing Allowance Report/Application—due prior to, or at the same time that the allowance is first reported on Form MMS-4014, and annually thereafter if the allowance does not change.....	1010-0074
MMS-4293—Coal Transportation Allowance Report/Application—due prior to, or at the same time that the allowance is first reported on Form MMS-4014 and annually thereafter if the allowance does not change.....	1010-0074
MMS-4295—Gas Transportation Allowance Report—due within 3 months following the last day of the month for which an allowance is claimed unless a longer period is approved by MMS.....	1010-0075

The information is being collected by the Department of the Interior to meet its congressionally mandated accounting and audit responsibilities relating to Federal and Indian mineral royalty management. The information collected will be used to determine whether royalty payments represent the proper values and to determine the transportation and processing allowances that may be deducted from royalty payments due on Federal and Indian lands. The reports are mandatory and are required to receive a benefit. Information reporting forms are available from MMS. Requests should be addressed to: Minerals Management Service, Royalty Management Program, P.O. Box 17110, Denver, Colorado 80217.

3. 30 CFR Part 206 is amended by adding §§ 206.250, 206.251, 206.252, 206.253, 206.254, 206.255, 206.256, 206.257, 206.258, 206.259, 206.260, 206.261, 206.262, 206.263, 206.264, and 206.265 to Subpart F to read as follows:

#### Subpart F—Coal

##### Sec.

- 206.250 Purpose and scope.
- 206.251 Definitions.
- 206.252 Information collection.
- 206.253 Coal subject to royalties—general provisions.
- 206.254 Quality and quantity measurement standards for reporting and paying royalties.
- 206.255 Point of royalty determination.
- 206.256 Valuation standards for cents-per-ton leases.
- 206.257 Valuation standards for ad valorem leases.
- 206.258 Washing allowances—general.
- 206.259 Determination of washing allowances.
- 206.260 Allocation of washed coal.
- 206.261 Transportation allowances—general.
- 206.262 Determination of transportation allowances.
- 206.263 Contract submission.
- 206.264 In situ and surface gasification and liquefaction operations.
- 206.265 Value enhancement of marketable coal.

#### § 206.250 Purpose and scope.

(a) This subpart prescribes the procedures to establish the value, for royalty purposes, of all coal from Federal and Indian Tribal and allotted leases (except leases on the Osage Indian Reservation).

(b) If the specific provisions of any statute, treaty, or settlement agreement between the United States (or Indian lessor) and a lessee resulting from administrative or judicial litigation, or any coal lease subject to the requirements of this subpart, are inconsistent with any regulation in this subpart, then the statute, treaty, lease

provision, or settlement shall govern to the extent of that inconsistency.

(c) All royalty payments made to the Minerals Management Service (MMS) are subject to later audit and adjustment.

(d) The regulations in this subpart are intended to ensure that the trust responsibilities of the United States with respect to the administration of Indian coal leases are discharged in accordance with the requirements of the governing mineral leasing laws, treaties, and lease terms.

#### § 206.251 Definitions.

"Ad valorem lease" means a lease where the royalty due to the lessor is based upon a percentage of the amount or value of the coal.

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

"Area" means a geographic region in which coal has similar quality and economic characteristics. Area boundaries are not officially designated and the areas are not necessarily named.

"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.

Notwithstanding any other provisions of this subpart, contracts between relatives, either by blood or by marriage, are not arm's-length contracts. 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.

"Audit" means a review, conducted in accordance with generally accepted accounting and auditing standards, of royalty payment compliance activities of lessees or other interest holders who pay royalties, rents, or bonuses on Federal or Indian leases.

"BIA" means the Bureau of Indian Affairs of the Department of the Interior.

"BLM" means the Bureau of Land Management of the Department of the Interior.

"Coal" means coal of all ranks from lignite through anthracite.

"Coal washing" means any treatment to remove impurities from coal. Coal washing may include, but is not limited to, operations such as flotation; air, water, or heavy media separation; drying; and related handling (or combinations thereof).

"Contract" means any oral or written agreement, including amendments or revisions thereto, between two or more persons and enforceable by law that with due consideration creates an obligation.

"Gross proceeds" (for royalty payment purposes) means the total monies and other consideration accruing to a coal lessee for the production and disposition of coal. 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 oil, 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. Gross proceeds, as applied to coal, also includes, but is not limited to: payments or credits for advanced prepaid reserve payments subject to recoupment through reduced prices in later sales; payments or credits for advanced exploration or development costs that are subject to recoupment through reduced prices in later sales; take-or-pay payments; and reimbursements, including but not limited to, reimbursements for royalties, taxes or fees. Tax reimbursements are part of the gross proceeds accruing to a lessee even though the Federal or Indian royalty interest may be exempt from taxation. Monies and other

consideration, including the forms of consideration identified in this paragraph, to which a lessee is contractually or legally entitled but which it does not seek to collect through reasonable efforts are also part of gross proceeds.

"Indian allottee" means any Indian for whom land or an interest in land is held in trust by the United States or who holds title subject to Federal restriction against alienation.

"Indian Tribe" means any Indian Tribe, band, nation, pueblo, community, rancheria, colony, or other group of Indians for which any land or interest in land is held in trust by the United States or which is subject to Federal restriction against alienation.

"Lease" means any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States for a Federal or Indian coal resource under a mineral leasing law that authorizes exploration for, development or extraction of, or removal of coal—or the land area covered by that authorization, whichever is required by the context.

"Lessee" means any person to whom the United States, an Indian Tribe, or an Indian allottee issues a lease, and any person who has been assigned an obligation to make royalty or other payments required by the lease. This includes any person who has an interest in a lease as well as an operator or payor who has no interest in the lease, but who has assumed the royalty payment responsibility.

"Like-quality coal" means coal that has similar chemical and physical characteristics.

"Marketable condition" means 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.

"Mine" means an underground or surface excavation or series of excavations and the surface or underground support facilities that contribute directly or indirectly to mining, production, preparation, and handling of lease products.

"Net-back method" means a method for calculating market value of coal at the lease or mine. Under this method, costs of transportation, washing, handling, etc., are deducted from the ultimate proceeds received for the coal at the first point at which reasonable values for the coal may be determined by a sale pursuant to an arm's-length contract or by comparison to other sales of coal, to ascertain value at the mine.

"Net output" means the quantity of washed coal that a washing plant produces.

"Person" means any individual, firm, corporation, association, partnership, consortium, or joint venture.

"Selling arrangement" means the individual contractual arrangements under which sales or dispositions of coal are made to a purchaser.

"Spot market price" means the price received under any sales transaction when planned or actual deliveries span a short period of time, usually not exceeding one year.

#### § 206.252 Information collection.

The information collection requirements contained in this subpart have been approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3501 *et seq.* The forms and approved OMB clearance numbers are identified in § 206.10 of this part.

#### § 206.253 Coal subject to royalties—general provisions.

(a) All coal (except coal unavoidably lost as determined by BLM pursuant to 43 CFR Group 3400) from a Federal or Indian lease subject to this part is subject to royalty. This includes coal used, sold, or otherwise disposed of by the lessee on or off the lease.

(b) If a lessee receives compensation for unavoidably lost coal through insurance coverage or other arrangements, royalties at the rate specified in the lease are to be paid on the amount of compensation received for the coal. No royalty is due on insurance compensation received by the lessee for other losses.

(c) In the event waste piles or slurry ponds are reworked to recover coal, the lessee shall pay royalty at the rate specified in the lease at the time the recovered coal is used, sold, or otherwise finally disposed of. The royalty rate shall be that rate applicable to the production method used to initially mine coal in the waste pile or slurry pond; i.e., underground mining method or surface mining method. Coal in waste pits or slurry ponds initially mined from Federal or Indian leases shall be allocated to such leases regardless of whether it is stored on Federal or Indian lands. The lessee shall maintain accurate records to determine to which individual Federal or Indian lease coal in the waste pit or slurry pond should be allocated. However, nothing in this section requires payment of a royalty on coal for which a royalty has already been paid.

#### § 206.254 Quality and quantity measurement standards for reporting and paying royalties.

(a) For leases subject to § 206.257, the quality of coal on which royalty is due shall be reported on the basis of percent

sulfur, percent ash, and number of British thermal units (Btu) per pound of coal. Coal quality determinations shall be made at intervals prescribed in the lessee's sales contract. If there is no contract, or if the contract does not specify the intervals of coal quality determination, the lessee shall propose a quality test schedule to MMS. In no case, however, shall quality tests be performed less than quarterly using standard industry-recognized testing methods. Coal quality information shall be reported on the appropriate forms required under 30 CFR Part 216.

(b) For all leases subject to this subpart, the quantity of coal on which royalty is due shall be measured in short tons (of 2,000 pounds each) by methods prescribed by the BLM. Coal quality information shall be reported on appropriate forms required under 30 CFR Part 216 and on the Report of Sales and Royalty Remittance, Form MMS-4014, as required under 30 CFR Part 210.

#### § 206.255 Point of royalty determination.

(a) For all leases subject to this subpart, royalty shall be computed on the basis of the quantity and quality of Federal or Indian coal in marketable condition measured at the point of royalty measurement as determined jointly by BLM and MMS.

(b) Coal produced and added to stockpiles or inventory does not require payment of royalty until such coal is later used, sold, or otherwise finally disposed of. The MMS may ask BLM or BIA to increase the lease bond to protect the lessor's interest when BLM determines that stockpiles or inventory become excessive so as to increase the risk of degradation of the resource.

(c) The lessee shall pay royalty at a rate specified in the lease at the time the coal is used, sold, or otherwise finally disposed of, unless otherwise provided for at § 206.256(d) of this chapter.

#### § 206.256 Valuation standards for cents-per-ton leases.

(a) This section is applicable to coal leases on Federal, Indian Tribal, and allotted Indian lands (except leases on the Osage Indian Reservation) which provide for the determination of royalty on a cents-per-ton (or other quantity) basis.

(b) The royalty for coal from leases subject to this section shall be based on the dollar rate per ton prescribed in the lease. That dollar rate shall be applicable to the actual quantity of coal used, sold, or otherwise finally disposed of, including coal which is avoidably lost as determined by BLM pursuant to 43 CFR Part 3400.

(c) For leases subject to this section, there shall be no allowances for transportation, removal of impurities, coal washing, or any other processing or preparation of the coal.

(d) When a coal lease is readjusted pursuant to 43 CFR Part 3400 and the royalty valuation method changes from a cents-per-ton basis to an ad valorem basis, coal which is produced prior to the effective date of readjustment and sold or used within 30 days of the effective date of readjustment shall be valued pursuant to this section. All coal that is not used, sold, or otherwise finally disposed of within 30 days after the effective date of readjustment shall be valued pursuant to the provisions of § 206.257 of this chapter, and royalties shall be paid at the royalty rate specified in the readjusted lease.

**§ 206.257 Valuation standards for ad valorem leases.**

(a) This section is applicable to coal leases on Federal, Indian Tribal, and allotted Indian lands (except leases on the Osage Indian Reservation) which provide for the determination of royalty as a percentage of the amount or value of coal (ad valorem). The value for royalty purposes of coal from such leases shall be the value of coal determined pursuant to this section, less applicable coal washing allowances and transportation allowances determined pursuant to §§ 206.258 through 206.262 of this chapter, or any allowance authorized by § 206.265 of this chapter. The royalty due shall be equal to the value for royalty purposes multiplied by the royalty rate in the lease.

(b)(1) The value of coal that is sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee, except as provided in paragraphs (b)(2), (b)(3), (b)(5), and (b)(8) of this section. The lessee shall have the burden of demonstrating that its contract is arm's-length. The value which the lessee reports, for royalty purposes, is subject to monitoring, review, and audit.

(2) In conducting reviews and audits, MMS will examine whether the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the coal. If the contract does not reflect the total consideration, then the MMS may require that the coal sold pursuant to that contract be valued in accordance with paragraph (c) of this section. Value may not be less than the gross proceeds accruing to the lessee, including the additional consideration.

(3) If the MMS determines that the gross proceeds accruing to the lessee pursuant to an arm's-length contract do

not reflect the reasonable value of the production because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the coal production be valued pursuant to paragraph (c)(2) (ii), (iii), (iv), or (v) of this section, and in accordance with the notification requirements of paragraph (d)(3) of this section. When MMS determines that the value may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's reported coal value.

(4) The MMS may require a lessee to certify that its arm's-length contract provisions include all of the consideration to be paid by the buyer, either directly or indirectly, for the coal.

(5) Notwithstanding any other regulations in this subpart, except for Indian leases the value of coal shall be reduced by the amounts of Federal Black Lung excise taxes and abandoned mine lands fees authorized by the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 *et seq.*), applicable to the coal production.

(6) The value of production for royalty purposes shall not include payments received by the lessee pursuant to a contract which the lessee demonstrates, to MMS's satisfaction, were not part of the total consideration paid for the purchase of coal.

(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 by other than an arm's-length contract), provided that those gross proceeds are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for sales, purchases, or other dispositions of like-quality coal 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; (ii) prices reported for that coal to a public utility commission; (iii) prices reported for that coal to the Energy Information Administration of the Department of Energy; (iv) other relevant matters including, but not limited to, published or publicly available spot market prices, or information submitted by the lessee concerning circumstances unique to a particular lease operation or the 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.

(3) When the value of coal is determined pursuant to paragraph (c)(2) of this section, that value shall be subject to the adjustments provided in paragraphs (b)(5) and (b)(6), as appropriate.

(d)(1) Where the value is determined pursuant to paragraph (c) of this section, that value does not require MMS's prior approval. However, the lessee shall retain all data relevant to the determination of royalty value. Such data shall be subject to review and audit, and MMS will direct a lessee to use a different value if it determines that the reported value is inconsistent with the requirements of these regulations.

(2) Any Federal or Indian lessee will make available upon request to the authorized MMS, State, or Indian representatives, or to the Inspector General of the Department of the Interior or other persons authorized to receive such information, arm's-length sales and sales quantity data for like-quality coal sold, purchased, or otherwise obtained by the lessee from the area.

(3) A lessee shall notify MMS if it has determined value pursuant to paragraphs (c)(2) (ii), (iii), (iv), or (v) of this section. The notification shall be by letter to the Associate Director for Royalty Management or his/her designee. The letter shall identify the valuation method to be used and contain a brief description of the procedure to be followed. The notification required by this section is a one-time notification due no later than the month the lessee first reports royalties on a Form MMS-4014 using a valuation method authorized by paragraphs (c)(2) (iv) or (v) of this section, and each time there is a change in a method under paragraphs (c)(2) (iv) or (v) of this section.

(e) If MMS determines that a lessee has not properly determined value, the lessee shall be liable for the difference.

if any, between royalty payments made based upon the value it has used and the royalty payments that are due based upon the value established by MMS. The lessee shall also be liable for interest computed pursuant to 30 CFR 218.202. If the lessee is entitled to a credit, MMS will provide instructions for the taking of that credit.

(f) The lessee may request a value determination from MMS. In that event, the lessee shall propose to MMS a value determination method, and may use that method in determining value for royalty purposes until MMS issues its decision. The lessee shall submit all available data relevant to its proposal. The MMS shall expeditiously determine the value based upon the lessee's proposal and any additional information MMS deems necessary. That determination shall remain effective for the period stated therein. After MMS issues its determination, the lessee shall make the adjustments in accordance with paragraph (e) of this section.

(g) Notwithstanding any other provisions of this section, under no circumstances shall the value for royalty purposes be less than the gross proceeds accruing to the lessee, less applicable allowances determined pursuant to §§ 206.258 through 206.262, and § 206.265 of this chapter. If take-or-pay payments are a part of gross proceeds, no additional royalty shall be due if future make-up deliveries are taken, unless the purchaser is required to pay any additional amount because only a partial payment was previously made or as a result of price increases during the make-up period.

(h) The 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.

(i) Value shall be based on the highest price a prudent lessee can receive through legally enforceable claims under its contract. Absent contract revision or amendment, if the lessee fails to take proper or timely action to receive prices or benefits to which it is entitled, it must pay royalty at a value based upon that obtainable price or benefit. Contract revisions or amendments shall be in writing and signed by all parties to an arm's-length contract, and may be retroactively applied to value for royalty purposes for a period not to exceed two

years, unless MMS approves a longer period. If the lessee makes timely application for a price increase allowed under its contract but the purchaser refuses, and the lessee takes reasonable measures, which are documented, to force purchaser compliance, the lessee will owe no additional royalties unless or until monies or consideration resulting from the price increase are received. This paragraph applies to price increases only and shall not be construed to permit a lessee to avoid its royalty payment obligation in situations where a purchaser fails to pay, in whole or in part or timely, for a quantity of coal.

(j) Notwithstanding any provision in these regulations to the contrary, no review, reconciliation, monitoring, or other like process that results in a redetermination by the MMS of value under this section shall be considered final or binding as against the Federal Government, its beneficiaries, the Indian Tribes, or allottees until the audit period is formally closed.

(k) Certain information submitted to MMS to support valuation proposals, including transportation, coal washing, or other allowances pursuant to § 206.265 of this chapter, is exempted from disclosure by the Freedom of Information Act, 5 U.S.C. 522. Any data specified by the Act to be privileged, confidential, or otherwise exempt shall be maintained in a confidential manner in accordance with applicable law and regulations. All requests for information about determinations made under this Part are to be submitted in accordance with the Freedom of Information Act regulation of the Department of the Interior, 43 CFR Part 2. Nothing in this section is intended to limit or diminish in any manner whatsoever the right of an Indian lessor to obtain any and all information as such lessor may be lawfully entitled from MMS or such lessor's lessee directly under the terms of the lease or applicable law.

#### § 206.258 Washing allowances—general.

(a) For ad valorem leases subject to § 206.257 of this chapter, MMS shall, as authorized by this section, allow a deduction in determining value for royalty purposes for the reasonable, actual costs incurred to wash coal, unless the value determined pursuant to § 206.257 was based upon like-quality unwashed coal. Under no circumstances shall the washing allowance and the transportation allowance authorized by § 206.262 of this subpart reduce the value for royalty purposes to zero.

(b) If MMS determines that a lessee has improperly determined a washing allowance authorized by this section,

then the lessee shall be liable for any additional royalties, plus interest determined in accordance with 30 CFR 218.202, or shall be entitled to a credit without interest.

(c) Lessees shall not disproportionately allocate washing costs to Federal or Indian leases.

(d) No cost normally associated with mining operations and which are necessary for placing coal in marketable condition shall be allowed as a cost of washing.

(e) Coal washing costs shall only be recognized as allowances when the washed coal is sold and royalties are reported and paid.

#### § 206.259 Determination of washing allowances.

(a) *Arm's-length contracts.* (1) For washing costs incurred by a lessee pursuant to an arm's-length contract, the washing allowance shall be the reasonable actual costs incurred by the lessee for washing the coal under that contract, subject to monitoring, review, audit, and possible future adjustment. The MMS's prior approval is not required before a lessee may deduct costs incurred under an arm's-length contract. However, before any deduction may be taken, the lessee must submit a completed page one of Form MMS-4292, Coal Washing Allowance Report, in accordance with paragraph (c)(1) of this section. A washing allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4292 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee.

(2) In conducting reviews and audits, MMS will examine whether the contract reflects more than the consideration actually transferred either directly or indirectly from the lessee to the washer for the washing. If the contract reflects more than the total consideration paid, then the MMS may require that the washing allowance be determined in accordance with paragraph (b) of this section.

(3) If the MMS determines that the consideration paid pursuant to an arm's-length washing contract does not reflect the reasonable value of the washing because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the washing allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the

value of the washing may be unreasonable. MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's washing costs.

(4) Where the lessee's payments for washing under an arm's-length contract are not based on a dollar-per-unit basis, the lessee shall convert whatever consideration is paid to a dollar value equivalent. Washing allowances shall be expressed as a cost per ton of coal washed.

(b) *Non-arm's-length or no contract.*

(1) If a lessee has a non-arm's-length contract or has no contract, including those situations where the lessee performs washing for itself, the washing allowance will be based upon the lessee's reasonable actual costs. All washing allowances deducted under a non-arm's-length or no contract situation are subject to monitoring, review, audit, and possible future adjustment. Prior MMS approval of washing allowances is not required for non-arm's-length or no contract situations. However, before any estimated or actual deduction may be taken, the lessee must submit a completed Form MMS-4292 in accordance with paragraph (c)(2) of this section. A washing allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4292 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee. The MMS will monitor the allowance deduction to ensure that deductions are reasonable and allowable. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual washing allowance.

(2) The washing allowance for non-arm's-length or no contract situation shall be based upon the lessee's actual costs for washing during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial depreciable investment in the wash plant multiplied by the rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the wash plant.

(i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes, rent; supplies; and any other

directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: Maintenance of the wash plant; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.

(iii) Overhead attributable and allocable to the operation and maintenance of the wash plant is an allowable expense. State and Federal income taxes and severance taxes, including royalties, are not allowable expenses.

(iv) A lessee may use either paragraph (b)(2)(iv) (A) or (B) of this section. After a lessee has elected to use either method for a wash plant, the lessee may not later elect to change to the other alternative without approval of the MMS.

(A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves, whichever is appropriate, which the wash plant services, or a unit of production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a wash plant shall not alter the depreciation schedule established by the original operator/lessee for purposes of the allowance calculation. With or without a change in ownership, a wash plant shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) The MMS shall allow as a cost an amount equal to the allowable initial capital investment in the wash plant multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to plants first placed in service or acquired after *{insert the effective date of these regulations}*.

(v) The rate of return shall be the industrial rate associated with Standard and Poor's BBB rating. The rate of return shall be the monthly average rate as published in *Standard and Poor's Bond Guide* for the first month of the reporting period for which the allowance is applicable and shall be effective during the reporting period. The rate shall be redetermined at the beginning of each subsequent washing allowance reporting period (which is determined pursuant to paragraph (c)(2) of this section).

(3) The washing allowance for coal shall be determined based on the lessee's reasonable and actual cost of

washing the coal. The lessee may not take an allowance for the costs of washing lease production that is not royalty bearing.

(c) *Reporting requirements.* (1) Arm's-length contracts.

(i) With the exception of those washing allowances specified in paragraphs (c)(1) (v) and (vi) of this section, the lessee shall submit page one of the initial Form MMS-4292 prior to, or at the same time as, the washing allowance determined pursuant to an arm's-length contract is reported on Form MMS-4014, Report of Sales and Royalty Remittance. A Form MMS-4292 receive by the end of the month that the Form MMS-4014 is due shall be considered to be received timely.

(ii) The initial Form MMS-4292 shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a washing allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier.

(iii) After the initial reporting period and for succeeding reporting periods, lessees must submit page one of Form MMS-4292 within 3 months after the end of the calendar year, or after the applicable contract or rate terminates or is modified or amended, whichever is earlier, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) The MMS may require that a lessee submit arm's-length washing contracts and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(v) Washing allowances which are based on arm's-length contracts and which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) The MMS may establish, in appropriate circumstances, reporting requirements that are different from the requirements of this section.

(2) *Non-arm's-length or no contract.*

(i) With the exception of those washing allowances specified in paragraphs (c)(2) (v) and (vii) of this section, the lessee shall submit an initial Form MMS-4292 prior to, or at the same time as, the washing allowance determined pursuant to a non-arm's-

length contract or no contract situation is reported on Form MMS-4014. Report of Sales and Royalty Remittance. A Form MMS-4292 received by the end of the month that the Form MMS-4014 is due shall be considered to be timely received. The initial reporting may be based on estimated costs.

(ii) The initial Form MMS-4292 shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a washing allowance and shall continue until the end of the calendar year, or until the washing under the non-arm's-length contract or the no contract situation terminates, whichever is earlier.

(iii) For calendar-year reporting periods succeeding the initial reporting period, the lessee shall submit a completed Form MMS-4292 containing the actual costs for the previous reporting period. If coal washing is continuing, the lessee shall include on Form MMS-4292 its estimated costs for the next calendar year. The estimated coal washing allowance shall be based on the actual costs for the previous period plus or minus any adjustments which are based on the lessee's knowledge of decreases or increases which will affect the allowance. Form MMS-4292 must be received by MMS within 3 months after the end of the previous reporting period, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) For new wash plants, the lessee's initial Form MMS-4292 shall include estimates of the allowable coal washing costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the plant, or if such data are not available, the lessee shall use estimates based upon industry data for similar coal wash plants.

(v) Washing allowances based on non-arm's-length or no-contract situations which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) Upon request by MMS, the lessee shall submit all data used by the lessee to prepare its Form MMS-4292. The data shall be provided within a reasonable period of time, as determined by MMS.

(vii) The MMS may establish, in appropriate circumstances, reporting requirements which are different from the requirements of this section.

(3) The MMS may establish coal washing allowance reporting dates for individual leases different from those specified in this subpart in order to provide more effective administration. Lessees will be notified of any change in their reporting period.

(4) Washing allowances must be reported as a separate line on the Form MMS-4014, unless MMS approves a different reporting procedure.

(d) *Interest assessments for incorrect or late reports and failure to report.* (1) If a lessee deducts a washing allowance on its Form MMS-4014 without complying with the requirements of this section, the lessee shall pay interest only on the amount of such deduction until the requirements of this section are complied with. The lessee also shall repay the amount of any allowance which is disallowed by this section.

(2) If a lessee erroneously reports a washing allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(3) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.202.

(e) *Adjustments.* (1) If the actual coal washing allowance is less than the amount the lessee has estimated and taken during the reporting period, the lessee shall be required to pay additional royalties due plus interest computed pursuant to 30 CFR 218.202, retroactive to the first month the lessee is authorized to deduct a washing allowance. If the actual washing allowance is greater than the amount the lessee has estimated and taken during the reporting period, the lessee shall be entitled to a credit without interest.

(2) The lessee must submit a corrected Form MMS-4014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(f) *Other washing cost determinations.* The provisions of this section shall apply to determine washing costs when establishing value using a net-back valuation procedure or any other procedure that requires deduction of washing costs.

#### § 206.260 Allocation of washed coal.

(a) When coal is subjected to washing, the washed coal must be allocated to the leases from which it was extracted.

(b) When the net output of coal from a washing plant is derived from coal obtained from only one lease, the quantity of washed coal allocable to the lease will be based on the net output of the washing plant.

(c) When the net output of coal from a washing plant is derived from coal obtained from more than one lease, the quantity of net output of washed coal allocable to each lease will be based on the ratio of measured quantities of coal delivered to the washing plant and washed from each lease compared to the total measured quantities of coal delivered to the washing plant and washed.

#### § 206.261 Transportation allowances—general.

(a) For ad valorem leases subject to § 206.257 of this chapter, where the value for royalty purposes has been determined at a point remote from the lease or mine, MMS shall, as authorized by this section, allow a deduction in determining value for royalty purposes for the reasonable, actual costs incurred to:

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

(2) Transport the coal from a Federal or Indian lease to a wash plant when that plant is remote from both the lease and mine and, if applicable, from the wash plant to a remote sales point.

In-mine transportation costs shall not be included in the transportation allowance.

(b) Under no circumstances shall the washing allowance and the transportation allowance authorized by § 206.259 of this subpart reduce the value of coal under any selling arrangement to zero.

(c) (1) When coal transported from a mine to a wash plant is eligible for a transportation allowance in accordance with this section, the lessee is not required to allocate transportation costs between the quantity of clean coal output and the rejected waste material. The transportation allowance shall be authorized for the total production which is transported. Transportation allowances shall be expressed as a cost per ton of cleaned coal transported.

(2) For coal that is not washed at a wash plant, the transportation allowance shall be authorized for the total production which is transported. Transportation allowances shall be expressed as a cost per ton of coal transported.

(3) Transportation costs shall only be recognized as allowances when the so transported coal is sold and royalties are reported and paid.

(d) If, after a review and/or audit, MMS determines that a lessee has improperly determined a transportation allowance authorized by this section, then the lessee shall pay any additional

royalties, plus interest, determined in accordance with 30 CFR 218.200, or shall be entitled to a credit, without interest.

(e) Lessees shall not disproportionately allocate transportation costs to Federal or Indian leases.

**§ 206.262 Determination of transportation allowances.**

(a) Arm's-length contracts.

(1) For transportation costs incurred by a lessee pursuant to an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting the coal under that contract, subject to monitoring, review, audit, and possible future adjustment. The MMS's prior approval is not required before a lessee may deduct costs incurred under an arm's-length contract. However, before any deduction may be taken, the lessee must submit a completed page one of Form MMS-4293, Coal Transportation Allowance Report, in accordance with paragraph (c) (1) of this section. A transportation allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4293 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee.

(2) In conducting reviews and audits, MMS will examine whether the contract reflects more than the consideration actually transferred either directly or indirectly from the lessee to the transporter for the transportation. If the contract reflects more than the total consideration paid, then the MMS may require that the transportation allowance be determined in accordance with paragraph (b) of this section.

(3) If the MMS determines that the consideration paid pursuant to an arm's-length transportation contract does not reflect the reasonable value of the transportation because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the transportation allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the value of the transportation may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's transportation costs.

(4) Where the lessee's payments for transportation under an arm's-length contract are not based on a dollar-per-unit basis, the lessee shall convert whatever consideration is paid to a

dollar value equivalent for the purposes of this section.

(b) *Non-arm's-length or no contract.*

(1) If a lessee has a non-arm's-length contract or has no contract, including those situations where the lessee performs transportation services for itself, the transportation allowance will be based upon the lessee's reasonable actual costs. All transportation allowances deducted under a non-arm's-length or no-contract situation are subject to monitoring, review, audit, and possible future adjustment. Prior MMS approval of transportation allowances is not required for non-arm's-length or no-contract situations. However, before any estimated or actual deduction may be taken, the lessee must submit a completed Form MMS-4293 in accordance with paragraph (c)(2) of this section. A transportation allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4293 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee. The MMS will monitor the allowance deductions to ensure that deductions are reasonable and allowable. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual transportation allowance deduction.

(2) The transportation allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial depreciable investment in the transportation system multiplied by the rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.

(i) Allowable operating expenses include: operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: maintenance of the transportation system; maintenance of equipment; maintenance labor; and other directly allocable and attributable

maintenance expenses which the lessee can document.

(iii) Overhead attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(iv) A lessee may use either paragraph (b)(2)(iv)(A) or (B) of this section. After a lessee has elected to use either method for a transportation system, the lessee may not later elect to change to the other alternative without approval of the MMS.

(A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves, whichever is appropriate, which the transportation system services, or a unit of production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a transportation system shall not alter the depreciation schedule established by the original transporter/lessee for purposes of the allowance calculation. With or without a change in ownership, a transportation system shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) The MMS shall allow as a cost an amount equal to the allowable initial capital investment in the transportation system multiplied by the rate of return determined pursuant to paragraph (b)(2)(B)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transportation facilities first placed in service or acquired after *[insert the effective date of these regulations]*.

(v) The rate of return shall be the industrial rate associated with Standard and Poor's BBB rating. The rate of return shall be the monthly average as published in *Standard and Poor's Bond Guide* for the first month of the reporting period for which the allowance is applicable and shall be effective during the reporting period. The rate shall be redetermined at the beginning of each subsequent transportation allowance reporting period (which is determined pursuant to paragraph (c)(2) of this section).

(3) A lessee may apply to the MMS for an exception from the requirement that it compute actual costs in accordance with paragraphs (b)(1) and (b)(2) of this section. The MMS will grant the exception only if the lessee has a rate for the transportation approved by a

Federal agency (for both Federal and Indian leases) or by a State regulatory agency (for Federal leases). The MMS shall deny the exception request if it determines that the rate is excessive as compared to arm's-length transportation charges by systems, owned by the lessee or others, providing similar transportation services in that area. If there are no arm's-length transportation charges, MMS shall deny the exception request if: (i) no Federal or State regulatory agency cost analysis exists and the Federal or State regulatory agency, as applicable, has declined to investigate pursuant to MMS timely objections upon filing; and (ii) the rate significantly exceeds the lessee's actual costs for transportation as determined under this section.

(c) *Reporting requirements.* (1) Arm's-length contracts.

(i) With the exception of those transportation allowances specified in paragraphs (c)(1) (v) and (vi) of this section, the lessee shall submit page one of the initial Form MMS-4293 prior to, or at the same time as, the transportation allowance determined pursuant to an arm's-length contract is reported on Form MMS-4014, Reports of Sales and Royalty Remittance.

(ii) The initial Form MMS-4293 shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier.

(iii) After the initial reporting period and for succeeding reporting periods, lessees must submit page one of Form MMS-4293 within 3 months after the end of the calendar year, or after the applicable contract or rate terminates or is modified or amended, whichever is earlier, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period). Lessees may request special reporting procedures in unique allowance reporting situations, such as those related to spot sales.

(iv) The MMS may require that a lessee submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(v) Transportation allowances that are based on arm's-length contracts and which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes

of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) The MMS may establish, in appropriate circumstances, reporting requirements that are different from the requirements of this section.

(2) Non-arm's-length or no contract.

(i) With the exception of those transportation allowances specified in paragraphs (c)(2) (v) and (vii) of this section, the lessee shall submit an initial Form MMS-4293 prior to, or at the same time as, the transportation allowance determined pursuant to a non-arm's-length contract or no-contract situation is reported on Form MMS-4014, Report of Sales and Royalty Remittance. The initial report may be based on estimated costs.

(ii) The initial Form MMS-4293 shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until the transportation under the non-arm's-length contract or the no-contract situation terminates, whichever is earlier.

(iii) For calendar-year reporting periods succeeding the initial reporting period, the lessee shall submit a completed Form MMS-4293 containing the actual costs for the previous reporting period. If the transportation is continuing, the lessee shall include on Form MMS-4293 its estimated costs for the next calendar year. The estimated transportation allowance shall be based on the actual costs for the previous reporting period plus or minus any adjustments that are based on the lessee's knowledge of decreases or increases that will affect the allowance. Form MMS-4293 must be received by MMS within 3 months after the end of the previous reporting period, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) For new transportation facilities or arrangements, the lessee's initial Form MMS-4293 shall include estimates of the allowable transportation costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the transportation system, or, if such data are not available, the lessee shall use estimates based upon industry data for similar transportation systems.

(v) Non-arm's-length-contract or no-contract-based transportation allowances that are in effect at the time these regulations become effective will

be allowed to continue until such allowances terminate. For purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) Upon request by MMS, the lessee shall submit all data used to prepare its Form MMS-4293. The data shall be provided within a reasonable period of time, as determined by MMS.

(vii) The MMS may establish, in appropriate circumstances, reporting requirements that are different from the requirements of this section.

(viii) If the lessee is authorized to use its Federal- or State-agency-approved rate as its transportation cost in accordance with paragraph (b)(3) of this section, it shall follow the reporting requirements of paragraph (c)(1) of this section.

(3) The MMS may establish reporting dates for individual lessees different than those specified in this paragraph in order to provide more effective administration. Lessees will be notified as to any change in their reporting period.

(4) Transportation allowances must be reported as a separate line item on Form MMS-4014, unless MMS approves a different reporting procedure.

(d) *Interest assessments for incorrect or late reports and failure to report.* (1) If a lessee deducts a transportation allowance on its Form MMS-4014 without complying with the requirements of this section, the lessee shall be liable for interest on the amount of such deduction until the requirements of this section are complied with. Penalties may also be assessed, if appropriate.

(2) If a lessee erroneously reports a transportation allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(3) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.202.

(e) *Adjustments.* (1) If the actual transportation allowance is less than the amount the lessee has estimated and taken during the reporting period, the lessee shall be required to pay additional royalties due plus interest, computed pursuant to 30 CFR 218.202, retroactive to the first month the lessee is authorized to deduct a transportation allowance. If the actual transportation allowance is greater than the amount the lessee has estimated and taken during the reporting period, the lessee shall be entitled to a credit without interest.

(2) The lessee must submit a corrected Form MMS-4014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(f) *Other transportation cost determinations.* The provisions of this section shall apply to determine transportation costs when establishing value using a net-back valuation procedure or any other procedure that requires deduction of transportation costs.

**§ 206.263 Contract submission.**

(a) The lessee and other payors shall submit to MMS, upon request, contracts for the sale of coal from ad valorem leases subject to this subpart. The MMS must receive the contracts within a reasonable period of time, as specified by MMS. Lessees shall include as part of the submittal requirements any contracts, agreements, contract amendments, or other documents that affect the gross proceeds received for the sale of coal, as well as any other information regarding any consideration received for the sale or disposition of coal that is not included in such contracts. At the time of its contract submittals, MMS may require the lessee to certify in writing that it has provided all documents and information that reflect the total consideration provided by purchasers of coal from ad valorem leases subject to this subpart. Information requested under this section may include contracts for both ad valorem and cents-per-ton leases and shall be available in the lessee's offices during normal business hours or provided to MMS at such time and in such manner as may be requested by authorized Department of the Interior personnel. Any oral sales arrangement negotiated by the lessee must be placed in a written form and be retained by the lessee. Nothing in this section shall be construed to limit the authority of MMS to obtain or have access to information pursuant to 30 CFR Part 212.

(b) Lessees and other payors shall designate, for each contract submitted pursuant to this section, whether the contract is arm's-length or non-arm's-length.

(c) 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.

(d) Information required to be submitted under this section that

constitutes trade secrets and commercial and financial information that is identified as privileged or confidential shall not be available for public inspection or made public or disclosed without the consent of the lessee or other payor, except as otherwise provided by law or regulation.

**§ 206.264 In-situ and surface gasification and liquefaction operations.**

If an ad valorem Federal coal lease is developed by in-situ or surface gasification or liquefaction technology, the lessee shall propose the value of coal for royalty purposes to MMS. The MMS will review the lessee's proposal and issue a value determination. The lessee may use its proposed value until MMS issues a value determination.

**§ 206.265 Value enhancement of marketable coal.**

If the lessee enhances the value of coal after the coal has been placed in marketable condition in accordance with § 206.257(h) of this chapter, prior to use, sale, or other disposition the lessee shall notify MMS that such processing is occurring or will occur. The value of that production shall be determined as follows:

(a) A value established for the feedstock coal in marketable condition by application of the provisions of § 206.257(c)(2)(i)-(iv); or,

(b) In the event that a value cannot be established in accordance with paragraph (a) of this section, then the value of production will be determined in accordance with § 206.257(c)(2)(v) and the value shall be the lessee's gross proceeds accruing from the disposition of the enhanced product, reduced by MMS-approved processing costs and procedures (including a rate of return on investment equal to two times the Standard and Poor's BBB bond rate applicable under § 206.259(b)(2)(v)).

**PART 212—RECORDS AND FILES MAINTENANCE**

1. The authority citation for Part 212 is revised to read as follows:

*Authority:* 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. The title of Subparts C, D, F, and G under Part 212 are revised to read as follows:

**Subpart C—Federal and Indian Oil— [Reserved]**

**Subpart D—Federal and Indian Gas— [Reserved]**

**Subpart F—Coal— [Reserved]**

**Subpart G—Other Solid Minerals— [Reserved]**

3. The following subparts are added to Part 212:

**Subpart H—Geothermal Resources— [Reserved]**

**Subpart I—OCS Sulfur [Reserved]**

4. Paragraph (b) introductory text of § 212.200 is revised to read as follows:

**§ 212.200 Maintenance of and access to records.**

(b) The MMS shall have access to all records of the operator/lessee pertaining to compliance to Federal royalties, including, but not limited to:

**TITLE 43—PUBLIC LANDS: INTERIOR  
GROUP 3400—COAL MANAGEMENT**

**PART 3480—COAL EXPLORATION  
AND MINING OPERATIONS RULES**

1. The authority citation for Part 3480 continues to read as follows:

*Authority:* The Mineral Leasing Act of February 25, 1920, as amended (30 U.S.C. 181, et seq.); the Mineral Leasing Act for Acquired Lands of 1947, as amended (30 U.S.C. 351-359); the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201, et seq.); the National Historic Preservation Act of 1966, as amended (16 U.S.C. 470, et seq.); the Endangered Species Act of 1973, as amended (16 U.S.C. 1531, et seq.); the Act of March 3, 1909, as amended (25 U.S.C. 396); the Act of May 11, 1938, as amended (25 U.S.C. 396a-396g); the Act of February 28, 1891, as amended (25 U.S.C. 397); the Act of May 29, 1924 (25 U.S.C. 398); the Act of March 3, 1927 (25 U.S.C. 398a-398e); the Act of June 30, 1919, as amended (25 U.S.C. 399); R.S. 441 (43 U.S.C. 1457); the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 471, et seq.); the National Environmental Policy Act of 1969, as amended (42 U.S.C. 4321, et seq.); and the Freedom of Information Act (5 U.S.C. 552).

2. Section 3485.2 of 43 CFR Part 3480 is amended by removing paragraphs (d), (e), (f), (g), (h), (i), and (k). Paragraph (j) of § 3485.2(j) is redesignated as paragraph (d) of § 3485.2.

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