



Royalty Management Program Transmittal Sheet



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Explanation of material transmitted:

Release 1.0 of the *AFS Payor Handbook—Solid Minerals, Chapter 10*, dated 10/26/92, provides information concerning coal product valuation. All other parts of the *AFS Payor Handbook—Solid Minerals* have been replaced by the *Solid Minerals Payor Handbook*, Release 1.0, dated 02/20/97.

David S. Guzy [original signature on file]

Chief, Rules and Publications Staff

Filing instructions:

AFS Payor Handbook

Solid Minerals

Chapter 10

Royalty Management Program

AFS Payor Handbook Solid Minerals

Chapter 10

Royalty Management Program

Release 1.0

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Written by:

**Solid Minerals Valuation and Reporting Branch,
Royalty Valuation Division**

Prepared by:

**American Management Systems
Operations Corporation, Inc.**

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**U.S. Department of the Interior
Minerals Management Service
Royalty Management Program**

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10. COAL PRODUCT VALUATION

10. COAL PRODUCT VALUATION

10.1 Introduction

The Minerals Management Service (MMS), Royalty Management Program (RMP), within the Department of the Interior (DOI), is responsible for ensuring that all revenues from Federal and Indian mineral leases are efficiently, effectively, and accurately collected, accounted for, and disbursed to the appropriate recipients in a timely manner and in accordance with existing laws, regulations, lease terms, orders, and notices. The MMS is also responsible for providing support for technical lease management functions.

Federal and Indian royalties are reported and paid to the MMS Auditing and Financial System (AFS) using the Report of Sales and Royalty Remittance, Form MMS-2014. A Payor Information Form (PIF), Form MMS-4030, must be submitted for each Federal or Indian mineral lease on which royalties are paid to AFS. The payor handbook was initially developed to assist the royalty payor in preparing these forms. Detailed instructions for completing and submitting the PIF and Form MMS-2014 are given in chapters 1 through 9, of this handbook, dated August 31, 1990.

Effective immediately, use of the Report of Sales and Royalty Remittance--Solid Minerals, Form MMS-4014, has been discontinued. Data previously reported on the Form MMS-4014 should now be reported on the Report of Sales and Royalty Remittance, Form MMS-2014.

Royalties are based on the amount or value of production removed or sold from the lease. To clarify and detail royalty valuation procedures for Federal and Indian coal production, MMS issued new royalty valuation regulations in Title 30, Code of Federal Regulations (CFR) Part 206 (54 Federal Register (FR) 1523, January 13, 1989), effective March 1, 1989. The purpose of this chapter of the payor handbook is to clarify these regulations and provide examples for determining the value of production for royalty computations in accordance with those regulations. Each royalty payor is responsible for the proper valuation, for royalty purposes, of Federal and Indian production.

10.2 Arm's-Length Contract (30 CFR 206.251)

The definition of arm's-length contract is fundamental to the proper determination of Federal and Indian royalties. Generally, the lessee's royalties are based on the lessee's sales price (gross proceeds) at the point of first sale, which normally occurs at the mine, wash plant, or a destination point of sale. If Federal or Indian lease coal is sold, transferred, or otherwise disposed of

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under circumstances that are not at arm's-length, then the lessee must resort to other valuation methods set forth by regulation to properly determine the basis for royalty value. However, the question of arm's-length contract arises in situations other than those of gross proceeds. Whether a transportation or washing arrangement exists at arm's-length or non-arm's-length affects the method under which the lessee computes its costs for allowance computation purposes.

"Arm's-length contract" is defined as a contract or agreement that has been arrived at in a marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. (The MMS defines "person" as an individual, firm, corporation, association, partnership, or joint venture.) Affiliation is determined by the following control test: Ownership in excess of 50 percent of the voting securities of an entity or other form of ownership constitutes control that cannot be rebutted; ownership of 10 to 50 percent creates a presumption of control that can be rebutted; and ownership of less than 10 percent creates a presumption of noncontrol that MMS can rebut.

For an entity to make a judgment as to whether its contractual arrangements are arm's-length, a determination must be made that the entity is legally distinguishable from its affiliates, and the entity and its affiliates have opposing economic interests regarding its contractual arrangements. This two-part test must be successfully addressed before a contract can be considered to be arm's-length.

The parties to the contract in question must establish that they are separate legal entities. The parties must submit evidence of separate incorporation, sole proprietorship business, partnership, or joint venture. Because the context of the inquiry is a contract relating to the sale, transportation, or washing of coal (that is, relating to the transaction of business), MMS requires proof that the entity is in fact engaging in a business that is distinguishable from that of the other parties to the contract.

However, recognition as a separate entity does not, in itself, satisfy the requirements of an arm's-length contract. The entity must rebut affiliation under the control test. If the entity has ownership or is owned in excess of 50 percent by the other party to the contract, then, by regulation, control exists and no rebuttal can be made. The entity may rebut control with the other contract parties when ownership is 10 to 50 percent of its affiliate. To do so, the entity must demonstrate that its affiliate (and (or) its joint venture owners) has opposing economic interest(s) regarding the coal supply agreements (contractual relationships) between itself and its affiliate. The arm's-length definition clearly places the burden of overcoming the presumption of control with its affiliate upon the lessee. In this regard, the lessee may present

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any information it deems appropriate to overcome the presumption of control.

For the affiliation test regarding ownership of less than 10 percent, considered to be a presumption of noncontrol, MMS may make a rebuttable argument to presumption of noncontrol. The MMS must establish that either the parties to a coal supply agreement do not constitute separate legal entities or the parties to that coal supply agreement do not have opposing economic interests regarding that contract. If either of these requirements can be met by MMS, the contract is be considered as a non-arm's-length contract.

10.3 Coal Subject to Royalties (30 CFR 206.253)

All coal mined or produced from a lease in accordance with the Bureau of Land Management (BLM)-approved Resource Recovery and Protection Plan is subject to royalty. Royalty must be paid on all coal that is sold, used by the lessee, or transferred to others, regardless of whether such coal disposition occurs on or off the lease or mine site. For example, if coal is used by the lessee for space heating, as fuel to dry washed coal, or to thermally dry run-of-mine (ROM) coal, the quantity and value of that coal must be reported on Form MMS-2014 and royalties paid on that reported value.

Coal that is determined to be avoidably lost is also subject to royalty. Such determinations are made by BLM. However, coal that is determined by BLM to have been unavoidably lost is not subject to royalty.

If the coal used, avoidably lost, or otherwise disposed of by the lessee is from a cents-per-ton lease, royalty must be paid on the tonnage at the cents-per-ton rate specified in the lease. This tonnage and royalty would be reported in the same line as normal sales using Selling Arrangement Code 300.

When coal from an ad valorem lease is used by the lessee, transferred to an affiliate without sale, or determined by BLM to be avoidably lost, a separate line must be reported on Form MMS-2014 using Selling Arrangement Code 200, non-arm's-length sale. The value of such coal must be determined in accordance with the non-arm's-length provisions of 30 CFR 206.257(c).

In some instances, the most applicable valuation benchmark will be the fifth (30 CFR 206.257(c)(2)(v)), which allows a net-back method or any other reasonable method to be used. One of many alternatives available, and one that MMS will normally accept as a reasonable valuation method under the fifth benchmark, is the use of the weighted average price of other coal sold from the mine

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under arm's-length contracts during the specific sales month. However, it should be noted that if the non-arm's-length sale or transfer price is greater than the weighted average arm's-length price for that sales month, then the non-arm's-length price must be used for royalty purposes (30 CFR 206.257(g)). Because 30 CFR 206.257(d)(3) requires lessees to notify MMS if the non-arm's-length value is established under criteria other than 30 CFR 206.257 (c)(2)(I), MMS will work closely with the lessee to ensure that the proper value for royalty purposes is established.

The following example illustrates the use of the fifth benchmark by a lessee whose coal sales are all arm's-length, but who consumes some Federal lease coal for space heating. Royalty is due based on the quantity of coal consumed during any royalty period.

Calculation of Royalty Due on Coal Used Onsite by the Lessee

Coal used = 51 tons

Weighted average price of coal sales
 = total value of coal sales in month ÷ total tons sold
 = \$745,143.39 ÷ 36,519 tons
 = \$20.404266 per ton

Royalty = tons used × weighted average price × royalty rate
 = 51 tons × \$20.404266 × 12.5%
 = \$130.08

The lessee must report royalty on the coal consumed on a separate line on Form MMS-2014, using Selling Arrangement Code 200. The lessee must also inform MMS in writing of this valuation method and the reason for its use (see discussion for 30 CFR 206.257(d)(3) in sec. 10.10.9).

10.4 Compensation for Unavoidably Lost Coal (30 CFR 206.253(b))

The BLM can, for a number of reasons, determine that coal was unavoidably lost at the mine site. Unavoidable losses also may occur when the coal is transported to a remote point of sale at the lessee's expense by truck, rail, or conveyor. An accident may occur en route resulting in a loss of most or all of the coal. In such situations, the coal lost may be insured against that specific loss under the terms of an insurance policy. The insurance compensation received for the loss of coal is royalty bearing at the royalty rate specified in the lease document. Applicable allowances are permitted from the insurance proceeds.

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For example, a mining company is transporting coal to a distant point of sale by rail. The mine loads a 100-car train (120-ton capacity per car) for shipment to the customer. En route the train is wrecked and 50 percent of the coal is lost (6,000 tons). A common practice for railroads is to insure each train with a blanket policy for damage to equipment and loss of transported product. The railroad receives compensation for the loss of 6,000 tons of coal at a rate of \$20 per ton. The railroad then compensates the mining company for undelivered coal at the same rate. Assuming all coal was produced from a lease having an 8 percent royalty rate, and disregarding the allowable transportation cost for purposes of this example, royalty on the coal lost is due and calculated as shown in the following example, part A. The same procedure would be applied to insurance or another form of compensation received for coal unavoidably lost at the mine.

Insurance Compensation Royalty Calculation

Part A, Without Allowance:

$$6,000 \text{ tons} \times \$20 \text{ per ton} = \text{gross proceeds} = \$120,000$$

$$\$120,000 \times 8\% \text{ royalty rate} = \$9,600$$

Part B, With Allowance:

$$6,000 \text{ tons} \times (\$20 \text{ per ton} - \$7 \text{ per ton}) = \text{value basis}$$

$$= \$78,000$$

$$\$78,000 \times 8\% \text{ royalty rate} = \$6,240$$

Using this same example, one can assume that if the coal lost had been washed, a deduction would be allowed. For example, if the cost of washing the coal lost was \$7 per ton (see section 10.12.7 for washing allowance calculation), that cost may be deducted from the gross value as shown in the previous example, part B.

10.5 Royalty on Previously Mined Coal (30 CFR 206.253(c))

Coal washing operations normally result in loss of coal in the course of removing the bone, rock, and shale to produce a clean coal product. This coal-containing refuse is typically slurried, conveyed, or trucked to waste ponds or pits, where it accumulates over the life of the operation permit. Over time, sufficient quantities of coal-bearing waste material accumulate to warrant the lessee's efforts to recover and process the waste coal for sale. Because royalties are normally due on the actual sale of produced coal, the waste coal was not previously subject to royalty payment. However, the subsequent recovery of this waste coal requires

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royalty payment on quantities allocable to the Federal or Indian lease.

In nonwashing situations, some mines double-screen coal, thereby eliminating coal fines from normal coal sales. Over time, substantial stockpiles of coal fines may accumulate until a buyer is found. As in the previous paragraph regarding coal washing, the rejected coal fines fraction did not require royalty payment when this coal was first mined and double-screened. However, when the inventoried coal fines are subsequently sold, royalty is required on quantities allocable to the Federal or Indian lease.

The royalty on such recovered coal is based on the rate applicable to the original type of mining for the initial source of the coal. Value for royalty purposes is normally based on the regulations in effect at the time the coal is mined, or in this instance, recovered and sold.

For example, coal was originally mined from an underground mine at a rate of 15 cents per ton. The wasted coal from the wash process went to a refuse disposal area without royalty payment, and that lease was subsequently readjusted to 8 percent. Royalty would now be due on the sale of that recovered coal at a rate of 8 percent.

Assuming the sale is arm's-length, the value would be based on the gross proceeds of the arm's-length contract. An allowance for the cost of the original coal washing would not be permitted; however, if the recovered waste coal is subjected to subsequent washing, an allowance would be permitted.

In another example, assume that coal was produced from a lease having an 8-percent royalty rate and that some coal was unavoidably lost through a washing process. In subsequent years the lessee obtains a royalty rate reduction to 5 percent, effective at a time when the previously unavoidably lost coal is being recovered from a waste pond. The lessee would pay royalty at a rate of 5 percent, because that is the effective rate when the lost coal is recovered for sale.

10.6 Coal Quality Standards (30 CFR 206.254(a))

Coal regulations at 30 CFR 206.254(a), effective March 1, 1989, modified the quality reporting standards for ad valorem coal leases. Prior to that time, lessees that sold Federal or Indian coal without washing were only required to report the heating value of the coal as British thermal units (Btu) per pound. Lessees that washed coal were requested to provide the number of Btu's per pound, percent ash, and percent sulfur of the cleaned coal. However, under 30 CFR 206.254(a), the quality reporting now

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required from all leases is the percent sulfur, percent ash, and number of Btu's per pound of coal.

The Production Accounting and Auditing System (PAAS) reports to MMS both the quantity and quality of coal input to a secondary processing facility, as well as the processed coal products produced at the facility. The data should be reported on Form MMS-4059, Solid Minerals Operations Report (SMOR-A), and Form MMS-4060, Solid Minerals Facility Report (SMFR-A).

The SMOR-A identifies the quantity and quality of all raw material produced from a Federal or Indian lease; specifies the disposition of raw materials, including sales, transfers, and adjustments; and tracks raw material inventories. The SMFR-A identifies quantity and quality of raw products input to a secondary processing facility, such as a washer or dryer, and identifies quantity and quality of processed products produced at the secondary processing facility. The reporting frequency is monthly or quarterly depending on lease terms, but not less frequently than quarterly. The quality data reported represent the weighted average of all coal produced, washed, or otherwise processed. The data are not reported on an individual sales contract basis.

Detailed instructions for completing these forms are contained in the PAAS Reporter Handbook. To purchase a copy, contact RMP at (303) 231-3090. For assistance in completing the PAAS forms, contact RMP toll free at 800-548-3094.

10.7 Quantity Reporting Standards (30 CFR 206.254(b))

The regulations at 30 CFR 206.254(b) require that coal quantity measurements be reported to AFS and PAAS in number of short tons. However, MMS is aware that export sales often measure sold tons in metric tons. In situations in which the sale occurs in metric tons, the lessee must convert to short tons to report to MMS. The MMS uses A Dictionary of Mining, Mineral, and Related Terms (Dictionary) published by DOI, Bureau of Mines (BOM), as the authority for conversion from metric tons to short tons. The Dictionary defines a metric ton as "a unit of mass and weight that equals 1,000 kilograms or 2,204.6 avoirdupois pounds."

From this definition, 1 metric ton is equal to 1.1023 short tons. Lessees should use these conversion factors, as shown by the following example, to report metric ton sales to MMS in terms of short tons.

Conversion From Metric Tons to Short Tons

100,000 metric tons sold
 Short tons = 100,000 metric tons × 1.1023

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= 110,230

Although not prescribed at 30 CFR 206.254(b), per-ton coal transportation costs must be reported based on the transportation cost per short ton, as shown in the following example.

Calculation of Transportation Cost per Short Ton

100,000 metric tons sold
 Transportation cost = \$20 per metric ton
 Cost per metric ton = 100,000 × \$20
 = \$2,000,000
 Conversion (from previous example):
 100,000 metric tons = 110,230 short tons
 Cost per short ton = \$2,000,000 ÷ 110,230 short tons
 = \$18.143881

10.8 Royalty Determination Point (30 CFR 206.255(a))

The value of coal is based on the gross proceeds accruing to the lessee pursuant to an arm's-length contract or acceptable non-arm's-length contract, except as otherwise provided in 30 CFR 206.257 (1991). Because the gross proceeds are normally determined under the terms of an acceptable arm's-length or non-arm's-length contract, the point of royalty measurement and the quality analysis are normally determined in accordance with the quantity and quality requirements identified in the coal supply agreement under which the coal is sold. Coal sales contracts often specify weight determination using weigh-in-motion rail scales, batch load facilities, truck scales, or belt scales. The scales used for measuring sales quantities may be located at the mine, en route to the sales destination, or at the sales destination. The designated point of sale is normally regarded as the point of royalty determination or point of royalty settlement. Because coal sales often involve the sale of production from several leases, the lessee is required to determine lease sale quantities for purposes of reporting and paying Federal or Indian royalties. Reported sales quantities are routinely verified by BLM using mine surveys, activity reports, or other production verification techniques.

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10.9 Cents-Per-Ton Leases (30 CFR 206.256)

Coal subject to fixed-rate, per-ton royalty terms is reported on Form MMS-2014 using Selling Arrangement Code 300. Royalty must be paid at the rate per ton on all coal tonnage sold, used by the lessee, transferred to an affiliate, determined by BLM to be avoidably lost, or otherwise discarded.

Transportation and washing allowances cannot be taken on coal subject to cents-per-ton royalty. Royalty is paid on the number of tons measured at the point designated under the contract for the sale of coal. Transportation allowances are not applicable because transportation arrangements do not affect the measured production quantity and resulting royalty due. In situations where lease production is put through a coal wash plant, the lessor participates somewhat in the cost of washing, because royalty is paid on the clean coal tonnage output rather than the ROM coal tonnage entering the wash plant.

When a cents-per-ton lease is readjusted to an ad valorem royalty rate, the lessee may continue to pay the cents-per-ton rate for up to 30 days on coal that was produced prior to the effective date of readjustment and is in inventory on the effective date. The following examples illustrate how the royalty rates are applied when a coal lease is readjusted. In all cases where a mine stockpile inventory exists on the effective date of lease readjustment, a first-in, first-out accounting method must be used in the transition from cents-per-ton royalty to ad valorem royalty.

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Example 1 of royalty reporting requirements when royalty changes from cents-per-ton to ad valorem and mines sale exceed mine inventory

All coal production from Butte's Coal Company comes from Federal Lease No. M50-012345-0. The lease royalty rate is readjusted from \$0.20 per ton to 12.5 percent of value effective January 1, 1995. On the effective date of lease readjustment, the mine has 50,000 tons in mine stockpile inventory. January 1995 sales total 60,000 tons.

The lessee reports January 1995 royalties by entering two royalty lines. One line is for 50,000 tons sold at the royalty rate of \$0.20 per ton using Selling Arrangement Code 300. The other line reported for January 1995 sales is for 10,000 tons sold at the readjusted royalty rate of 12.5 percent of the gross proceeds using Selling Arrangement Code 100 for arm's-length sales, or Selling Arrangement Code 200 for non-arm's-length sales. All coal sold during the following month of February 1995 is subject to the readjusted rate of 12.5 percent of value and would be reported using Selling Arrangement Code 100 (assuming the sale was arm's-length). Figure 10-1 shows the Form MMS-2014 reporting requirements.

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Example 2 of royalty reporting requirements when royalty changes from cents-per-ton to ad valorem and mine sales are less than mine inventory

All coal production from Butte's Coal Company comes from Federal Lease No. M50-012345-0. The lease royalty rate is readjusted from \$0.20 per ton to 12.5 percent of value effective March 1, 1995. On the effective date of readjustment, the mine has 80,000 tons of coal stockpiled in mine inventory. March 1995 sales total 60,000 tons.

The lessee reports March royalties by entering one royalty line. The one line reported is for 60,000 tons at the royalty rate of \$0.20 per ton using Selling Arrangement Code 300. The remaining 20,000 tons of coal mined before the effective date of lease readjustment that remains in inventory must be reported at the ad valorem royalty rate for the April 1995 sales month. Royalty is reported on Selling Arrangement Code 100 for arm's-length sales or Code 200 for non-arm's-length sales. Figure 10-2 shows Form MMS-2014 reporting requirements.

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Example 3 of royalty reporting requirements when royalty changes from cents-per-ton to ad valorem and the mine produces coal from Federal and non-Federal leases

Coal production from Butte's Coal Company is from both a Federal lease and a private fee lease. Coal mined from each lease is commingled at the mine facilities in a single stockpile. The Federal lease royalty rate is readjusted from \$0.20 per ton to 12.5 percent of value effective March 1, 1995. On the effective date of lease readjustment, the mine has 100,000 tons of coal stockpiled in mine inventory. Production records show that 75,000 tons or 75 percent of the inventory was mined from the Federal lease and the remaining 25,000 tons were mined from the private fee lease. Coal sales for March 1995 total 80,000 tons.

The lessee reports March royalties by entering one royalty line for Federal Lease No. M50-012345-0 on Form MMS-2014. The one line reported is for 60,000 tons at the royalty rate of \$0.20 per ton. The reported Federal tonnage is 75 percent of total sales for the March sales month, which is the proportion of Federal coal to fee coal that was in the stockpile inventory on the effective date of lease readjustment. All Federal coal reported as sold in April 1995 is subject to the readjusted ad valorem royalty rate. Figure 10-3 shows Form MMS-2014 reporting requirements.

Figure 10-3--Royalty Changes From Cents-Per-Ton to Ad Valorem
and Mine Produces Coal from Federal and Non-Federal Leases

Form MMS-2014 Revised 3/91

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service - Royalty Management Program

OH 9 1010-0029
(Exp. April 30, 19XX)

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REPORT MO./YR. [04/95]

1 PAYORS NAME Butte's Coal Co.
ADDRESS 14 18th Street
CITY/STATE Craig, CO

2 PAYOR CODE M A 7120

3 FEDERAL OR INDIAN

3a PAYOR ASSIGNED DOCUMENT NUMBER _____

4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
RESERVED FOR PREPARERS USE	ACCOUNTING IDENTIFICATION (AID) NUMBER	PRODUCT CODE	REG PRICE	SELLING ARR CODE	SALES MONTH/YEAR	TRANS CODE	ADJ REAS CODE	SALES QUANTITY	QUALITY MEASURE-MENT	CALC METH	SALES VALUE	ROYALTY QUANTITY	ROYALTY VALUE	PAYMENT METHOD CODE	
1	M500123450101	EI		300	0395	01		60,000.00					12,000.00		
2															
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REPORT CONTROL BLOCK		WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s). The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires us to inform you that this information is being collected to document details of royalty payments on sales of oil and gas from leases on Federal and Indian lands. MMS will use this information to maintain and audit lease accounts.	20 PAGE TOTAL	12,000.00
22 Checks to MMS (01)	Amount		21 REPORT TOTAL	12,000.00
23 Payments to Others (02)				
24 EFT to MMS (03)				
25 Royalty-In-Kind (04)				
26 Checks to MMS for BIA (05)				
27 EFT to BIA (06)				
28 Payments to Lockboxes (07)				
29 TOTAL OF ITEMS 22-28				

I have read and examined the statements in this report and agree they are accurate and complete.

30 Edward M. King 04/22/95
Name (typed or printed) and authorized signature Date

31 Edward M. King (303) 411-2222
Name of preparer Telephone

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

10.10 Ad Valorem Lease Coal Value (30 CFR 206.257)

Lessees that produce coal from Federal and Indian ad valorem coal leases that are subject to the MMS coal product valuation regulations must value that coal in accordance with the provisions of 30 CFR 206.257. Coal produced from leases that have specific valuation terms, or coal that is subject to the specific provisions of any statute, treaty, or settlement agreement between the Federal or Indian lessor and the lessee, must be valued in accordance with the specific terms of that lease, statute, treaty, or settlement agreement. However, the specific valuation provisions of any lease, statute, treaty, or settlement agreement govern only to the extent of the inconsistency that exists between language of the lease, statute, treaty, or settlement agreement and the regulatory provisions.

For example, Federal Lease No. M50-0012345-0 has a special provision for computation of royalties due the lessor. This provision states that the gross value shall be adjusted for mine haulage and routine crushing costs. The sales price is the measure of the value of coal at the mine mouth. This special lease valuation provision, however, establishes royalty value for coal at other than the free on board (FOB) mine point of sale and is unique to this lease. Under this unique lease term, value for royalty purposes would be based on the sales price less a transportation allowance for mine haulage and a processing allowance for crushing and related handling and (or) loading costs at the sales point.

The value of coal from ad valorem leases is normally based on the gross proceeds of an arm's-length contract, less any applicable transportation and washing allowances. The lessee's costs for Federal Black Lung excise tax, abandoned mine land (AML) fees, and State and local severance taxes can only be excluded from value for production that occurred during the period March 1, 1989, through September 30, 1990.

For coal sold under an arm's-length contract, the value of coal is to be based on the total gross proceeds received for Federal or Indian coal sold under that sales agreement. When coal is sold pursuant to a specific pricing provision of an arm's-length contract, then the value would normally be based on the invoiced price reflecting the pricing requirements of that specific portion of the coal supply agreement. Royalties are reported to MMS on Form MMS-2014 at the lease level, not at the sale contract level, and not necessarily at the mine level. Therefore, in computing the royalty due, if the sales agreements do not specify a particular lease, then the proceeds received under that agreement are allocated by production to each producing lease at the mine. However, if a sales agreement specifies a particular lease, then the proceeds from that sale must be attributed to that particular

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lease. One method to allocate the production is demonstrated in the following example.

Example of Multiple Lease Royalty Calculations

The Raider Mine has producing leases and sales as follows:

Lease No. 123 produces 20,000 tons; royalty rate is 5%.

Lease No. 999 produces 10,000 tons; royalty rate is 8%.

Lease No. 765 produces 30,000 tons; royalty rate is 5%.

Total production is 60,000 tons.

The mine has two ongoing sales contracts, one long-term contract under which 50,000 tons are sold this month at \$15 per ton (total gross proceeds is \$750,000), and one spot sales contract under which 10,000 tons are sold this month at \$5 per ton (total gross proceeds is \$50,000). If the sales contracts do not specify the source of coal or specify only the mine as the source of coal, royalty for the three leases should be calculated as follows:

Lease No. 123 royalty = 20,000 tons × \$13.333333
(the weighted average price per ton of all sales,
or \$800,000 ÷ 60,000 tons) × 5% = \$13,333.33

Lease No. 999 royalty = 10,000 tons × \$13.333333
(derived as shown above) × 8% = \$10,666.67

Lease No. 765 royalty = 30,000 tons × \$13.333333
(derived as shown above) × 5% = \$20,000

In the absence of a specific sales contract provision indicating the lease-specific source of the coal, the \$5 per ton coal sales may not be arbitrarily assigned by the lessee to Lease No. 999, which has the 8-percent royalty rate.

Although the value for royalty purposes sometimes involves multiple deductions for transportation or washing (or for production-related taxes and fees for production from March 1, 1989, through September 30, 1990), these deductions should not be netted from the royalty due line. Instead, these deductions must always be shown as separate lines on Form MMS-2014. The MMS may determine that certain proceeds are not to be related to the value of coal and are therefore not part of gross proceeds. In such instances, because the exclusion of contract proceeds requires explicit MMS approval,

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MMS furnishes any necessary reporting instructions to the lessee at the time of the determination.

10.10.1 Total Consideration for Value (30 CFR 206.257(b)(2))

In most situations the sales price of an arm's-length contract represents the total consideration flowing from the buyer to the seller (lessee). However, in certain cases the buyer and seller have mutually agreed on other noncash forms of consideration which supplement the cash price paid for the coal. The value for royalty purposes must include all forms of consideration paid for coal even if some portion of the total consideration is not in the form of cash and is not necessarily identified in the invoiced price.

An example is when a coal purchaser provides mine development capital (power shovels, draglines, bulldozers, front-end loaders, and so forth) or mine facilities (crushers, silos, administrative buildings, change houses, garages, and other buildings) imperative to the mining operations. Because these mine development, operating, and maintenance costs are usually fully borne by the mining firm (lessee), excluding these costs from the value of coal would be equivalent to permitting deductions for these mining costs. However, no deductions for these mining costs are allowed from royalty. Accordingly, MMS requires that the per-ton cash equivalent of these noncash assets be determined and added to the cash price received for the sale of coal under that arm's-length contract. This is demonstrated in the following example.

Noncash Consideration for Crushing Performed by the Buyer

A mine-mouth utility station furnishes and operates the primary coal crushing plant that receives run-of-mine coal. The lessee incurs no cost related to the ownership or operation of the crushing facility.

The sale price of run-of-mine uncrushed coal is \$14 per ton. The crushing facility ownership costs and operating expenses are:

Annual production from the mine:
5 million tons

Annual operating and maintenance expenses:
\$750,000

Annual depreciation:
\$50,000 (\$1,000,000 cost ÷ 20-year life;
salvage value is assumed to be zero)

Return on investment:

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\$85,000 (\$1,000,000 capital cost × 8.5%,
which is assumed to be the cost of capital to
the utility)

(As is permitted in the computation of a transportation
or washing allowance under non-arm's-length conditions,
a return on investment component is included to reflect
the total cost of capital equipment acquisition.)

The additional value for royalty purposes is:

$$\begin{aligned} & \$750,000 + \$50,000 + \$85,000 \\ & = \$885,000 \div 5,000,000 \text{ tons} \\ & = \$0.177000 \text{ per ton} \end{aligned}$$

The total gross proceeds is therefore:
\$14 + \$0.177000 = \$14.177000 per ton

If the value of the arm's-length noncash benefits cannot be determined, then MMS may resort to the non-arm's-length benchmarks to establish the value of that production. This option includes using values from other sales contracts for coal sold in the same area and under comparable sales circumstances. For example, if the contract in question is long term, then MMS would seek other long-term contracts in the same area to establish the value of production. Another option is to determine the value of that coal as reported to a State public utility commission (PUC) or to the Federal Energy Regulatory Commission (FERC). Utilities normally include the costs of these noncash assets in their cost basis for electricity rate-setting purposes. In this regard, utility reports to FERC or PUC may be an objective data source for determining the cash equivalency of the noncash consideration paid for the coal.

10.10.2 Unreasonable Value for Arm's-Length Production (30 CFR 206.257(b)(3))

If MMS determines that the gross proceeds under an arm's-length contract do not reflect a reasonable value for production because of misconduct between the contracting parties or because the lessee has otherwise breached its duty to market production for the mutual benefit of itself and the lessor, then MMS may require that the coal be valued pursuant to the first applicable valuation benchmark of the non-arm's-length valuation standards at 30 CFR 206.257(c)(2). Thus, MMS first must determine that a price is unreasonable; for example, by comparing the price to other prices from comparable contracts. Then MMS must determine that the unreasonably low price is a result of misconduct or a breach by the lessee of its duty to market the production for the mutual benefit of itself and the lessor. If such is the case, MMS determines the value to be unreasonable.

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Lessee misconduct or breach of duty may include, but is not limited to, the following situations:

- Collusion between the producer (seller) and buyer
- Negligence in negotiating contracts
- Pricing practices found by a court or regulatory authority to be incorrect or fraudulently manipulated

When MMS makes the preliminary determination that the value may be unreasonable, MMS notifies the lessee and provides the lessee an opportunity to supply written information justifying the lessee's coal sales price. If MMS makes a final determination that the coal value is unreasonable, then that coal is valued pursuant to 30 CFR 206.257(c).

10.10.3 Certification of Gross Proceeds (30 CFR 206.257(b)(4))

As stated in 30 CFR 206.257(b)(1), the value reported by the lessee and accepted by MMS is subject to monitoring, review, and audit. As a result of this process, MMS identifies reported values that, when compared with other reported values, appear lower than what otherwise might have been predicted based on previous data, market surveys, or other value indicia. In such cases, MMS may request that the lessee (1) review its sales contract(s) to determine whether all elements of value have been properly included in the basis for royalty valuation, and (2) submit a letter certifying that all components of value have been included in the value for royalty purposes. Such a certification is subject to MMS review, and as necessary, MMS may request under 30 CFR 206.263 that the lessee submit sales contracts and other related material.

10.10.4 Value Exclusions for Taxes and Fees (30 CFR 206.257(b)(5)) (Citation is correct only for the time period March 1, 1989, through September 30, 1990.)

During the period March 1, 1989, through September 30, 1990, the value of Federal coal for royalty purposes was computed by excluding from the gross proceeds the costs of Federal Black Lung excise taxes, AML fees, and State and local severance taxes that are levied on the basis of production. Coal sales agreements may include pricing provisions that in some way reimburse the lessee for production fees and taxes. In some cases these pricing provisions differ from the lessee's actual costs. Payors should note that only the actual cost of these production taxes and fees can be excluded from value. The rates for the Federal taxes and fees are as follows:

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1. Black Lung excise taxes

Surface mining:

- For unit price \geq \$13.05: \$0.55 per ton
- For unit price $<$ \$13.05:
 $0.044 \times \text{unit price (\$ per ton)} \div 1.044$

Underground mining:

- For unit price \geq \$26.10: \$1.10 per ton
- For unit price $<$ \$26.10:
 $0.044 \times \text{unit price (\$ per ton)} \div 1.044$

Lignite: \$0 per ton (Black Lung excise tax is not levied on lignite.)

2. AML fees (for all States)

The instructions for AML fee computations can be found at 30 CFR 870.13, which states as follows:

- (a) Surface mining fees.—The fee for anthracite, bituminous, and subbituminous coal, including reclaimed coal, is 35 cents per ton unless the value of such coal is less than \$3.50 per ton, in which case the fee is 10 percent of the value.
- (b) Underground mining fees.—The fee for anthracite, bituminous, and subbituminous coal is 15 cents per ton unless the value of such coal is less than \$1.50 per ton, in which case the fee is 10 percent of the value.
- (c) Surface and underground mining fees for lignite coal.—The fee for lignite coal is 10 cents per ton unless the value of such coal is less than \$5.00 per ton, in which case the fee charged is 2 percent of the value.

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The regulations at 30 CFR 870.5 define "value" as follows:

Value means gross value at the time of initial bona fide sale, transfer of ownership, or use by the operator, but does not include the reclamation fee required by this part.

The rates for State and local severance taxes vary considerably by State, county, or municipality and therefore are not presented in this summary.

The exclusions for production-related taxes and fees became effective on March 1, 1989. Lessees were entitled to claim these exclusions on coal that was mined and sold after February 28, 1989. Coal mined prior to March 1, 1989, and in inventory that was sold in March 1989 is not eligible for the tax and fee exclusions. By amendment to the regulations, the tax and fee exclusions may not be claimed for coal mined and sold on or after October 1, 1990.

The rates per-ton shown for the Black Lung excise tax and the AML fee are not always assessed on an actual mined ton basis. The tax or fee payor may, if necessary, make adjustments for excess moisture content, thereby reducing the tonnage of coal upon which the tax or fee is assessed. This, of course, reduces the total amount of taxes and fees paid by the lessee. However, no moisture weight adjustment is permitted for royalty valuation purposes. Because of this resulting weight discrepancy, lessees should be careful to properly compute the amount of tax or fee actually paid. For example, if a lessee computes and reports the Black Lung excise tax or AML fee to MMS using the stated face value of the tax or fee without any moisture adjustment but employs the moisture adjustment factor when actually computing and paying those taxes and fees, overstated exclusions for royalty purposes will result. The outcome is eventual repayment of royalties and assessment of late-payment charges.

When reporting tax and fee exclusions on Form MMS-2014, lessees must use separate lines to report each exclusion. Detailed instructions on reporting these exclusions to MMS have previously been issued and are now contained in section 7.3.2 of this handbook.

Although these exclusions are not permitted for Federal coal produced on or after October 1, 1990, the exclusion categories will remain active for reporting purposes. Lessees must retroactively adjust erroneous exclusions previously reported for the sale of coal produced between March 1, 1989, and October 1, 1990.

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**10.10.5 Other Exclusions from Royalty Value
(30 CFR 206.257(b)(5)) (Citation is correct for periods beginning
October 1, 1990.)**

In general, the proceeds paid to the lessee by the coal purchaser under a coal supply agreement are for the coal purchased. Such payments can include any item that the buyer and seller (lessee) have agreed upon; the more common payment elements identified in contracts include labor wages and fringe benefits, welfare fund, material and supplies, reimbursement for taxes, fees, royalties, insurance costs, capital item replacement, efficiency payments, management fees, and profitability factors. The MMS considers all of these payments to be normally related to the sale of coal and thus royalty bearing. However, there are certain situations under which payments received by the lessee under a coal supply agreement may not be considered to be royalty bearing, because the payments are made for reasons other than the purchase of coal. For this reason MMS has provided a regulatory provision in 30 CFR 206.257(b)(5) that permits lessees the opportunity to come forward with arguments concerning the issue of why certain compensation paid under a coal sales contract is not part of the value of the coal production.

For general guidance regarding whether certain compensation is considered royalty bearing, the following discussion is restated from the Federal Register preamble to the January 13, 1989, final rulemaking at 54 FR 1513:

. . . MMS will certainly consider such factors as the terms of the sales contract, the lessee's rationale for its claim that the payment is not part of the value of production, how the purchaser characterizes the transaction (particularly if it is a public utility subject to state public utilities commission regulation), and any other relevant matters. Other factors could include the following:

1. The unit sale or contract price, including prices that explicitly vary with the level of production, are considered royalty bearing.
2. Payments not designated as part of the purchase price, but made on a periodic or regularly scheduled basis, generally are royalty bearing.
3. "Settlement" payments made to terminate a sales contract before the contractually-specified termination date will usually not be considered payment for produced coal. If there is a follow-on contract, MMS will review the circumstances to

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determine if some or all of the payment is royalty bearing.

4. Payments or reimbursements for services or processing costs customarily the responsibility of the lessee, including that required to put the product in marketable condition, will usually be considered payment for produced coal.
5. Damages recovered under a court judgment, or included in a liquidated damages clause, that are for the purchaser's breach of a sales contract are usually not considered payment for produced coal, if they correspond to or are a reasonable estimate of the producer's lost profit.

With regard to royalty on take-or-pay and other similar type payments, the preamble to the January 1989 final rulemaking states at 54 FR 1498:

Therefore, MMS's final coal regulations have been revised from previous proposed rules by revising the definition of "gross proceeds" in 30 CFR 206.251 to exclude the phrase "*** 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***." Of course, as discussed further below, if any of such payments at some point is used as a payment for produced coal, then they would still be subject to royalty as gross proceeds for produced coal.

In deciding whether a lessee has met its burden to demonstrate that certain compensation is not royalty bearing, the preamble to the January 1989 final rulemaking explains at 54 FR 1498:

Since the question at issue is not whether a payment was made but, instead, whether that payment is part of the consideration paid for coal, MMS would expect any rebuttal to address the commercial relationship between the buyer and the seller (lessee). Specifically, MMS would require substantial explanation of why the value paid by a purchaser, under a coal sales contract, is not equitable to the value received by the lessee for the sale of coal.

In all instances, the substance of the transaction or contract clause, and not its form, will control.

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10.10.6 Non-Arm's-Length Coal Value Procedures (30 CFR 206.257(c-f))

WHEN TO USE NON-ARM'S-LENGTH VALUATION CRITERIA

When Federal or Indian coal is sold, used, or otherwise finally disposed of under a non-arm's-length contract or no contract, the lessee must use the non-arm's-length valuation criteria to establish the value of coal for royalty purposes. The lessee must also use the non-arm's-length valuation criteria if, prior to disposition, the lessee enhances the value of coal (by means other than coal washing) after the coal has been placed in marketable condition (see 30 CFR 206.265). The MMS may also direct the lessee to use the non-arm's-length valuation criteria if MMS determines that the transaction is non-arm's-length, or if the proceeds received under its contract do not represent a reasonable value because of misconduct between the contracting parties or because the lessee otherwise breached its duty to market production for the mutual benefit of the lessee and lessor.

HOW THE NON-ARM'S-LENGTH PROCEDURE IS APPLIED

The non-arm's-length valuation procedure is based on a sequentially ordered benchmark system wherein the value for royalty purposes is established by use of the first applicable valuation benchmark. The sequenced valuation criteria provide the lessee with the necessary framework from which to select the correct valuation procedure based upon its situation. However, lessees should be aware that the non-arm's-length method chosen by the lessee is not binding to MMS and may not be accepted if MMS determines that the method is inappropriate or otherwise not in accordance with regulations.

DISCUSSION OF VALUATION BENCHMARKS

First Valuation Benchmark

The first benchmark for determining the value of coal sold under non-arm's-length conditions (or other disposition of produced coal by other than an arm's-length contract) is the gross proceeds accruing to the lessee provided that those gross proceeds are within the range of the gross proceeds derived from comparable arm's-length contracts. These comparable arm's-length contracts may not be between buyers or sellers affiliated with the lessee for sales, purchases, or other dispositions of like-quality coal produced in the area. In evaluating the gross proceeds paid under arm's-length contracts, the comparability of the contracts must be examined as to the time of execution, duration, markets, terms, quality of coal, quantity, and other factors as may be appropriate to reflect the value of coal.

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Second Valuation Benchmark

The lessee must look to the second benchmark if the gross proceeds of the contract are not within the range of the gross proceeds paid or offered under comparable arm's-length contracts, or if no comparable arm's-length contracts exist in the same area. The second benchmark for coal valuation requires the lessee to use the coal prices reported to a PUC by the purchasing utility company. This valuation benchmark is, for the most part, applicable to integrated (affiliated) mining companies and their electric utility counterparts. The fuel costs are reported annually, or more often, to a PUC and are based on delivered costs of fuel. In this circumstance, when electricity is produced from the lessee's coal, a portion of the regulated sale price of the electricity received by the utility is attributable to the fuel cost factor included in the rate base. Indirectly, the delivered cost of coal represents the gross proceeds accruing to the lessee through the sale of electricity. This benchmark is inapplicable for valuing non-arm's-length sales to customers not regulated by a PUC.

Because the rate approval is based on a delivered cost to the generating plant, the delivered cost may include transportation to a remote generating plant and the costs accrued if the coal has been washed prior to delivery. Transportation and washing allowances may be appropriate in such cases because the reported delivered cost of fuel is used as the basis of value as follows:

Reported cost of coal delivered to a remote powerplant owned by a public utility - transportation allowance = effective value FOB mine

\$40.00 per ton - \$13.00 per ton = \$27.00 per ton

The lessee would use \$40 per ton to calculate and report that month's sales value (gross proceeds) and would report and receive a \$13 per ton transportation allowance.

The MMS is aware that coal costs reported to a PUC may not necessarily be accepted and approved by the PUC. In such a situation, lessees are encouraged to seek MMS guidance on whether the unapproved cost components will be accepted by MMS.

Third Valuation Benchmark

This benchmark bases value on the delivered cost of coal reported to FERC. This information is collected and published by the Energy Information Administration of the Department of Energy. This benchmark is applicable only to electric utilities that have fossil fuel plants with a total generation nameplate capacity of 50 or more megawatts and therefore are required to report fuel purchases to FERC using FERC Form 423. These utilities may include publicly

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owned utilities, private (investor-owned) utilities, and electric cooperatives.

This benchmark is available for valuation in situations where use of State PUC rate settings is either inapplicable or unavailable. For instance, electric cooperatives report to FERC but do not report to the State PUC. Also, if an investor-owned electric utility sells the majority of its power to out-of-state buyers, then resorting to fuel prices reported to FERC may be more appropriate than those reported to State PUC authorities.

Coal prices reported to FERC are disclosed on a delivered basis monthly on FERC Form 423. Other reports such as FERC Form 1 or Rural Electric Administration Form 7 or 12a through 12i may also be applicable for determining delivered fuel cost. The lessee (utility) should consult with MMS to establish a mutual understanding of which form would constitute an acceptable basis for valuing Federal or Indian coal for royalty purposes. As stated previously, because the price of coal is on a delivered basis, a transportation allowance may be appropriate to establish the value for royalty purposes FOB the mine. A washing allowance may also be appropriate if the coal is washed prior to delivery.

Fourth Valuation Benchmark

This benchmark establishes value based on other relevant matters that include publicly available spot market prices or other information unique to a particular lease or to the salability of certain types of coal.

The use of spot market prices is, like the first benchmark, a market-based valuation procedure in that actual market prices are used to determine the acceptability of the non-arm's-length transaction value. As in the first benchmark, all elements of contract comparability must be satisfied. Therefore, lessees should not use spot market prices to establish the value of long-term or otherwise continuing non-arm's-length sales or other dispositions. Spot sales contracts are typically for periods of 1 year or less. The MMS recognizes that coal transactions between affiliates normally occur over extended periods of time, usually over the life of a mine or electric generating plant. If the non-arm's-length sale or use arrangement is for periods longer than a year, then the comparability standard of contract duration is not met.

Upon examining the spot market for non-arm's-length valuation purposes, lessees may consider only spot market prices under which volumes of coal were actually sold. Quoted prices and unsuccessful bids under which no coal can be shown to have been sold are not acceptable for non-arm's-length valuation purposes. Further, if the lessee determines that publicly available spot prices should be

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used to establish the value for royalty purposes, then these prices must not be lower than the gross proceeds accruing to the lessee for the sale of the lessee's coal.

Fifth Valuation Benchmark

If the previous four benchmarks are inapplicable, the lessee must apply the last benchmark. This benchmark requires the lessee to use any other reasonable valuation method to determine value, including a net-back valuation method. Other reasonable methods include the monthly weighted average of long-term contract sales prices and the monthly weighted average of all arm's-length sales from the same mine or from another mine operated by the lessee in the same area. A lessee's affiliated utility may be purchasing coal from the lessee and from unaffiliated sellers in the same area. The monthly weighted average arm's-length prices paid by the utility (excluding non-arm's-length sales) may be another reasonable basis for establishing value for the non-arm's-length coal sold by the lessee to the utility. Under any circumstance, because this valuation methodology requires the lessee to notify MMS under 30 CFR 206.257(d)(3), those valuation procedures as well as any other reasonable method would be discussed with the lessee prior to any final determination of an appropriate valuation procedure.

As with the previous valuation procedures, the net-back method is a method for determining value at the lease or mine. The net-back procedure differs from the previous valuation standards; the valuation process may, if necessary, start with the gross proceeds received by the lessee for the sale of electricity, gas, liquids, or other chemicals, or products derived from the processing or use of Federal or Indian coal. From those gross proceeds, all costs applicable to transportation, washing, other processing, and handling are deducted to arrive at the value of coal in marketable condition FOB the mine. The net-back calculation method must be consistent with the calculation method employed for allowance calculations (see 30 CFR 206.259 and 206.262) and consistent with the requirements of 30 CFR 206.257. In addition to being a benchmark, 30 CFR 206.257(c)(2)(v) also provides that if a lessee establishes an unreasonable value using benchmarks (I) through (iv), then any other reasonable method shall be used to determine a reasonable royalty value. For example, if the prevalent market value of coal in the area significantly exceeds the non-arm's-length value reported by the lessee, then MMS selects a valuation method that produces a value consistent with the prevalent market value.

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**10.10.7 Non-Arm's-Length Exclusions from Royalty Value
(30 CFR 206.257(c)(3))**

This section specifies that if value is determined using the non-arm's-length valuation benchmarks at 30 CFR 206.257(c)(2), then the exclusions from value for production-related taxes and fees allowed for arm's-length sales for the period March 1, 1989, through September 30, 1990, are also permitted for non-arm's-length coal. Further, payments received by the lessee pursuant to its contract, but not part of the total consideration paid for the sale of coal, may be excluded from value only if MMS agrees that the proceeds are not related to the purchase of coal production.

For example, a mine fire at an underground mine halts production. The mine invokes the force majeure clause in the mine's non-arm's-length coal sales agreement with its parent utility company. When force majeure is invoked by the mine, the non-arm's-length agreement requires the parent utility company to make monthly payment for the mine's fixed costs for a period not to exceed 12 consecutive months. The fire is extinguished and the mine resumes production after 4 months. Because no production occurred during those 4 months that the mine could not be operated, the payment for fixed costs during those months is not royalty bearing.

**10.10.8 Retention and Use of Non-Arm's-Length Data
(30 CFR 206.257(d)(1) and (2))**

The lessee does not need to obtain MMS approval of its non-arm's-length valuation procedure. However, MMS may request submission of data used by the lessee to form the non-arm's-length valuation basis. For example, these data could include comparable arm's-length contracts, copies of FERC Form 423, other utility reports mandated by FERC or the Rural Electrification Administration (REA), and State PUC documents.

10.10.9 Valuation Benchmark Notification (30 CFR 206.257(d)(3))

The lessee must submit a one-time written notification to MMS if the lessee uses any valuation benchmark method other than the first benchmark. The notice must include the valuation method used and a description of the procedure that is followed. The notification is to be submitted no later than the end of the month the lessee first reports royalties on Form MMS-2014 using the valuation method selected. If the lessee changes valuation procedures, it must notify MMS of the new procedures (new valuation benchmark) no later than the end of the month the lessee first reports royalties under the new valuation procedure on Form MMS-2014. The lessee must also notify MMS each time there is a change in method using benchmarks (iv) or (v). All notifications should be sent to:

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Minerals Management Service
Valuation and Standards Division
P.O. Box 25165, Mail Stop 3510
Denver, CO 80225-0165

10.10.10 Improper Non-Arm's-Length Valuation (30 CFR 206.257(e))

If MMS determines that the lessee has improperly determined value, then the lessee is liable for any difference between the royalty payments made based upon the value used by the lessee and the value determined by MMS. Late-payment interest will also be assessed on the underpayment pursuant to 30 CFR 218.202.

10.10.11 Lessee Requests MMS Value Determination (30 CFR 206.257(f))

At any time, the lessee may request a value determination from MMS by either requesting that MMS determine the value or by proposing a valuation method to MMS for review and approval. All relevant data must be submitted along with the proposal to MMS for review. The lessee may use its proposed method until MMS makes its determination. The MMS valuation determination remains effective for the period specified by MMS. Regardless of the circumstances, if a final valuation decision results in additional royalties due for past periods, late-payment interest will be assessed on the amount of the underpayment.

10.10.12 Value Not Less Than Gross Proceeds (30 CFR 206.257(g))

The value for royalty purposes cannot be less than the gross proceeds the lessee receives for the sale or disposition of Federal or Indian lease production. Under arm's-length sales conditions, gross proceeds are essentially equivalent to the contract sales price set forth in the arm's-length contract under which lease production is sold. Under non-arm's-length conditions, however, this section requires that the lessee use its non-arm's-length contract value for royalty purposes if the gross proceeds under that contract exceed those found in comparable arm's-length contracts.

For example, the proceeds accruing to a lessee under a non-arm's-length transaction equal \$10 per ton. However, the comparable value of like-quality coal sold under arm's-length conditions by other nonaffiliated coal mines is in the range of \$7 to \$9 per ton. Even though the comparable arm's-length market value is \$7 to \$9 per ton, the value for royalty purposes in this case is a minimum of \$10 per ton, the lessee's gross proceeds.

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On the other hand, if comparable arm's-length contract prices are in the \$12 to \$15 per ton range, the regulations at 30 CFR 206.257(c)(2)(v) require the lessee to pay royalty on value of \$12 per ton even though the non-arm's-length contract price is \$10 per ton.

This section also is applicable to arm's-length contracts in situations in which the full value of the coal is not reflected in the sales price. This includes situations in which the lessee receives from the coal purchaser noncash benefits such as those discussed and exemplified in section 10.10.1. In the example, a lessee receives mine development capital for equipment and other mining facilities from a coal buyer. The example points out that although the cash sales price is \$14 per ton, the value for royalty purposes cannot be less than gross proceeds which, for example, are \$14 per ton plus the value of the noncash benefits provided by the purchaser to the lessee. The value of noncash benefits must also be added to the cash transfer price under non-arm's-length contracts in order to determine gross proceeds.

Lessees should be aware that under all conditions they must account for the entire value of the coal, or all gross proceeds accruing to the lessee, even when it can be demonstrated that the cash sales price equals or exceeds the average price of coal sold in the same area.

10.10.13 Requirement to Place Coal in Marketable Condition (30 CFR 206.257(h))

The preamble discussion to the January 1989 final rulemaking explained in detail the requirements of 30 CFR 206.257(h) at 54 FR 1498-1499:

The requirement that the lessee place the lease product in marketable condition at no expense to the lessor is a vital royalty concept. It defines the minimum level of effort and expenditure the lessee must undertake to place leasehold production in merchantable condition without any contribution or sharing of expenses by the lessor. Any further processing activity beyond that necessary for placing the lease product in marketable condition would be a derivative of the lessee's contractual sales obligation. From a royalty perspective, the additional processing would ostensibly qualify for a deduction from royalties accruing from the sale of leasehold production that has undergone processing beyond that necessary to prepare the mineral as a marketable product.

Marketable condition is the form and condition of leasehold production resulting from the application of

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normal mining processes. The established market demands and expects that lease production be in such a condition that it can be accommodated by existing buyer facilities used for receipt, handling, and consumption of leasehold production. With respect to coal, processes commonly applied by mine operators (or lessees) to prepare coal for the market include all operations which extract, sever, or otherwise separate coal from its in-place position in the geologic strata; crushing (to limit upward size), sizing, storing, blending, and loading for shipment (including oiling); and all transportation requirements in and about the mine beginning at the point of extraction and including movement to all plants and facilities in which normal mining processes are applied.

Processes which are not identified with common mine operations or practices include both surface and in-situ coal gasification or liquefaction operations, any other operations involving the chemical alteration of coal, and operations involving the physical processing of coal to a condition of quality beyond that normally attributed or associated with coal marketed from the same area.

However, the conditioning of coal for the market does not consist of a uniform set of processes. Rather, the marketable condition requirement is as flexible as the requirements of different market segments. For example, some types of coal sold to certain market segments are not normally screened. Instead, the run-of-mine coal is passed through a crusher to reduce the large pieces. The result of this size reduction is prepared coal that can be accommodated by both seller (lessee) and buyer's coal handling facilities. In other situations where coal fines present problems, the marketable condition requirement for coal will include screening, to eliminate the specified coal fines fraction.

Therefore: the test of marketable condition relies on: (1) The market segment that coal is sold into, (2) the customary requirements of preparation or conditioning normally expected by that market segment: and (3) the typical level of preparation or conditioning by coal producers in that area.

Therefore, under no circumstances will MMS accept the gross proceeds established under any sale of coal that does not meet the market's minimum requirement for marketable condition. Specifically, the sale of run-of-mine coal for steam coal utilization by an electric utility does not constitute coal in marketable condition. In this situation, MMS will add to the gross proceeds the

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cost of those normal mining processes which are ordinarily the responsibility of the lessee. This provision is explicitly set forth at § 206.257(h).

10.11 Diligence Requirements (30 CFR 206.257(I))

It is the policy of MMS that royalty payments on retroactive price adjustments are due no later than the end of the month following the month that the price adjustments were invoiced as due and payable in accordance with contract terms, or payment is received, whichever occurs first. Therefore, in order to pay royalty timely on retroactive price adjustments, the lessee must normally remit royalty no later than the end of the month following the month in which retroactive price adjustments were invoiced to the coal buyer.

Normally, MMS looks to the lessee's retroactive price adjustment invoice date as the critical date from which to measure timely royalty remittance. Payment of royalty is normally based on the sale of production; whether the lessee has sold coal under a cash transaction or for another asset, such as accounts receivable, does not affect the lessee's obligation to pay royalty in a timely manner.

For example, a coal sales agreement calls for a price adjustment to the sales price charged during the previous year based on a Bureau of Labor Statistics index that is published in February of the following year. The lessee invoices the buyer for retroactive price increases applicable to calendar year (CY) 1991 in February 1992 as specified by the sales agreement. The price increases must be reported, and additional royalties due must be remitted to MMS the month following the month that invoicing occurred, or by the last day of March 1992. Additional royalties received after the last day of March will be charged late-payment interest on the number of days the royalty remittance is late.

Because the contract proceeds are the basis for valuing production from Federal coal leases, it is not unreasonable to impose on the lessee an obligation to opportunely obtain all compensation due under the contract for coal sold from the Federal lease. Therefore, lessees that do not expediently enforce the price escalators set forth in their sales contracts are subject to late-payment assessments on the amount of the underbilling in the sales price from the time royalties were due, based on the contractual effective date of the price increase, until the time the royalty based on the price increase was actually paid. To avoid late-payment charges where questions of contract diligence arise, the lessee must demonstrate that it invoiced for the additional price increments and, if necessary, pursued remedies set forth in the

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coal supply contract for nonpayment of price increases in a timely manner.

Using the previous example, the coal sales agreement specifies that a retroactive price adjustment for the previous calendar year is to be invoiced the month a Bureau of Labor index is available (February 1992). The lessee invoices for the retroactive price increase in April 1992 and remits the additional royalties resulting from the price increase by the last day of May 1992. Although the lessee remitted royalties by the last day of the month following the month invoicing occurred, the lessee did not punctually enforce the price escalators in its contract. Invoicing should have occurred in February 1992 and royalties should have been paid by the last day of March 1992. Because the royalty payment was not made until the last day of May 1992, late-payment interest is assessed for the 2-month period the royalty payment was late.

The MMS uses the date under the sales contract to determine timely royalty remittance, because that is the date in which the lessee was entitled to invoice its buyer for additional cost reimbursement. This is the requirement of 30 CFR 206.257(I), which infers a lack of diligent contract enforcement whenever the lessee does not pursue the collection of funds to which it is contractually entitled.

In the event of a dispute between the lessee and coal producer regarding a pricing provision of their sales contract in which the lessee claims it is due a higher price than the purchaser is willing to pay, the lessee must take ". . . reasonable measures, which are documented, to force purchaser compliance" Should the lessee and purchaser enter negotiations regarding this issue, the lessee should preserve for MMS review pertinent correspondence such as the initial unpaid invoice, the correspondence initiating discussions and (or) negotiations, and any resulting settlement agreement.

If the lessee prevails, and a price increase results, additional royalty will be due based on the amount of the price increase and the tonnage sold. No late-payment interest will be assessed unless the lessee does not timely remit royalty following resolution of the price dispute.

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10.12 General Discussion for Washing and Transportation Allowances (30 CFR 206.258 and 206.261)

Coal transportation and washing allowances are essentially computed by summing the total annual cost associated with coal transportation or washing operations and dividing that cost by the total (Federal and non-Federal) clean coal tonnage transported or washed. The resulting dollar-per-ton allowance rate is then multiplied by the clean coal tonnage sold in any monthly royalty reporting period and by the lease royalty rate to determine the allowance deduction for that month. The costs that are included in the coal transportation or washing cost basis are limited to direct transportation or washing costs and an allocated amount of indirect costs. These costs must be demonstrated as necessary and attributable to coal transportation or washing operations.

The allowance cost computation is usually a two-step procedure. The first step is to determine the lessee's estimated costs for the current annual allowance period. The second step occurs after completion of the allowance period (usually a calendar-year period), when the lessee determines actual costs and actual tonnages for a final allowance determination. Differences between estimated allowances and actual allowances must be accounted for by correcting, as necessary, allowances claimed on past Form MMS-2014 royalty reports that were based on estimated costs. Overstated allowances that result in underpaid royalty must be repaid. The MMS assesses a late-payment charge for the underpaid royalty. Understated allowances resulting in overpaid royalty may be recouped by the lessee without interest.

The procedure used by the lessee to determine transportation or washing costs depends on whether the lessee has its coal transported or washed under a non-arm's-length situation or an arm's-length situation. Such situations include those in which the lessee performs the transportation or washing operation itself, or the lessee contracts at arm's-length with an independent, unaffiliated party to perform the transportation or washing service. If the situation is arm's-length, the costs are determined by summing the allowable arm's-length contract's transportation or washing costs and dividing that cost by the transported or washed (clean) coal tonnage. If the transportation or washing is non-arm's-length, the lessee sums its operating and maintenance costs with capitalized transportation or wash plant equipment depreciation expenses (determined only by using straight line or units of production depreciation methods based on life of equipment or life of reserves) and a return on investment (ROI) dollar amount. The ROI is computed by multiplying the beginning of year (b.o.y.) capitalized cost of the wash plant or transportation facilities by the Standard & Poor's (S&P) BBB industrial bond rate in effect at the beginning of each allowance period. This rate is the monthly average as published in the S&P Bond Guide. The sum of

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these non-arm's-length cost components is then divided by transported or washed coal tonnage to determine the dollar-per-ton allowance rate. Details of how to report these various costs follow in the discussion of general allowance reporting procedures and in the specific allowance sections.

For wash plants and capital investments in the transportation system placed in service or acquired after March 1, 1989, the lessee may use an alternative method to determine its allowance. A cost equal to the allowable capital investment (rather than the remaining undepreciated portion of the capital investment) in the transportation system or the wash plant is multiplied by S&P's BBB rate to determine the ROI. The S&P BBB bond rate is redetermined at the beginning of each subsequent allowance reporting period, but unless assets are retired or upgraded, the investment cost remains the same for the life of the investment. No allowance is provided for depreciation. The sum of the ROI and the operating and maintenance costs is then divided to determine the dollar-per-ton allowance rate. This is illustrated in the following example. The lessee may not change to another method to determine its allowance without MMS approval.

Alternative Allowance Calculations

A wash plant is purchased and operated by the lessee. The following cost parameters are assumed:

Annual operating and maintenance expenses:
 \$2,000,000

Annual depreciation:
 \$1,500,000 ([\$30,500,000 capital cost
 - \$500,000 salvage value] ÷ 20-year life)

Annual ROI for year 1:
 \$3,000,000 (S&P BBB industrial bond rate
 of 10%)

These amounts are entered or computed on Form MMS-4292, Coal Washing Allowance Report; however, for purposes of emphasizing the computation mechanics, the allowance may be determined under the first described procedure as:

Allowance rate per ton
 = (\$2,000,000 + \$1,500,000 + \$3,000,000)
 ÷ 1,500,000 tons
 = \$4.333333 per clean ton

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The allowance rate determined under the alternative procedure (applicable only to wash plants placed into service after March 1, 1989) is:

$$\begin{aligned} &\text{Allowance rate per ton} \\ &= (\$2,000,000 + \$3,000,000) \div 1,500,000 \text{ tons} \\ &= \$3.333333 \text{ per clean ton} \end{aligned}$$

Assuming all cost and tonnage inputs to be the same for year 2, the allowance under the first procedure would be:

$$\begin{aligned} &\text{Allowance rate per ton} \\ &= (\$2,000,000 + \$1,500,000 + \$2,850,000^*) \\ &\div 1,500,000 \text{ tons} \\ &= \$4.233333 \text{ per clean ton} \end{aligned}$$

- * The ROI for year 2 is computed by subtracting first-year depreciation from initial capital investment (\$30,000,000 - \$1,500,000) and multiplying the remaining amount by the S&P BBB rate in effect, which is assumed to be unchanged from the 10% prior-year rate (\$28,500,000 × 10% = \$2,850,000).

Under the alternative allowance calculation procedure:

$$\begin{aligned} &\text{Allowance rate per ton} \\ &= (\$2,000,000 + \$3,000,000) \div 1,500,000 \text{ tons} \\ &= \$3.333333 \text{ per clean ton} \end{aligned}$$

10.12.1 Maximum Limitation of Allowances (30 CFR 206.258(a) and 206.261(b))

Under no situation can the washing or transportation allowance reduce the value of coal sold under a selling arrangement to zero. The maximum allowance permitted is 99 percent of the royalty due for any coal sales under any individual selling arrangement. The full cost of the washing or transportation must be computed and reported on Form MMS-4292, Coal Washing Allowance Report, or Form MMS-4293, Coal Transportation Allowance Report, respectively. However, when reporting and deducting that allowance on Form MMS-2014, the lessee must limit the allowance deduction to 99 percent of the royalty due.

For example, if the royalty for the sale of coal is \$500, then the maximum allowance deduction permitted would be 99 percent of \$500, or \$495. However, the allowances reported on Forms MMS-4292 or MMS-4293 must be the actual costs incurred by the lessee without regard to the 99-percent limitation. For example, assume a sale of 100 tons of coal for \$40 per ton from a lease with a royalty rate

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of 12.5 percent. For reasons beyond the lessee's control, the washing or transportation cost is \$41 per ton as calculated on Forms MMS-4292 and MMS-4293. The Form MMS-2014 transportation allowance line (Transaction Code 11) should be computed and filed using a unit rate of \$39.600000 per ton ($\$40 \text{ per ton} \times 99\% = 39.600000$), and a total allowance deduction of \$495 ($\$39.600000 \text{ per ton} \times 100 \text{ tons} \times 12.5\% = \495).

10.12.2 General Allowance Reporting Procedures (30 CFR 206.259 and 206.262)

Allowance reporting procedures may differ depending on whether the transportation or washing operations occur under arm's-length or non-arm's-length conditions. Normally, an allowance is initially computed and reported based on the lessee's best estimate of produced tonnage and either arm's-length or non-arm's-length transportation or washing costs incurred over the course of the annual allowance period. The estimate is reported to MMS on Form MMS-4292 (coal washing) or Form MMS-4293 (coal transportation) on page 1 of the form, and is designated as Reporting Type 1. The unit (per-ton) rate estimated and reported on Form MMS-4292 or Form MMS-4293 is then used to determine the monthly allowance deduction from royalty reported on Form MMS-2014. The allowance period ends upon the end of the calendar year, when washing or transportation operations end, or when the arm's-length washing or transportation contract terminates. Following the end of the allowance period, the lessee uses actual tons and costs to compute its final allowance rate. This rate will most likely differ from the estimated unit rate calculation based on estimated tons and costs. The final washing or transportation allowance is reported to MMS on Form MMS-4292 or Form MMS-4293 by designating Reporting Type 2 on page 1 of the form. Because the monthly allowance deductions claimed on Form MMS-2014 were calculated using the estimated unit amount, each month's allowance deduction must be revised to conform with the final allowance calculation. Overestimated allowances result in royalty repayments plus a late-payment interest charge. Underestimated allowances may be recouped by the lessee without interest.

In some instances, the circumstances of the transportation or washing operation may change, either favorably or unfavorably, making the original allowance estimate inappropriate for further use. In such situations, lessees should file a Reporting Type 3 as soon as possible, notifying MMS that a new unit rate is being substituted for the original estimate. The reporting period would be unchanged from that used in the initial Reporting Type 1. At the same time the lessee submits a Reporting Type 3, the lessee may retroactively correct its allowances that were previously taken on its Form MMS-2014 reports. If the revisions result in payment of additional royalty because the initial allowance was too large,

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then late-payment interest is assessed. However, because the revision was made during the year rather than at the end of the allowance reporting period, the amount of interest assessed is less. The submission of a Reporting Type 3 correcting a Reporting Type 1 does not alter the final requirement to submit a Reporting Type 2 when the allowance reporting period is complete.

An exception to this normal procedure is available to lessees that have arm's-length transportation or washing allowance arrangements wherein the monthly unit cost varies because of contract escalators or other cost adjustment factors. In such situations, although the lessee is required to estimate and report the unit rate applicable over the allowance period (usually a calendar year) on Form MMS-4292 or Form MMS-4293, the lessee may deduct its actual monthly transportation or washing costs, if known, on its Form MMS-2014 report rather than the estimated per-ton amount that was computed and reported on the Form MMS-4292 or Form MMS-4293. In deducting its allowances in this fashion, the lessee eliminates the need to correct its previously reported allowances that were deducted on each monthly Form MMS-2014 report. The total annual amount of allowance deduction taken on Form MMS-2014 reports must still equal the total annual final allowance reported on Form MMS-4292 or Form MMS-4293 Reporting Type 2; however, the unit rate used to calculate the allowance shown on Form MMS-2014 for each month would differ from that calculated as the final unit rate and shown on the allowance forms. In effect, the annual unit rate reported on Form MMS-4292 or Form MMS-4293 becomes the weighted average rate for the entire annual allowance reporting period.

To illustrate this concept, the following example is provided.

1. The royalty rate is 8 percent.
2. The annual tonnage from the only producing lease is 30,000 tons.
3. The estimated arm's-length per-ton transportation cost is \$4.000000.
4. Transportation will continue for CY 1991.

The lessee timely files its Reporting Type 1 of Form MMS-4293 no later than the first month that it will report and take an allowance deduction (February report for the January sales month).

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The estimated annual allowance is:

$$30,000 \text{ tons} \times \$4 \times 8\% = \$9,600$$

The lessee is aware of its actual monthly transportation costs prior to the time when royalty reports are due. Therefore, its actual transportation costs may be used to calculate the allowance reported on Form MMS-2014. The lessee is also aware that its per-ton transportation costs may change from month to month, depending on whether certain transportation cost factors are triggered in a particular month. A summary of each monthly allowance deduction taken on Form MMS-2014 is shown in table 10-1:

Table 10-1--Monthly Allowance Deduction Summary

Sales month	Tons	Unit rate	Allowance deduction
01/91	1,000	\$4.02	\$321.60
02/91	1,500	4.01	481.20
03/91	2,000	3.99	638.40
04/91	2,000	4.00	640.00
05/91	1,800	4.05	583.20
06/91	2,500	4.03	806.00
07/91	3,000	3.98	955.20
08/91	2,000	3.99	638.40
09/91	2,000	4.01	641.60
10/91	1,500	4.04	484.80
11/91	1,900	4.01	609.52
12/91	2,100	4.08	685.44
TOTAL	23,300		\$7,485.36

With the completion of the calendar year, the lessee is now required to file a completed Reporting Type 2 of Form MMS-4293 showing actual costs and actual tons transported during CY 1991. The weighted average per-ton rate may be computed by dividing the total cost by the total tons, or in several other arithmetically equivalent ways. In all cases, however, the dollar amount and the tonnage must be on the same basis; that is, both must be the

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royalty equivalent or at the gross level. From the example above, the allowance is shown as the actual deduction; therefore, it is the product of the per-ton cost, the total lease tons, and the royalty rate. The tons are lease tons and therefore must be multiplied by the royalty rate to place them on the same basis as the allowance deduction. Thus, the royalty tons are determined as:

$$23,300 \text{ tons} \times 8\% \text{ royalty rate} = 1,864.00 \text{ tons}$$

The unit allowance rate is computed as:

$$\$7,485.36 \div 1,864 \text{ tons} = \$4.015751 \text{ per ton}$$

Because the lessee reported its actual allowance cost each month, no retroactive corrections need to be made (unless there was an error or a retroactive cost adjustment) even though the estimated amount and the final (actual) amount on Form MMS-4293 differ.

If a lessee has a nonrecurring spot sale, completing all transportation and sales in 1 month, the lessee needs to submit only a Reporting Type 2 to claim a transportation allowance. For example, a lessee wants to claim a transportation allowance for the sales month of July 1991. In this month the lessee transported and sold 5,000 tons to a cement plant. All coal is from a single Federal lease having a royalty rate of 12.5 percent. The selling arrangement (sales agreement) is noncontinuing, and all coal intended to be sold under that selling arrangement is sold in July 1991. The transportation arrangement is arm's-length and the cost is \$2 per ton. The lessee can submit a Form MMS-4293 Reporting Type 2 claiming actual costs at the same time it submits Form MMS-2014 showing the transportation deductions for the period. These submittals must have been filed by August 31, 1991. In both reports the lessee would report its transportation allowance of \$1,250 (5,000 tons \times \$2 per ton \times 12.5 percent).

10.12.3 Timely Reporting (30 CFR 206.259© and 206.262(c))

Under 30 CFR 206.259 for coal washing and 30 CFR 206.262 for coal transportation, lessees are not required to obtain advance approval from MMS prior to claiming a washing or transportation allowance. In lieu of this requirement, however, the allowance regulations impose a strict standard for timely filing the requisite allowance form. Basically, the standard requires that lessees file Form MMS-4292, Coal Washing Allowance Report, or Form MMS-4293, Coal Transportation Allowance Report, no later than the end of the month in which the lessee first deducts the allowance on its monthly Form MMS-2014, Report of Sales and Royalty Remittance. Therefore, lessees desiring to deduct a washing or transportation allowance for the March 1992 sales month must file a Form MMS-4292 or Form MMS-4293 no later than April 30, 1992, when Form MMS-2014 is due (see fig. 10-4). This filing is considered timely.

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Without the requisite allowance form on file, any allowance taken on Form MMS-2014 is unauthorized and accordingly is considered as a royalty underpayment. As with any royalty underpayment, MMS regulations require that late-payment interest be assessed from the time that the underpayment occurred until it is corrected. A lessee has 3 months in which to file the appropriate allowance form beginning the month in which an allowance is claimed on Form MMS-2014. For example, if the lessee claims an allowance for a single month on Form MMS-2014, then the appropriate allowance form must be filed within 3 months of the month in which the lessee claimed the allowance on Form MMS-2014. For this sales month, the lessee is charged interest for underpayment of royalty for not having an allowance form on file with MMS when the allowance was taken. As shown in figure 10-4, the lessee claims an allowance for the March 1992 sales month, but does not file an allowance form until July 1992. In this case, the lessee is charged interest from May 1, 1992, to the day the allowance form is filed with MMS in July 1992. An underpayment of royalty exists until the allowance form is filed.

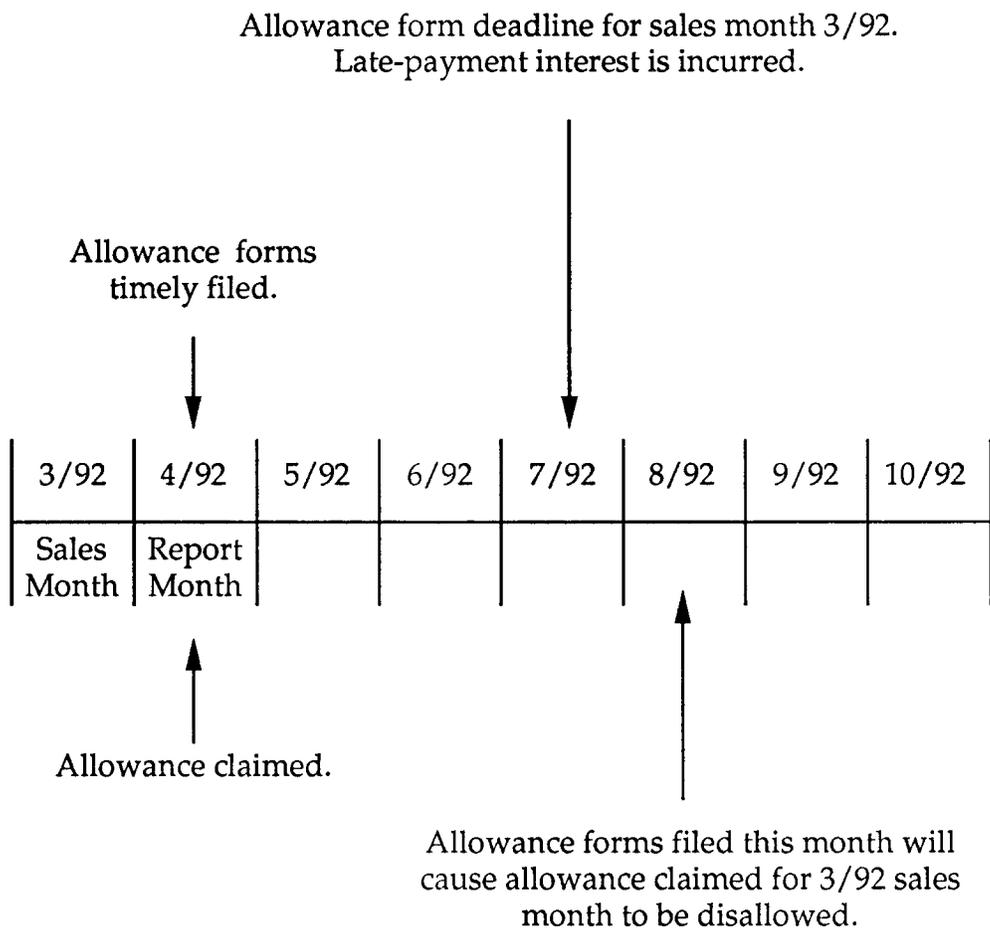
After the lessee exceeds the 3-month limitation, the lessee loses the right to claim an allowance on Form MMS-2014 for each month the lessee claims an allowance on Form MMS-2014. The lessee regains the right to claim such allowance only after the appropriate allowance form is filed with MMS. If the lessee claimed an allowance for March 1992 (as well as for subsequent sales months), then the lessee must repay the allowance claimed for March 1992 (and for subsequent sales months claimed on Form MMS-2014 following the 3-month rule) until the appropriate allowance form is filed with MMS.

When allowances are denied for past months, they must be repaid. After the allowances are repaid, interest is then assessed on the amount of the allowance denied for the period it was improperly deducted.

The MMS may approve allowances to be claimed retroactively for a period longer than 3 months upon the lessee's demonstrating good cause. In order to receive approval to exceed the 3-month retroactive allowance filing requirement, the lessee must request such approval in writing and provide evidence of good cause for failing to meet the deadline for filing allowance reports.

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Figure 10-4--Filing Deadlines



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"Good cause" has been administratively defined by MMS in terms of two basic elements:

1. Justifiable delay.--The existence of an event proximate in time to the date which was beyond the control of the lessee; and
2. Reasonable diligence.--Evidence that the lessee was diligent up to the point in time when the problem and (or) justifiable delay occurred and acted promptly after the cause of the delay was identified and (or) removed.

The filing requirement of the allowance forms is lease specific; that is, every lease for which an allowance is claimed must be included in the allowance form. If a lease is excluded, either by oversight or because the lessee thought no production would be washed or transported, then late-payment interest charges (or lost allowances) will be assessed on allowance deductions taken on Form MMS-2014 even though the allowance form was timely filed for other leases. Lessees that are uncertain if a particular lease will have washed or transported production should include the lease in its allowance form filing. There is no reporting problem associated with including on an allowance report form a lease that subsequently takes no actual allowance deductions.

After submitting an initial (Reporting Type 1) Form MMS-4292 or Form MMS-4293, the lessee must timely submit a Reporting Type 2 of the form within 3 months after the end of the calendar year, or after the applicable contract terminates or is modified or amended, whichever is earlier. The MMS may approve a period exceeding 3 months. During this period, the lessee shall continue to use the allowance rate from the previous reporting period.

For example: The lessee timely submitted an initial (Reporting Type 1) Form MMS-4293 containing an estimated allowance rate per ton (\$0.980000) for the period January through December 1990. The regulatory requirements allow the lessee to submit the succeeding allowance report (Reporting Type 2 with actual 1990 data) by March 31, 1991. The lessee may use the allowance rate of \$0.980000 per ton for the January 1991 and February 1991 sales months and claim allowances on Form MMS-2014 for these sales months. However, to prevent any late-payment interest assessments by MMS, the lessee must submit the allowance form (Reporting Type 2) by March 31, 1991. If the lessee submits the allowance form by July 31, 1991, then a late-payment interest charge is assessed on allowances claimed on Form MMS-2014 starting with the January 1991 sales month. If the lessee submits the allowance form (Reporting Type 2) on September 30, 1991, and the lessee has been claiming allowances every month on Form MMS-2014, then the lessee would be subject to loss of allowances for the sales months of March and April 1991. The lessee would also be subject to late-

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payment interest assessments for the sales months of January through July 1991.

10.12.4 Coal Washing Allowances (30 CFR 206.258 through 206.260)

WHO MAY CLAIM AN ALLOWANCE

Lessees that wash coal produced from Federal and Indian ad valorem coal leases are authorized to claim a washing allowance for the cost of washing the lease production. When computing the unit washing allowance rate, the lessee must use clean coal tonnage exiting the wash plant. Coal washing allowances are not authorized for cents-per-ton leases, but the lessee is permitted to report cents-per-ton royalties on the basis of clean coal sold.

PROHIBITED COSTS

Under no circumstances shall costs associated with standard mining operations be included in the coal washing allowance calculation. Costs not permitted in the washing allowance calculation include, but are not limited to, coal extraction, primary crushing, loading, or screening (screening is excluded if performed separately from the washing process). Costs for coal storage are allowed only to the extent that the cost is for coal storage equipment that is an integral part of the coal washing operation, such as surge bins for ROM coal or washed coal. Costs of coal handling are allowable only to the extent that they are associated with the washing operation itself. If clean coal is blended with ROM production, the cost of blending operations is not permitted.

10.12.5 Claiming a Washing Allowance on Form MMS-2014 (30 CFR 206.259(c))

A lessee may not claim a washing allowance unless it also files a completed Form MMS-4292. Failure to correctly complete and submit this report in a timely fashion may result in MMS assessing the lessee late-payment interest on allowances taken, because the Form MMS-4292 must be complete and correct before allowances are permitted. Ultimately, delay in correcting a Form MMS-4292 may result in the loss of allowances. Because of the importance attached to completing this form correctly, a review of each schedule that composes the Form MMS-4292 follows.

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DESCRIPTION OF FORM MMS-4292, COAL WASHING ALLOWANCE REPORT

Form MMS-4292 consists of four pages: Page 1 and Schedules 1, 1A (Supplemental 1A), and 1B. Page 1 and Schedule 1 must be filed by all lessees; Schedules 1A and 1B must be filed by lessees incurring washing costs in non-arm's-length or no-contract situations, such as those instances in which lessee performs the washing.

PAGE 1

The Coal Washing Allowance Report, Page 1 (fig. 10-5), is used to report royalty allowance amounts claimed during the prior reporting period and to estimate the royalty allowance amount for the current reporting period.

The level of detail for reporting a washing allowance on Page 1 is by lease (accounting identification (AID)) number, product code, and number of washing facilities used to wash lease production. If coal from two leases is washed using one washing facility, but sold under multiple selling arrangements, only two lines (one for each lease) on Page 1 need to be completed.

Important Points for Page 1

1. The form lists all leases for which a washing allowance is claimed in the reporting period.
2. If designated as Reporting Type 1, the form shows only estimated washing costs in column 13, both on a per-ton basis and as a total amount of deduction for the entire reporting period. The reporting period should include all months for which a washing allowance will be deducted on Form MMS-2014 but cannot exceed a 12-month period, normally a calendar year.
3. If designated as Reporting Type 2, the form shows actual costs in column 12 for the completed allowance reporting period and, if operations are continuing, the estimated costs in column 13 for the current allowance reporting period. The reporting period should cover all months for which a washing allowance was authorized (see discussion of timely reporting requirements in sec. 10.12.3) and deducted on Form MMS-2014.

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10. COAL PRODUCT VALUATION

Figure 10-5--Coal Washing Allowance Report, Page 1

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

OMB NO. 1010-0074
Expires March 31, 19XX
The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.)
requires MMS to inform you that the information is being collected
for the purpose of managing its coal washing allowance program.

COAL WASHING ALLOWANCE REPORT

1 PAYOR NAME _____ 2 PAYOR CODE _____

ADDRESS _____ 4 FEDERAL OR INDIAN

CITY _____ STATE _____ ZIP _____ 5 REPORTING TYPE

6 REPORTING PERIOD _____ 19 _____ to _____ 19 _____

Public reporting burden for this form is estimated to range from 1 to 40 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form including suggestions for reducing this burden to the Information Collection Clearance Officer, Mail Stop 2300, Minerals Management Service, 381 Elden Street, Herndon, Va. 22070; and the Office of Management and Budget, Paperwork Reduction Project (1010-0074), Washington, DC 20503.

FOR MMS USE ONLY:

3 FOR PAYOR USE ONLY:

7	8	9	10	11	12 PRIOR PERIOD ACTUAL DATA			13 CURRENT PERIOD ESTIMATED DATA		
					a	b	c	a	b	c
	ACCOUNTING IDENTIFICATION NUMBER (AID)	PRODUCT CODE	SELLING ARRANGEMENT CODE	ARM'S-LENGTH/PAYOR-OWNED INDICATOR	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT
1										
2										
3										
4										
5										
6										
7										
8										
9										
10										
11										

14 PAGE TOTAL _____

15 REPORT TOTAL (Last Page Only) _____

IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4292

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.

NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed) _____ DATE: _____

AUTHORIZED SIGNATURE: _____ DATE: _____

NAME OF PREPARER: _____ TELEPHONE NUMBER: _____

WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s).

FORM MMS-4292 (REV. 3/91) THIS INFORMATION SHOULD BE CONSIDERED (Please check one) PROPRIETARY NONPROPRIETARY Page 1

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

SCHEDULE 1, COAL WASHING SUMMARY SHEET

Schedule 1 (fig. 10-6) is used to accumulate washing costs and to compute the royalty allowance rate and amount for the washing facility. If washing is conducted under arm's-length conditions, then only Page 1 and Schedule 1 are required. The per-ton arm's-length washing cost is reported at line 5B of Schedule 1. Lines 1 through 3, and 5A, which are for non-arm's-length expense identification, are not used in arm's-length situations.

Schedule 1 is required for each lease when coal is washed and sold. If coal from a single lease is washed at two separate wash plants, then two Schedule 1 forms are required for one lease.

In all instances, one Schedule 1 must be completed for each line reported on Page 1 of Form MMS-4292.

10. COAL PRODUCT VALUATION

Table 10-2 illustrates the number of Schedule 1 forms necessary in two different situations:

Table 10-2--Number of Schedule 1 Forms Required

Situation	Number of Schedule 1 forms required
Three Federal leases have coal washed at one wash plant under non-arm's-length conditions.	Three Schedule 1 forms are required, one for each Federal lease. The information on Lines 1 through 6 is identical for each Schedule 1; however, because the form is lease specific, information on lines 7 through 11 will be for a specific lease.
One Federal lease has production washed at two separate wash plants.	Two Schedule 1 forms are required, one for each wash plant. Each Schedule 1 would contain the costs that are unique to a specific wash plant.

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Important Points About Schedule 1

1. A Schedule 1 identifies the washing facility at which Federal or Indian coal is being washed.
2. A Schedule 1 is required for each line reported on Page 1. Therefore, a Schedule 1 is necessary for each lease claiming a washing allowance.
3. A Schedule 1 is submitted whether washing is under arm's-length or non-arm's-length conditions.
4. Lines 1 through 6 on Schedule 1 accumulate costs for the washing facility. Lines 7 through 12 determine the total royalty washing allowance amount for the lease.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-6--Schedule 1, Coal Washing Summary Sheet

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- COAL WASHING SUMMARY SHEET

Payor Name and Code: _____ / _____

Address: _____

City _____ State _____ Zip _____

AID Number: _____

Selling Arrangement Code: _____

Facility Name/ID Number: _____

Product Code: _____

Period: _____ 19 _____ to _____ 19 _____

Depreciation and Return on Undepreciated Capital Investment (From Schedule 1B)

(a)	(b)	(c)	(d)	(e)	
Plant Depreciation	Undepreciated Capital Investment at Beginning-of-Period	Rate of Return	Return on Undepreciated Capital Investment	Depreciation Plus Return on Capital Investment	
\$ _____	\$ _____	_____	\$ _____	\$ _____	1
Operating, Maintenance, and Overhead Expenses (From Schedule 1A, Line 18)				\$ _____	2
Total Non-Arm's-Length Plant Expenses				\$ _____	3
Total Plant Output (Including non-Federal coal washed by lessee)				_____	4
Non-Arm's-Length Washing Cost Per Ton Clean Coal				\$ _____	5a
Arm's-Length washing Cost per Ton Clean Coal				\$ _____	5b
Total Allowance Rate per Ton Clean Coal				_____	6
Total Quantity of Lease Coal Washed During the Reporting Period and Sold.				_____	7
Lease Ad Valorem Royalty Rate				_____ %	8
Royalty Quantity of Coal Washed and Sold During the Reporting Period				_____	9
Royalty Washing Allowance Amount				\$ _____	10
Royalty Washing Allowance Amount for Coal Washed During the Prior Period and Sold During the Report Period = Allowance Rate for Deferred Tons (_____) times Lease Tons of Deferred Coal Sold During the Reporting Period (_____ Tons) Times the lease Ad Valorem Royalty rate (_____ %).				\$ _____	11
Total Royalty Washing Allowance Amount				\$ _____	12

FORM MMS-4292 SCHEDULE 1 (REV. 2/89)

Page 2

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

SCHEDULE 1A, NON-ARM'S-LENGTH WASHING OPERATIONS, MAINTENANCE, AND OVERHEAD EXPENDITURES

Schedule 1A (fig. 10-7) summarizes all costs associated with the washing facility that are not due to capitalized costs. Accordingly, all costs except depreciation and ROI are entered on this schedule. Examples of these costs are labor, supervision, materials, supplies, fuel, rent (lease payments), and property taxes. This form is used only when the washing arrangement is non-arm's-length, either because the lessee's affiliate is performing the service or because the lessee is washing its coal.

The MMS is aware that many lessees elect to acquire wash plant assets through leasing or rental rather than purchase (ownership). When the coal lessee incurs rental or leasing expenses for wash plant equipment, the lessee should include these costs on line 6, regardless of whether the leases are capital or operating leases. For either form of lease, the cash payment represents the MMS-accepted cost basis for leased equipment.

When coal lessees have entered into non-arm's-length equipment leases with affiliated firms or parent companies, MMS normally does not accept the leasing arrangement, but rather looks to the actual capitalized purchase cost for determining depreciation expenses and ROI.

10. COAL PRODUCT VALUATION

Each lease that has production washed at a washing facility requires a separate Schedule 1A. Table 10-3 illustrates the number of Schedule 1A forms required in a typical situation:

Table 10-3--Number of Schedule 1A Forms Required

Situation	Number of Schedule 1A forms required
A lessee owns and operates a plant in which production from four Federal leases is washed and sold.	Four schedule 1A forms are necessary, one for each Federal lease. The cost data recorded on each form are identical. These data represent <u>total wash plant</u> operating and maintenance costs for the allowance reporting period (usually a calendar year). Only the AID number differs for each Schedule 1A.

10. COAL PRODUCT VALUATION

Important Points About Schedule 1A

1. A Schedule 1A is required for each Schedule 1.
2. A Supplemental Schedule 1A may be used to report costs incurred under "Other" category (lines 7, 12, and 16) for sections A, B, and C. The lessee attaches a Supplemental Schedule 1A for each paragraph that utilizes the "Other" cost category.
3. A Schedule 1A is submitted only for non-arm's-length contract or no-contract situations.

10. COAL PRODUCT VALUATION

Figure 10-7--Schedule 1A, Non-Arm's-Length Washing Operations, Maintenance and Overhead Expenditures

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

**SCHEDULE 1A -- NON-ARM'S-LENGTH
WASHING OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES**

PAYOR IDENTIFICATION BLOCK			
Payor Name and Code:	_____		
AID No:	_____		
Selling Arrangement Code:	_____		
Facility ID No:	_____		
Period:	19	to	19

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for Washing Facility

Operations Supervision and Engineering	\$ _____	1
Operations Labor	_____	2
Utilities	_____	3
Materials and Supplies	_____	4
Ad Valorem Property Taxes	_____	5
Rent / Leasing	_____	6
Other (specify). Attach Supplemental Schedule 1A as necessary	_____	7
Total Operating Costs -- Subtotal	\$ _____	8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ _____	9
Maintenance Labor	_____	10
Materials	_____	11
Other (specify). Attach Supplemental Schedule 1A as necessary	_____	12
Total Maintenance Costs -- Subtotal	\$ _____	13

C. Lessee's Overhead Allocation (specify)

_____	\$ _____	14
_____	_____	15
Other (specify) use Supplemental Schedule 1A	_____	16
Total Overhead Allocation	\$ _____	17

D. Total Operating and Maintenance Costs

\$ _____ **18**

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

SUPPLEMENTAL SCHEDULE 1A, NON-ARM'S-LENGTH WASHING FACILITIES,
OPERATIONS, MAINTENANCE, AND OVERHEAD EXPENDITURES

A Supplemental Schedule 1A (fig. 10-8) is used to identify and document the lessee's portion of all operating, maintenance, and overhead expenditures as listed under "Other" expenditure categories (lines 7, 12, and 16, respectively) on Schedule 1A.

Important Points About Supplemental Schedule 1A

1. A separate Supplemental Schedule 1A must be prepared for other operating, maintenance, and overhead costs associated with the plant (facility) but not listed on Schedule 1A.
2. Supplemental Schedule 1A need not accompany every Schedule 1A.

10. COAL PRODUCT VALUATION

SCHEDULE 1B, NON-ARM'S-LENGTH WASHING FACILITIES DEPRECIATION AND CAPITAL EXPENDITURE SUMMARY

Schedule 1B (fig. 10-9) summarizes depreciation and undepreciated investment capital costs for a non-arm's-length or no-contract washing arrangement. Accordingly, no costs other than capitalized wash plant equipment and facility costs are entered on this schedule.

As stated earlier in the discussion for Schedule 1A, wash plant equipment and other facilities that are acquired under an arm's-length operating or capital lease arrangement are not accounted for as owned assets, and no depreciation or ROI is allowed for leased equipment. Leased equipment and facilities are accounted for in Schedule 1A using the lessee's cash lease payments as the basis for costs.

The depreciation and undepreciated capital investment determined on Schedule 1B is carried forward and recorded on Schedule 1. Schedule 1B, like Schedule 1A, is lease specific. Therefore, even though a single wash plant is utilized to clean coal, a separate Schedule 1B must be provided for each lease. The lessee should note that all information on multiple Schedule 1B forms (submitted because of multiple leases having production washed) is identical except for the AID number. Table 10-4 illustrates the number of Schedule 1B forms required in a typical situation.

10. COAL PRODUCT VALUATION

Table 10-4--Number of Schedule 1B Forms Required

Situation	Number of Schedule 1B forms required
Coal from four leases is processed at the wash plant.	Four Schedule 1B forms are required, one for each lease. Because the wash plant is the same for all leases, costs recorded on the four Schedule 1B forms are identical. Only the AID numbers differ.

10. COAL PRODUCT VALUATION

Important Points About Schedule 1B

1. A Schedule 1B summarizes depreciation and undepreciated investment capital costs for non-arm's-length or no-contract washing operations.
2. A Schedule 1B is required for each lease reported on Page 1.
3. A Schedule 1B is submitted only for non-arm's-length contract or no-contract situations.
4. The lessee may summarize capitalized costs on Schedule 1B and append a detailed list of capitalized equipment to Schedule 1B.

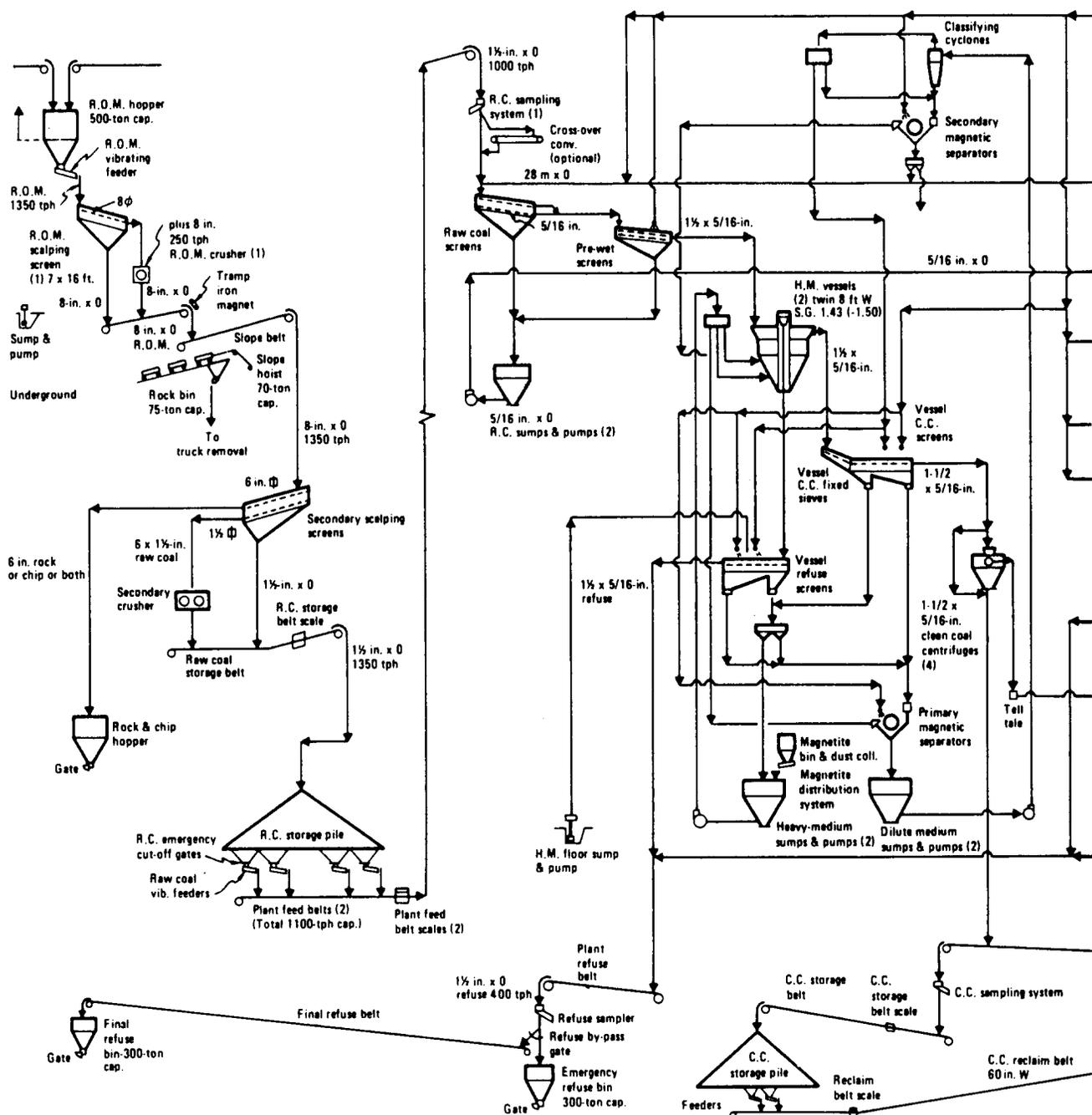
The MMS requests that major equipment exceeding \$50,000 in initial capitalized value be listed individually on Schedule 1B.

Schematic of Operation

An additional requirement of Form MMS-4292 is to submit a schematic diagram of the lessee's wash plant. Figure 10-10 illustrates the detail required in this submittal, which shows major pieces of equipment and flow lines.

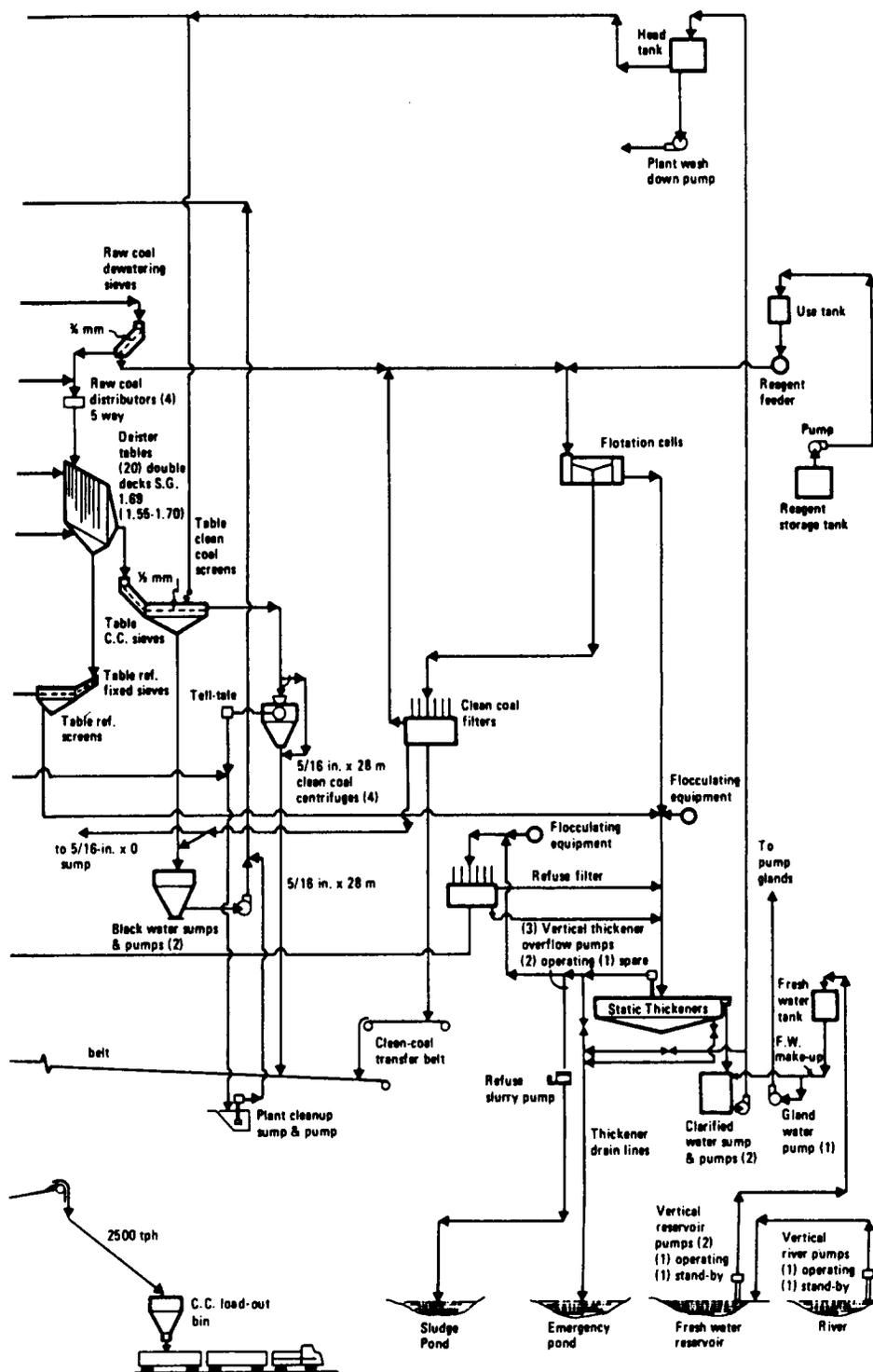
10. COAL PRODUCT VALUATION

Figure 10-10--Schematic of Operation
(Copyright McLean-Hunter Publishing Co., used with permission)



10. COAL PRODUCT VALUATION

Figure 10-10--Schematic of Operation--Continued



10. COAL PRODUCT VALUATION

10.12.6 Allocation of Washed Coal (30 CFR 206.260)

Washed coal must be allocated to the leases from which it was extracted. When wash plant output (clean coal) is derived from coal mined from more than one lease, the quantity of clean coal allocable to each lease is generally based on the wash plant recovery efficiency and the lease tons allocation factor. If raw coal washed in the wash plant is mined from various lands, including lease land and fee land, then the quantity of coal allocable to the lease is determined by multiplying the total raw coal fed to the wash plant by the wash plant recovery efficiency and the lease tons allocation factor. This is demonstrated in the following example.

Example of Allocation of Washed Coal

Lease A produced 12,500 tons of raw coal.

Lease B produced 10,000 tons of raw coal.

The total output from the mine in November was 140,000 tons, of which 138,000 tons were washed and 2,000 tons were stockpiled.

Total clean coal output from the wash plant in November was 112,000 tons.

Wash plant recovery efficiency
 = clean coal tons ÷ raw coal feed
 = 112,000 tons ÷ 138,000 tons
 = 0.811594

Lease A tons allocation factor
 = raw coal lease tonnage from lease A
 ÷ total raw coal mined
 = 12,500 tons ÷ 140,000 tons
 = 0.089286

Lease B tons allocation factor
 = 10,000 tons ÷ 140,000 tons
 = 0.071429

Clean tonnages are produced from the raw coal mined from various lands and sent to the wash plant.

10. COAL PRODUCT VALUATION

Lease A allocation of clean coal tons
= 138,000 tons × 0.089286 × 0.811594
= 10,000 tons

Lease B allocation of clean coal tons
= 138,000 tons × 0.071429 × 0.811594
= 8,000 tons

10.12.7 Determination of Washing Allowances (30 CFR 206.259)

WASHING ALLOWANCE REPORTING EXAMPLE

The following example illustrates reporting for a non-arm's-length washing situation. The background and detail data are listed and are followed by figures 10-11 through 10-16, which show the final royalty remittance form and the requisite Form MMS-4292, Reporting Type 2. Within the example, sample calculations are included to illustrate a correct method for determining calculated entries on the reporting forms.

The following facts apply to this example:

1. Ed's Coal Company mines bituminous coal from a Federal lease and from privately held land.
2. Mining takes place on the Federal lease only sporadically.
3. All coal is sold according to a single arm's-length contract.
4. All coal mined must be washed before being sold. The washing expenses consist of non-arm's-length washing costs incurred by the company in washing the coal, and costs for maintaining some of the washing equipment in accordance with an arm's-length contract. Drying the coal following washing is handled by the lessee using equipment leased under an arm's-length equipment lease contract.
5. The Federal lease royalty rate is 12.5 percent.
6. Clean Federal coal was sold in January, November, and December 1990, and in January 1991.

10. COAL PRODUCT VALUATION

7. The lessee has previously submitted Form MMS-2014, reporting January 1990 royalties due, and Form MMS-4292, showing the determination of the estimated per-ton 1990 washing allowance at \$2.038000 per ton. For brevity, these forms are not illustrated.

Figure 10-11 illustrates the Form MMS-2014 submitted by the lessee after it had determined actual 1990 washing costs. The Form MMS-2014 accomplishes the following:

1. Revises washing allowances previously taken for the sales months of January, November, and December 1990 (lines 1 through 6).
 - a. Initial washing allowance is based on the estimated cost of \$2.038000 per ton.
 - b. Final washing allowance is based on the per-ton cost determined in column 12b, Page 1, Form MMS-4292 (fig. 10-12).
2. States the royalty due on January 1991 coal sold (line 7).
3. States washing allowance for January 1991 coal sold (line 8). The allowance amount is based on the per-ton washing cost estimated in column 13b, Page 1, Form MMS-4292 (fig. 10-12).

Figures 10-12 through 10-16 show a completed Form MMS-4292 submitted in 1991 for the 1990 calendar year reporting period.

Figure 10-12 is Page 1 of the Form MMS-4292. It summarizes data furnished by the other pages of Form MMS-4292 (figs. 10-13 through 10-15).

If the mine contained two Federal leases (M50-0024720101 and another), two line entries would be made on Page 1 (fig. 10-12), and two sets, each consisting of Schedule 1, Schedule 1A, and Schedule 1B, would need to be furnished, one for each lease. Submittal of a single Depreciation and Capital Expenditure Summary (fig. 10-15) and operation schematic (fig. 10-16) would suffice for both leases.

Figure 10-11--Ed's Coal Company Form MMS-2014

AFS Payor Handbook--Solid Minerals
MMS/RMP Release 1.0, 10/26/92

10-67

Form MMS-2014 Revised 3/91

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service - Royalty Management Program
**REPORT OF SALES AND ROYALTY
REMITTANCE**

OMB 1010-0022
(Exp. April 30, 1993)

Page 1 of 1

REPORT MO/YR: 10/2/91

1 PAYOR NAME Ed's Coal Company
ADDRESS 14 18th Street
CITY/STATE Craig, CO

3 FEDERAL
OR
INDIAN

38 PAYOR ASSIGNED DOCUMENT NUMBER _____

For
MMS
Use
Only

2 PAYOR CODE: MIA4010

4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
RESERVED FOR PREPARERS USE	ACCOUNTING IDENTIFICATION (AI) NUMBER	PRODUCT CODE	REG PRICE CODE	SELLING ARR CODE	SALES MONTH/ YEAR	TRANS CODE	ADJ. REAR CODE	SALES QUANTITY	QUALITY MEASURE	CALC METH	SALES VALUE	ROYALTY QUANTITY	ROYALTY VALUE	PAYMENT METHOD CODE	
	M500024720101	EC		100	01/90	15	04					2,112.00	4,304.26	01	
	M500024720101	EC		100	01/90	15	04					-2,112.00	-4,355.13	01	
	M500024720101	EC		100	11/90	15	04					2,262.62	4,611.23	01	
	M500024720101	EC		100	11/90	15	04					-2,262.62	-4,665.72	01	
	M500024720101	EC		100	12/90	15	04					1,250.37	2,548.26	01	
	M500024720101	EC		100	12/90	15	04					-1,250.37	-2,578.37	01	
	M500024720101	EC		100	01/91	01		1,510.00			37,750.00	188.75	4,718.75	01	
	M500024720101	EC		100	01/91	15						-188.75	-385.05	01	

REPORT CONTROL BLOCK	
Payment (Method Code)	Amount
22 Checks to MMS (01)	\$ 4,198.23
23 Payments to Others (02)	
24 EFT to MMS (03)	
25 Royalty-in-Kind (04)	
26 Checks to MMS for BIA (05)	
27 EFT to BIA (06)	
28 Payments to Lockboxes (07)	
29 TOTAL OF ITEMS 22-28	\$ 4,198.23

WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s).

The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires us to inform you that this information is being collected to document details of royalty payments on sales of oil and gas from leases on Federal and Indian lands. MMS will use this information to maintain and audit lease accounts.

PROPRIETARY FOR U.S. GOVERNMENT USE ONLY

20 PAGE TOTAL 4,198.23

21 REPORT TOTAL 4,198.23

I have read and examined the statements in this report and agree they are accurate and complete.

30 Name (typed or printed) and authorized signature _____ Date _____

31 Name of preparer _____ Telephone _____

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AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Page 1 (fig. 10-12) includes the following information:

1. In item 5, the Reporting Type is 2, indicating a continuing report. Reporting Type 1 would be for an initial submittal of Form MMS-4292.
2. In column 11, the Arm's-Length/Payor-Owned Indicator is 5, indicating total costs consist of both non-arm's-length and arm's-length components. A "4" would indicate all non-arm's-length costs. A "6" would indicate all arm's-length costs.
3. In column 12a, the Royalty Tons are calculated as the sum of Schedule 1, line 9, plus the figure obtained from multiplying the tonnage and royalty rate entries on Schedule 1, line 11 (fig. 10-13).
4. In column 12c, the Royalty Allowance Amount is from Schedule 1, line 12.
5. In column 12b, the Allowance Rate Per Ton is calculated by dividing the entry in column 12c by the entry in column 12a.

10. COAL PRODUCT VALUATION

Schedule 1 (fig. 10-13) includes the following information:

1. Data on lines 1 and 2 are taken from Schedule 1B (fig. 10-15), Schedule 1A (fig. 10-14), and the depreciation schedule (table 10-5).
2. Entries in lines 1 through 9 lead to the computation of the cost of washing the lessor's portion of lease production washed and sold during 1990. Total plant output was 800,000 tons.
3. Line 5b shows the arm's-length cost component for the contract maintenance of washing equipment.
4. Line 11 shows the calculation and total washing cost of coal sold in 1990 but washed in 1989. An entry is made in line 12 for the total washing costs of coal sold in 1990 but washed in both 1989 and 1990. Thus, when coal inventories from a prior year are sold, the reporting period per-ton allowance rate shown in column 12b of Page 1 (fig. 10-12) is the weighted average of washing costs for the coal sold in 1990.
5. The entry for line 11 (fig. 10-13) is the cost of washing the royalty share of lease production sold in 1990 but washed in 1989. This amount is calculated using entries (on the left side of line 11) for 1989 deferred tonnage sold in 1990, the allowance rate for the deferred tons, and the lease ad valorem royalty rate for 1990.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-13--Schedule 1, Coal Washing Summary Report

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- COAL WASHING SUMMARY SHEET

Payor Name and Code: Ed's Coal Co. / MA400
Address: 14 18th St.
City Craig State Colorado Zip 81625

AID Number: M50-0024720101
Selling Arrangement Code: 100
Facility Name/ID Number: Wash Plant
Product Code: EC

Period: 01 19 90 to 12 1990

Depreciation and Return on Undepreciated Capital Investment (From Schedule 1B)

(a)	(b)	(c)	(d)	(e)	
Plant Depreciation	Undepreciated Capital Investment at Beginning-of-Period	Rate of Return	Return on Undepreciated Capital Investment	Depreciation Plus Return on Capital Investment	
\$ 245,000	\$ 4,510,000	10.29	\$ 464,079	\$ 709,079	1
				\$ 210,500	2
				\$ 919,579	3
				800,000	4
				\$ 1.149474	5a
				\$ 0.900000	5b
				2.049474	6
				40,000	7
				12.5 %	8
				5,000	9
				\$ 10,247.37	10
				\$ 1,351.88	11
				\$ 11,599.25	12

Total Royalty Washing Allowance Amount
FORM MMS-4292 SCHEDULE 1 (REV. 2/89)

Page 2

FOR ILLUSTRATIVE PURPOSES ONLY

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Schedule 1A (fig. 10-14) shows that the lessee's actual non-arm's-length costs consisted of:

Operating costs: Supervision and engineering = \$30,000
 Labor = \$95,000
 Utilities = \$50,000
 Materials and supplies = \$20,000
 Leasing of drying equipment = \$5,000

Maintenance costs: Supervision = \$2,000
 Labor = \$5,000
 Materials = \$3,000

Overhead costs: Employee counseling = \$500

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-14--Schedule 1A, Non-Arm's-Length Washing Operations, Maintenance and Overhead Expenditures

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1A -- NON-ARM'S-LENGTH
WASHING OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES

PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Ed's Coal Co./MA400
AID No:	M50-024720101
Selling Arrangement Code:	100
Facility ID No:	Wash Plant
Period:	01 19 90 to 12 19 90

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for Washing Facility

Operations Supervision and Engineering	\$ 30,000	1
Operations Labor	95,000	2
Utilities	50,000	3
Materials and Supplies	20,000	4
Ad Valorem Property Taxes		5
Rent / Leasing	5,000	6
Other (specify). Attach Supplemental Schedule 1A as necessary		7
Total Operating Costs -- Subtotal	\$ 200,000	8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ 2,000	9
Maintenance Labor	5,000	10
Materials	3,000	11
Other (specify). Attach Supplemental Schedule 1A as necessary		12
Total Maintenance Costs -- Subtotal	\$ 10,000	13

C. Lessee's Overhead Allocation (specify)

_____	\$ 500	14
_____		15
Other (specify) use Supplemental Schedule 1A		16
Total Overhead Allocation	\$ 500	17

D. **Total Operating and Maintenance Costs**

\$ 210,500 18

FOR ILLUSTRATIVE PURPOSES ONLY

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Schedule 1B is completed based on the depreciation schedule in table 10-5.

Table 10-5--Depreciation Schedule--Wash Plant

Calendar year	Investment	Beg. of year undeprec. capital investment	Annual deprec.	End of year undeprec. capital investment	Annual return on undeprec. capital investment
1988	\$5,000,000	\$5,000,000	\$245,000	\$4,755,000	\$551,500 @ 11.03%
1989	\$5,000,000	\$4,755,000	\$245,000	\$4,510,000	\$509,736 @ 10.72%
1990	\$5,000,000	\$4,510,000	\$245,000	\$4,265,000	\$464,079 @ 10.29%
1991	\$5,000,000	\$4,265,000	\$245,000	\$4,020,000	\$452,943 @ 10.62%

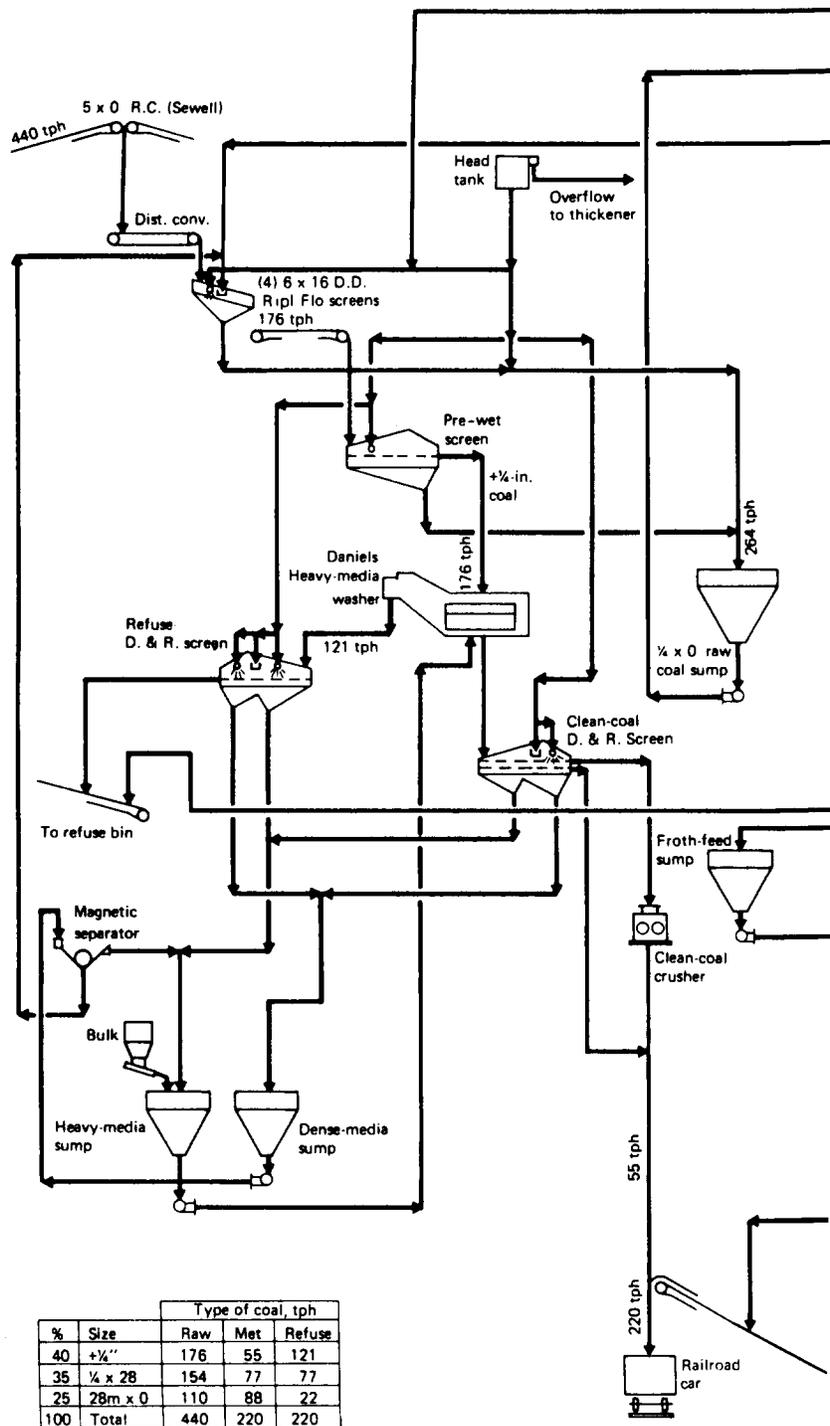
Figure 10-15 is based on the following information:

1. The wash plant was in place on January 1, 1988.
2. The cost was \$5,000,000.
3. The estimated salvage value is \$100,000.
4. Annual depreciation is based on the estimated life of the equipment (20 years) and the total investment less salvage.
5. Annual return rates are based on S&P's Bond Guide for the first month of each reporting period for industrial bonds rated BBB.
6. The salvage value is included when calculating the return on investment.

An additional requirement of Form MMS-4292 is to submit a schematic diagram of the lessee's wash plant. Figure 10-16 illustrates the detail required in this submittal, which shows major pieces of equipment and flow lines.

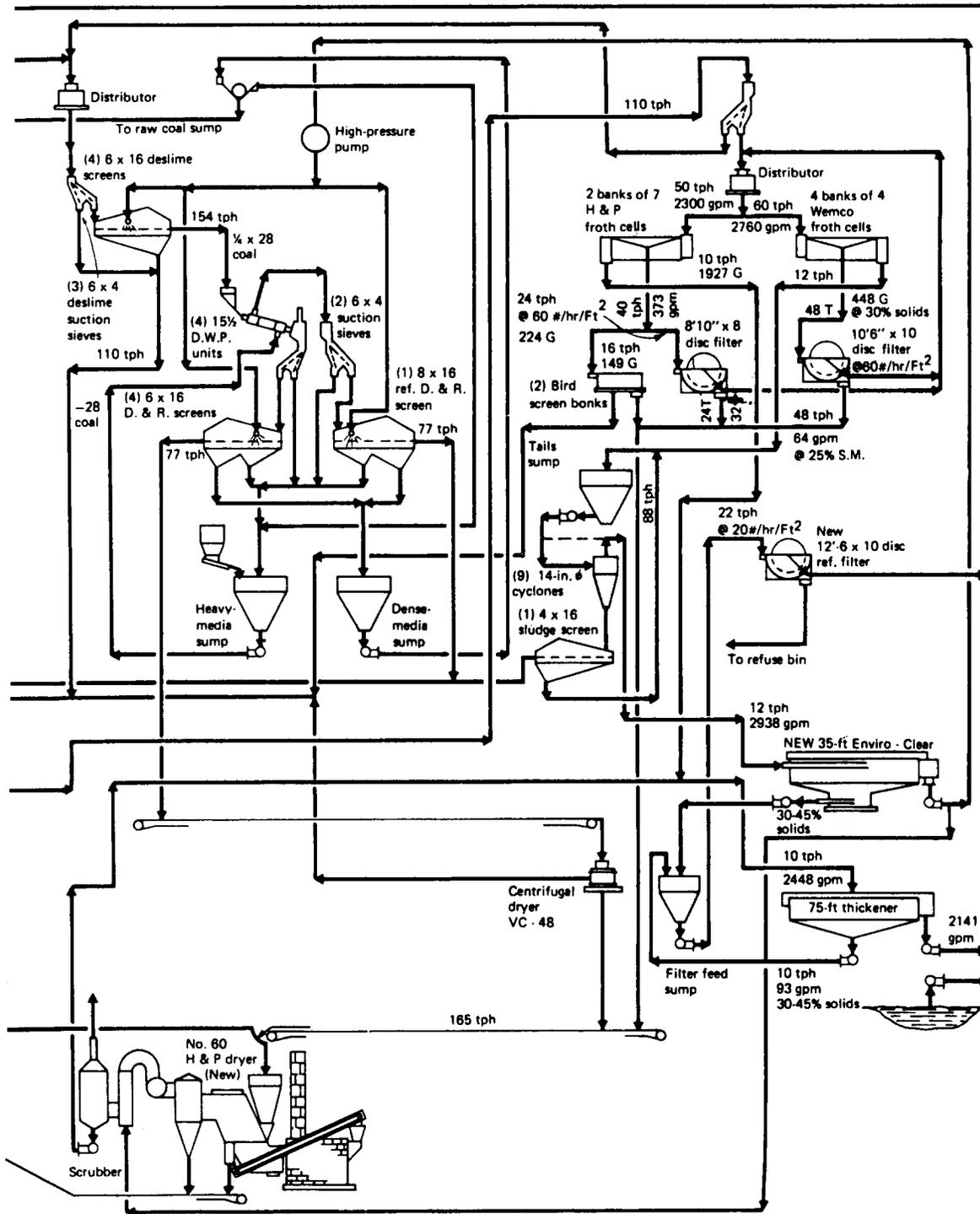
10. COAL PRODUCT VALUATION

Figure 10-16--Schematic of Operation
 (Copyright McLean-Hunter Publishing Co., used with permission)



10. COAL PRODUCT VALUATION

Figure 10-16--Schematic of Operation--Continued



10. COAL PRODUCT VALUATION

**10.12.8 Coal Transportation Allowances
(30 CFR 206.261 and 206.262)**

WHO MAY CLAIM A TRANSPORTATION ALLOWANCE

Any lessee that transports coal from a Federal or Indian lease to a distant sales point or transports the coal from a lease or mine area to a wash plant remote from the lease and the mine may claim a transportation allowance. However, MMS does not permit transportation allowances for any movement of coal in and around the mine area.

CRITERIA FOR DETERMINING IF A TRANSPORTATION ALLOWANCE IS APPLICABLE

The lessee should ask the following questions about its operation to determine if a transportation allowance is applicable. An explanation of the MMS policy follows each question.

1. Does coal transportation occur in what could reasonably be considered the vicinity of the mine, lease, etc., which is defined by some administrative boundary or definition?

Transportation in the vicinity of the mine or lease would normally constitute mine haulage and would not qualify for a transportation allowance. No allowance is authorized within the mine area for movement of coal between mine facilities, including transportation between the pit (or portals) and the crusher, or for the transfer from the crusher to other mine surface facilities, including the storage and loadout facility. Further, MMS considers the cost of normal mine haulage and processing to produce a marketable product to be expenses to be borne by the lessee and at no cost to the lessor. The MMS considers these operations to be occurring at the mine, although they may not be carried out in the immediate proximity of the point of extraction.

2. Is the coal transportation considered a normal mining operation?

Haulage recognized as necessary to normal day-to-day operations of the mine would not qualify for transportation allowances. This includes ROM coal haulage from pit or underground operation to a loadout facility, grizzly/crusher, or any other normal operational facility that receives this ROM coal. Generally, coal moved within the mine permit boundary is not considered eligible for any transportation allowance deductions.

3. Does the transportation of coal occur prior to the first point where production can reasonably be marketed?

10. COAL PRODUCT VALUATION

The first point where coal may be marketed is the point where title, possession, and liability of loss can transfer from the mine operator to a buyer. This point is normally the mine loadout facility. If the transportation segment in question is prior to the first point where production can reasonably be marketed, then usually the transportation does not qualify for a transportation allowance.

4. Are there any extraordinary or exceptional circumstances involving coal transportation that should be considered as relevant factors or that could render other transportation allowance criteria invalid?

Distance measured in absolute terms of miles from the pit or portal to primary crushers or stockpiles/loadout facilities is not an accurate basis from which to determine if a transportation allowance is authorized. Large mines, particularly large surface mines, may have 15- to 20-mile hauls from the pit to surface processing facilities during the life of the mine. Yet this haulage is all within the mine area and, accordingly, would not be eligible for a transportation allowance. Some mines have their coal processing, storage, and loadout (sales) facilities located apart from one another due to terrain, access to water or electric utilities, or other reasons. Haulage between these mine facilities, even if the mine is underground, is normally considered as mine-related transportation and is not eligible for transportation allowances.

Rather than use absolute distance measurement as a criterion for transportation allowances, MMS believes a more relevant measurement would be the ratio of off-mine-property haulage to on-mine-property haulage. Many mines locate their surface processing storage and sales facilities off leased lands but, to the extent possible, in the vicinity of the leases that make up the mine. Therefore, as general guidance, when the ratio of off-mine haulage to on-mine haulage exceeds 1:1, that is, the lessee transports coal a greater distance off mine property than on mine property, then it is likely that such haulage is eligible for a transportation allowance. However, this determination is not conclusive, and the lessee should review all transportation allowance criteria before making a final determination.

Under normal mining conditions, all transportation occurring prior to an FOB mine sales point must be borne solely by the lessee. However, unusual situations may require the lessee to incur transportation costs that are uncommon. In such cases, MMS may grant a transportation allowance. Lessees that are uncertain of whether their circumstances warrant a transportation allowance may request a determination from MMS. In such an event, the lessee should include with its request maps displaying the transportation

10. COAL PRODUCT VALUATION

route, mine facilities, sales point(s), and any other information that the lessee believes bears upon the transportation allowance question.

10.12.9 Unit Rate of Allowance, Clean Coal Transported

For coal transported to a remote wash plant, that is, a plant located away from the mine, a transportation allowance may be authorized. Transportation allowance criteria 1, 2, and 4 in section 10.12.8 may be applied to determine whether a transportation allowance to a wash plant is authorized. The transportation allowance is based on the total cost incurred to transport the ROM coal to the wash plant. When computing the unit rate, however, the lessee must use clean coal tonnage exiting the wash plant. This procedure is required because allowances are normally deducted from the sale of coal production, not coal production itself. Failure to use clean coal tons in the denominator with total cost in the numerator results in a unit rate that is insufficient to recoup total incurred cost for transporting ROM production to the wash plant.

For example, the lessee transports 1,000 tons of ROM production to the wash plant under an arm's-length contract at a cost of \$3 per ton. The total cost is therefore \$3,000. However, as a result of the washing process, only 700 tons of clean coal exits the wash plant and is sold. To compute the unit (per-ton) rate, the lessee must divide \$3,000 by 700 tons, for a result of \$4.285714 per ton. This would be the rate computed and reported on Form MMS-4293 and would also be the rate used to claim the monthly allowance deduction on Form MMS-2014.

10. COAL PRODUCT VALUATION

**10.12.10 Claiming Transportation Allowance on Form MMS-2014
(30 CFR 206.262(c))**

The filing of a Form MMS-4293 is, among other purposes, a notification to MMS that the lessee intends to claim a transportation allowance in its royalty report. The filing of that form does not authorize the lessee to commence transportation allowance deductions in its Form MMS-2014 royalty report unless it is reporting sales and paying royalty on coal that was transported for that sale.

Often coal may be transported in one month but not sold until several months later. The lessee cannot claim those transportation costs until the transported coal is sold and royalty is paid. This requirement applies even if the lessee is paying royalty under that lease for other sales that do not involve the specific transportation arrangement.

DESCRIPTION OF THE FORM MMS-4293, COAL TRANSPORTATION ALLOWANCE REPORT

A lessee may not claim a transportation allowance unless the lessee also files a completed Form MMS-4293. Failure to complete this report correctly and submit it timely may result in MMS assessing the lessee late-payment interest on allowances taken, because the Form MMS-4293 must be complete and correct before allowances are permitted. Ultimately, delay in submitting a Form MMS-4293 may result in the loss of allowances.

Because of the importance attached to completing and filing this form correctly, a review of each schedule that composes the Form MMS-4293 follows.

Form MMS-4293 consists of five pages: Page 1 and Schedule 1 must be filed by all lessees. In addition, Schedules 1A (and Supplemental Schedule 1A, if used) and 1B must be submitted by lessees incurring transportation costs in non-arm's-length or no-contract situations, such as those instances when the lessee performs the transportation service itself.

The Coal Transportation Allowance Report, Page 1 (fig. 10-17), is used to report royalty allowance amounts claimed during the prior reporting period and to estimate the royalty allowance amount for the current reporting period.

10. COAL PRODUCT VALUATION

The level of detail for reporting transportation allowances on Page 1 is by lease (AID) number, product code, and transportation arrangement. Page 1 does not explain where coal is being transported, and, therefore, for each line reported on Page 1 there must be an accompanying Schedule 1, Coal Transportation System Summary Sheet. Table 10-6 briefly outlines these requirements.

Table 10-6--MMS Form-4293 Filing Requirements

Number of separate transportation arrangements	Number of leases having production transported under each transportation arrangement	Number of lines necessary on Page 1 to report transportation arrangements correctly
1	1	1
2	1	2
2	2	4
3	4	12

Schedule 1 (fig. 10-18) is used to accumulate transportation segment costs and to compute the royalty allowance rate and amount for a transportation facility.

Note that a separate Schedule 1 is used for each transportation facility (i.e., each transportation arrangement) over which coal is transported. Therefore, a separate Schedule 1 must be completed for each line reported on Page 1 of Form MMS-4293. Table 10-7 illustrates the number of Schedule 1 forms required for the described situation.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Table 10-7--Number of Schedule 1 Forms Required

Transportation situation	Number of leases having production transported under each sales contract	Number of Schedule 1 forms required
Mine transports coal about 40 miles from mine to remote wash plant facility. Clean coal is sold under two separate sales contracts at different prices. Four leases have production transported for each sale.	4	Because all transportation is conducted over a single transportation facility, separate Schedule 1 forms for each selling arrangement are not required. However, a Schedule 1 is required for each lease. Therefore, a total of four Schedule 1 forms is required.
Mine transports coal to electric utility plant by rail line. Distance is about 12 miles (one selling arrangement).	3	Three Schedule 1 forms are required to show that there is one selling arrangement, but three leases.
Mine transports coal to port facilities by rail. There are six export sales (six selling arrangements).	2	Twelve Schedule 1 forms are required. Two Schedule 1 forms (one for each lease) are necessary for each selling arrangement.

10. COAL PRODUCT VALUATION

SCHEDULE 1A, NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/SEGMENT OPERATIONS, MAINTENANCE, AND OVERHEAD EXPENDITURES

Schedule 1A (fig. 10-19) summarizes all costs associated with transportation that are not due to capitalized costs. Accordingly, all costs except depreciation and the ROI are entered on this schedule. Examples of these costs are labor, supervision, materials and supplies, fuel, rent and (or) lease payments, or property taxes. This form is used only when the transportation arrangements are non-arm's-length, either because the lessee's affiliate is performing the service or because the lessee is transporting the coal. Table 10-8 shows the required number of Schedule 1A forms for different transportation situations.

The MMS is aware that many lessees elect to acquire transportation equipment and facilities through arm's-length equipment and (or) facility leasing arrangements rather than purchase (ownership). When the coal lessee incurs rental or leasing expenses for transportation equipment, the lessee should include these costs on line 6 of Schedule 1A, regardless of whether the leases are capital or operating leases. For either form of leasing, the cash lease payment represents the cost basis for leased equipment.

When coal lessees have entered into non-arm's-length equipment leases with affiliated firms or parent companies, MMS does not normally accept the leasing arrangement, but rather looks to the actual capitalized purchase cost for determining depreciation expenses and ROI.

10. COAL PRODUCT VALUATION

Table 10-8--Number of Schedule 1A Forms Required

Transportation situation	Number of Schedule 1A forms
A lessee owns and operates a rail transportation system in which production from three Federal leases is transported from the mine loadout facility 12 miles to the electric utility plants where coal is consumed (one selling arrangement).	Three Schedule 1A forms are required, one for each Federal lease. The cost data recorded on each Schedule 1A are identical. These data represent <u>total transportation facility</u> costs for the allowance reporting period (usually a calendar year). Only the lease number differs for each Schedule 1A.
A lessee owns and operates a truck transportation system in which production from two Federal leases is hauled 40 miles from the mine to a rail loadout facility, where the coal is sold under three different coal supply agreements.	Two Schedule 1A forms are required, one for each Federal lease. Because the cost basis is the same (coal is transported in one transportation facility), only one Schedule 1A form per lease is necessary even though the transported coal is sold under multiple selling arrangements.

10. COAL PRODUCT VALUATION

SCHEDULE 1B, NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/SEGMENT DEPRECIATION AND CAPITAL EXPENDITURE SUMMARY

Schedule 1B (fig. 10-21) summarizes depreciation and undepreciated investment capital costs for a non-arm's-length or no-contract transportation segment. All depreciation and the ROI are entered on this schedule. These costs are capital equipment that is an integral part of the transportation system and may include, for example, trucks, rail cars, or locomotives.

A separate Schedule 1B is required for each segment of the transportation facility. For instance, the lessee transports coal to the point of sale by two segments, truck and slurry pipeline. The truck transportation segment is by lessee-owned trucks to a remote slurry pipeline headgate.

The second segment of the transportation facility to the point of sale is a slurry pipeline also owned and operated by the lessee. The depreciation and undepreciated capital investment for the truck segment are shown on one Schedule 1B, and the depreciation and undepreciated capital investment for the slurry pipeline are shown on another Schedule 1B. All transportation facility segments are totaled on Schedule 1 to determine total facility costs.

Separate Schedule 1 forms with accompanying Schedules 1A and 1B must be submitted for each lease. Because the costs for each segment are fixed for the allowance period, photocopies of original Schedules 1A and 1B may be attached to each lease's Schedule 1 in order to fulfill the reporting requirements.

Using the above example of a non-arm's-length two-segment transportation facility composed of truck and slurry pipeline, with the mine producing from two Federal leases, the transportation allowance form submitted would include:

- One Page 1 showing both leases
- Two Schedule 1 forms, one for each lease
- Four Schedule 1A forms, a schedule for both segments for both leases
- Four Schedule 1B forms, a schedule for both segments for both leases

10. COAL PRODUCT VALUATION

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10. COAL PRODUCT VALUATION

Important Points for Page 1

1. Figure 10-17 lists all transportation allowances claimed in the reporting period by lease, product code, and transportation arrangement.
2. If designated as Reporting Type 1, the form shows estimated transportation costs in column 13, both on a per-ton basis and as a total amount of deduction for the entire reporting period. The reporting period should include all months for which a transportation allowance will be deducted on Form MMS-2014 but cannot exceed a calendar year.
3. If designated as Reporting Type 2, the form shows actual costs in column 12 for the completed allowance reporting period and, if operations are continuing, the estimated costs in column 13 for the current allowance reporting period. The reporting period should include all months for which a transportation allowance was authorized (see discussion of timely reporting requirements in sec. 10.12.3) and deducted on Form MMS-2014.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-17--Page 1, Coal Transportation Allowance Report

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

OMB NO. 1010 - 0074
Expires March 31, 1993
The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires MMS to inform you that this information is being collected for the purpose of managing its coal transportation allowance program.

COAL TRANSPORTATION ALLOWANCE REPORT

1 PAYOR NAME _____ 2 PAYOR CODE _____
 ADDRESS _____ 4 FEDERAL OR INDIAN
 CITY _____ STATE _____ ZIP _____ 5 REPORTING TYPE
 6 REPORTING PERIOD _____ 19 _____ to _____ 19 _____

FOR MMS USE ONLY:

3 FOR PAYOR USE ONLY:

Public reporting burden for this form is estimated to range from 1 to 40 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form including suggestions for reducing this burden to the Information Collection Clearance Officer, Mail Stop 2300, Minerals Management Service, 381 Eldon Street, Herndon, Va. 22070; and the Office of Management and Budget, Paperwork Reduction Project (1010-0074), Washington, DC 20503.

7	8	9	10	11	12 PRIOR PERIOD ACTUAL DATA			13 CURRENT PERIOD ESTIMATED DATA		
					a	b	c	a	b	c
ACCOUNTING IDENTIFICATION NUMBER (AID)		PRODUCT CODE	SELLING ARRANGEMENT CODE	AFMS-LENGTH/PAYOR-OWNED INDICATOR	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT
1										
2										
3										
4										
5										
6										
7										
8										
9										
10										
11										

14 PAGE TOTAL _____ XXXXXXXXXXXXX
 15 REPORT TOTAL (Last Page Only) _____ XXXXXXXXXXXXX
 IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4293

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.
 NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed) _____ DATE: _____
 AUTHORIZED SIGNATURE: _____ DATE: _____
 NAME OF PREPARER: _____ TELEPHONE NUMBER: _____

WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s).
 FORM MMS-4293 (REV. 3/91) THIS INFORMATION SHOULD BE CONSIDERED (Please check one) PROPRIETARY NONPROPRIETARY Page 1

10. COAL PRODUCT VALUATION

Important Points About Schedule 1, Form MMS-4293

1. A Schedule 1 (fig. 10-18) identifies the segments of the transportation system over which Federal or Indian coal is being transported.
2. A Schedule 1 is required for each line reported on Page 1; that is, a Schedule 1 is necessary for each lease claiming a transportation allowance.
3. A Schedule 1 is submitted whether transportation is under arm's-length or non-arm's-length conditions.
4. A Schedule 1 accumulates costs for the individual segments over which coal is transported from lease to final sales point.
5. Separate Schedules 1A and 1B are required for each non-arm's-length transportation segment reported on Schedule 1.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-18--Schedule 1, Coal Transportation System Summary Sheet

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 - COAL TRANSPORTATION SYSTEM SUMMARY SHEET

1 PAYOR NAME AND CODE _____ / _____ 2 AID NUMBER: _____
 ADDRESS _____
 CITY _____ STATE _____ ZIP _____
 SELLING ARRANGEMENT CODE: _____
 FACILITY NAME/ID NUMBER: _____
 PRODUCT CODE: _____
 LINE NUMBER(S) FROM PAGE 1: _____

PERIOD: 19__ to 19__

(a) Segment of Transportation	(b) Mode of Transportation	(c) Arm's-Length/Payor-Owned Indicator	(d) Arm's-Length Contract/Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Beginning-of-Year Undepreciated Capital Investment	(h) Return on Investment (f) x (g)
----------------------------------	-------------------------------	---	--	---------------------	-----------------------	---	---------------------------------------

From To
 A. TRANSPORTING COAL TO A REMOTE WASHING FACILITY.

_____	_____	_____	\$ _____	\$ _____	_____	\$ _____	\$ _____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
Totals			\$ _____	\$ _____	_____	_____	\$ _____

Allowance rate = (6d + 6e + 6h) / Tons of production transported from the mine to the washing facility, expressed in terms of clean coal tonnage.
 Part A Total Cost _____ Part A Total Clean Tons _____ Cost per Ton _____

B. TRANSPORTING COAL TO A REMOTE SALES POINT.

_____	_____	_____	\$ _____	\$ _____	_____	\$ _____	\$ _____
_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
Totals			\$ _____	\$ _____	_____	_____	\$ _____

Allowance rate = (11d + 11e + 11h) / Tons of coal transported from the mine/plant to the sales point.
 Part B Total Cost _____ Part B Total Tons _____ Cost per Ton _____

Total Unit Allowance Rate = line 7h plus line 12h. \$ _____

Royalty Allowance Amount for coal transported and sold during the reporting period = Allowance rate (line 13) times lease tons transported and sold during the reporting period (_____ tons) times the lease ad valorem royalty rate (_____ %). \$ _____

Royalty Allowance Amount for coal transported during a prior period and sold during the reporting period = Allowance rate for deferred tons (_____) times lease tons of deferred coal sold during the reporting period (_____ tons) times the lease ad valorem royalty rate (_____ %). \$ _____

Total Royalty Allowance Amount = line 14 plus line 15. \$ _____

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

Important Points About Schedule 1A

1. A Schedule 1A (fig. 10-19) is submitted only under non-arm's-length conditions. This schedule is used to report costs on a segment basis.
2. A Schedule 1A is required for each segment reported on each Schedule 1.
3. A Supplemental Schedule 1A must be used to report costs incurred under the "Other" category (lines 7, 12, and 16) for sections A, B, and C. The lessee attaches a supplemental Schedule 1A for each section that utilizes the "Other" category.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-19--Schedule 1A, Non-Arm's-Length Transportation System/Segment Operations, Maintenance and Overhead Expenditures

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1A -- NON-ARM'S-LENGTH
TRANSPORTATION SYSTEM/
SEGMENT OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES

PAYOR IDENTIFICATION BLOCK		
Payor Name and Code:	_____	
AID No:	_____	
Selling Arrangement Code:	_____	
Facility ID No:	_____	
Segment ID No:	_____	
Period:	19	to 19

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for System / Segment

Operations Supervision and Engineering	\$ _____	<input type="checkbox"/> 1
Operations Labor	_____	<input type="checkbox"/> 2
Utilities	_____	<input type="checkbox"/> 3
Materials and Supplies	_____	<input type="checkbox"/> 4
Ad Valorem Property Taxes	_____	<input type="checkbox"/> 5
Rent / Leasing	_____	<input type="checkbox"/> 6
Other (specify). Attach Supplemental Schedule 1A as necessary	_____	<input type="checkbox"/> 7
Total Operating Costs -- Subtotal	\$ _____	<input type="checkbox"/> 8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ _____	<input type="checkbox"/> 9
Maintenance Labor	_____	<input type="checkbox"/> 10
Materials	_____	<input type="checkbox"/> 11
Other (specify). Attach Supplemental Schedule 1A as necessary	_____	<input type="checkbox"/> 12
Total Maintenance Costs -- Subtotal	\$ _____	<input type="checkbox"/> 13

C. Lessee's Overhead Allocation (specify)

_____	\$ _____	<input type="checkbox"/> 14
_____	_____	<input type="checkbox"/> 15
Other (specify) use Supplemental Schedule 1A	_____	<input type="checkbox"/> 16
Total Overhead Allocation	\$ _____	<input type="checkbox"/> 17

D. Total Operating and Maintenance Costs	\$ _____	<input type="checkbox"/> 18
--	----------	-----------------------------

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

Important Points for Supplemental Schedule 1A

1. Supplemental Schedule 1A (fig. 10-20) is used to identify and document segment operating, maintenance, and overhead expenditures listed under "Other" expenditure categories (lines 7, 12, and 16) on Schedule 1A.
2. A separate Supplemental Schedule 1A is used for entries made on lines 7, 12, and 16, Schedule 1A.

10. COAL PRODUCT VALUATION

Important Points About Schedule 1B

1. A Schedule 1B (fig. 10-21) summarizes depreciation and undepreciated investment capital costs for non-arm's-length or no-contract transportation operations.
2. A Schedule 1B is required for each transportation segment reported on Schedule 1.
3. The lessee may summarize capitalized costs on Schedule 1B and append a detailed list of capitalized equipment to Schedule 1B.

The MMS requests that major equipment exceeding \$50,000 in initial capitalized value be listed individually on Schedule 1B.

10. COAL PRODUCT VALUATION

10.12.11 Allocation of Transportation Costs to Federal or Indian Coal

Coal mined from a lease is often commingled with coal from other Federal or Indian leases, State leases, and fee properties. If such commingled production is transported to a remote point of sale or to a remote wash plant, the transportation cost for moving that production is uniformly applied to all transported tonnage, regardless of the ownership status of the lease from which the coal was originally produced. This concept is implemented in Form MMS-4293, which requires lessees to compute the allowance using the total tons transported and the total cost incurred.

10.12.12 Determination of Transportation Allowances (30 CFR 206.262)

TRANSPORTATION ALLOWANCE REPORTING EXAMPLES

The following transportation allowance examples are provided for illustrative purposes. In addition to studying these examples, lessees claiming transportation allowances should also refer to sections 10.12.1 through 10.12.11, which discuss washing allowances specifically and allowances in general.

Example 1 illustrates an arm's-length transportation report that provides costs for three distinct stages (segments) of coal transportation. These segments are from:

1. The mine to Oak Wash Plant,
2. The wash plant to rail spur, and
3. The rail spur to Colorado Springs, Colorado.

Example 2 illustrates a typical non-arm's-length transportation scenario with three distinct segments. These segments include:

1. The mine to wash plant,
2. The wash plant to rail loadout, and
3. The rail loadout to powerplants.

Example 3 illustrates how to account for deferred tons of coal transported in a prior period but sold in the current period.

Example 4 illustrates how to report leasing costs.

10. COAL PRODUCT VALUATION

Example 1. Arm's-Length Transportation Allowance

Figures 10-22 and 10-23 illustrate Example 1.

Situation

1. The reporting status is a routine report (Reporting Type 2).
2. The period is January 1, 1990, through December 31, 1990.
3. The facility transportation is from the mine to a sales point remote from the mine (three segments).
4. There is one Federal lease, M50-0012345-001.
5. The product is Washed Coal (EC).
6. All transportation expenses are arm's-length.
7. Segment 1 transports 60,200 tons of raw coal at \$3.75 per ton. Total cost is \$225,750.
8. Segment 2 transports 57,300 tons of clean coal at \$0.19 per ton. Total cost is \$10,887.
9. Segment 3 transports 57,300 tons at \$3.54 per ton. Total cost is \$202,842.
10. Clean coal sold totals 55,200 tons.
11. The royalty rate is 12½ percent.

For this arm's-length transportation situation, only Page 1 and Schedule 1 of Form MMS-4293 need to be filed. Schedule 1 would be completed first, because Page 1 entries are in part taken from Schedule 1.

10. COAL PRODUCT VALUATION

Page 1 (fig. 10-22) includes the following information for Example 1:

1. In item 5, the Reporting Type is 2, indicating a continuing report. Columns 12 and 13 are completed.
2. In column 11, the Arm's-Length/Payor-Owned Indicator is 6, indicating arm's-length costs. A "4" would indicate all non-arm's-length costs. A "5" would indicate non-arm's-length and arm's-length components.
3. In column 12a, Royalty Tons are calculated as the sum of royalty tons transported in 1990 plus royalty tons transported in a prior year (deferred tons). Royalty tons for 1990 are calculated by multiplying entries on Schedule 1, line 14 (lease tons transported and sold in reporting period times royalty rate). Deferred royalty tons would be calculated the same way, using entries on Schedule 1, line 15.
4. In column 12b, the Allowance Rate Per Ton is calculated by dividing the entry in column 12c by the entry in column 12a. In this example, because there are no deferred tons, the allowance rate per ton is the entry on Schedule 1, line 13.
5. In column 12c, the Royalty Allowance Amount is taken from Schedule 1, line 16.
6. In column 13a, the Royalty Tons are the lessee's best estimate for coal tons to be transported from January 1991 through December 1991.
7. In column 13b, the Allowance Rate Per Ton is the lessee's estimate of the allowance rate per ton for January 1991 through December 1991.
8. In column 13c, the Royalty Allowance Amount is calculated by multiplying entries in column 13a by entries in column 13b.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-22--Page 1 Showing Reporting Type 2 with Columns 12 and 13 Completed, Example 1

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Minerals Management Service
Royalty Management Program

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Expires March 31, 19XX
The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires MMS to inform you that this information is being collected for the purpose of managing its coal transportation allowance program.

COAL TRANSPORTATION ALLOWANCE REPORT

FOR MMS USE ONLY:

FOR PAYOR USE ONLY:

1 PAYOR NAME Butte's Coal Company 2 PAYOR CODE MA720
 ADDRESS 14 18th Street 4 FEDERAL OR INDIAN
 CITY Craig STATE Colorado ZIP 81625 5 REPORTING TYPE 2
 6 REPORTING PERIOD 01 19 90 to 12 19 90

Public reporting burden for this form is estimated to range from 1 to 40 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form including suggestions for reducing this burden to the Information Collection Clearance Officer, Mail Stop 2300, Minerals Management Service, 381 Eiden Street, Herndon, Va. 22070; and the Office of Management and Budget, Paperwork Reduction Project (1010 - 0074), Washington, DC 20503.

7	8	9	10	11	12 PRIOR PERIOD ACTUAL DATA			13 CURRENT PERIOD ESTIMATED DATA		
					a	b	c	a	b	c
	ACCOUNTING IDENTIFICATION NUMBER (AID)	PRODUCT CODE	SELLING ARRANGEMENT CODE	ARM'S-LENGTH/PAYOR-OWNED INDICATOR	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT
1	M50-0012345-001	EC	100	6	6,900	7.669790	52,922	4,500	7.900000	35,550
2										
3										
4										
5										
6										
7										
8										
9										
10										
11										

14	PAGE TOTAL	6,900	XXXXXXXXXXXX	52,922	4,500	XXXXXXXXXXXX	35,550
15	REPORT TOTAL (Last Page Only)	6,900	XXXXXXXXXXXX	52,922	4,500	XXXXXXXXXXXX	35,550

IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4293

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.

NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed) Edward M. King DATE: 3/25/91
 AUTHORIZED SIGNATURE: [signature] DATE: _____
 NAME OF PREPARER: James King TELEPHONE NUMBER: (303) 411-2222

WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s).

FORM MMS-4293 (REV. 3/91) THIS INFORMATION SHOULD BE CONSIDERED (Please check one) PROPRIETARY NONPROPRIETARY Page 1

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

Schedule 1 (fig. 10-23) includes the following information for Example 1:

1. For this three-segment facility, parts A and B must be completed.
2. The entry for column (c) is 6, indicating the transportation is under arm's-length conditions. Therefore, only columns (a) through (d) are required to be completed.
3. Transportation rates are developed for parts A (line 7) and B (line 12). These rates are added together to arrive at a total transportation rate entered on line 13.
4. Line 16 is the sum of entries on lines 14 and 15, showing the total transportation cost of coal sold in 1990. (If coal had been transported in a prior year but sold in 1990, the cost of that transportation would be entered on line 15.)

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-23--Schedule 1 Showing Arm's-Length Transportation, Example 1

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- COAL TRANSPORTATION SYSTEM SUMMARY SHEET

1 PAYOR NAME AND CODE Butte's Coal Company / MA720 2 AID NUMBER: M50-0012345-001
 ADDRESS 14 18th Street
 CITY Craig STATE Colorado ZIP 81625
 SELING ARRANGEMENT CODE: 100
 FACILITY NAME/ID NUMBER: Colorado Springs Sales
 PRODUCT CODE: EC
 LINE NUMBER(S) FROM PAGE 1: 1
 PERIOD: 01 19 90 to 12 19 90

(a) Segment of Transportation	(b) Mode of Transportation	(c) Arm's-Length/Payor-Owned Indicator	(d) Arm's-Length Contract/Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Beginning-of-Year Undepreciated Capital Investment	(h) Return on Investment (f) x (g)		
From	To								
A. TRANSPORTING COAL TO A REMOTE WASHING FACILITY.									
Mine	<u>Oak Wash Plant</u>	<u>Truck</u>	<u>6</u>	<u>\$ 225,750</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	3	
								4	
								5	
		Totals		<u>\$ 225,750</u>	<u>\$</u>		<u>\$</u>	6	
Allowance rate = (6d + 6e + 6h) / Tons of production transported from the mine to the washing facility, expressed in terms of clean coal tonnage.				<u>\$ 225,750</u>	<u>÷</u>	<u>57,300</u>	<u>=</u>	<u>\$ 3.939790</u>	7
				Part A Total Cost		Part A Total Clean Tons	Cost per Ton		
B. TRANSPORTING COAL TO A REMOTE SALES POINT.									
<u>Oak Wash Plant</u>	<u>Rail Spur</u>	<u>Truck</u>	<u>6</u>	<u>\$ 10,887</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	8	
<u>Rail Spur</u>	<u>Colorado Springs</u>	<u>Rail</u>	<u>6</u>	<u>202,842</u>				9	
								10	
		Totals		<u>\$ 213,729</u>	<u>\$</u>		<u>\$</u>	11	
Allowance rate = (11d + 11e + 11h) / Tons of coal transported from the mine/plant to the sales point.				<u>\$ 213,729</u>	<u>÷</u>	<u>57,300</u>	<u>=</u>	<u>\$ 3.730000</u>	12
				Part B Total Cost		Part B Total Tons	Cost per Ton		
Total Unit Allowance Rate = line 7h plus line 12h.							<u>\$ 7.669790</u>	13	
Royalty Allowance Amount for coal transported and sold during the reporting period = Allowance rate (line 13) times lease tons transported and sold during the reporting period (<u>55,200</u> tons) times the lease ad valorem royalty rate (<u>12.5</u> %).							<u>\$ 52,922</u>	14	
Royalty Allowance Amount for coal transported during a prior period and sold during the reporting period = Allowance rate for deferred tons (<u>0</u>) times lease tons of deferred coal sold during the reporting period (<u>0</u> tons) times the lease ad valorem royalty rate (<u>0</u> %).							<u>\$ 0</u>	15	
Total Royalty Allowance Amount = line 14 plus line 15.							<u>\$ 52,922</u>	16	

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

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10. COAL PRODUCT VALUATION

Example 2. Non-Arm's-Length Transportation Allowance

Figures 10-24 through 10-30 illustrate Example 2.

Situation

1. Transportation allowance is claimed for three segments, two non-arm's-length and one arm's-length.
2. Butte's Coal mine started operation/sales in January 1987.
3. The period is January 1, 1990, to December 31, 1990 (continuing report shows 1990 actual data, 1991 estimate).
4. The facility is Butte's Mine, three segments.
5. There is one Federal lease, M75-0088888-000.
6. The royalty rate is 12½ percent.

For this transportation allowance with two non-arm's-length transportation segments, two Schedules 1A and two Schedules 1B must be submitted (one for each non-arm's-length segment) along with Page 1 and Schedule 1 (figs. 10-24 through 10-29).

The Schedules 1B are completed first using data on depreciation schedules (tables 10-9 and 10-10), which do not need to be submitted with Form MMS-4293.

The Schedules 1A are then completed using data from the Schedules 1B. The non-arm's-length segment data from the Schedules 1A are compiled on Schedule 1 with the arm's-length segment data. Page 1 summarizes the data from the schedules.

An additional requirement of all transportation allowance submittals is a schematic of the transportation facility (fig. 10-30).

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Page 1 (fig. 10-24) includes the following information for Example 2:

1. In item 5, the Reporting Type is 2, indicating a continuing report for which columns 12 and 13 are completed.
2. In column 11, the Arm's-Length/Payor-Owned Indicator is 5, indicating total costs under non-arm's-length conditions, as well as arm's-length conditions.
3. In column 12a, the Royalty Tons are calculated as the sum of the number obtained by multiplying the tonnage and royalty rate entries on Schedule 1, line 14 (lease tons times royalty rate), plus the number obtained from multiplying the tonnage and royalty rate entries on Schedule 1, line 15 (fig. 10-25). (This example has no deferred tons.)
4. In column 12c, the Royalty Allowance Amount is taken from Schedule 1, line 16.
5. In column 12b, the Allowance Rate Per Ton is calculated by dividing the entry in column 12c by the entry in column 12a. For this example, because no deferred tons are included, the allowance rate per ton is obtained from Schedule 1, line 13.
6. In column 13a, the Royalty Tons are the lessee's best estimate for the amount of royalty tons transported from January 1991 through December 1991. For each lease, this number is the lease tons transported and sold times the lease royalty rate.
7. Column 13b, Allowance Rate Per Ton is the lessee's best estimate for the unit cost of transportation from January 1991 through December 1991.
8. In column 13c, the Royalty Allowance Amount is obtained by multiplying entries from column 13a and column 13b.

NOTE

Column 13 is filled out if transportation of coal from Federal leases is expected during 1991. If no transportation is expected, then this column is left blank.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-24--Page 1, Example 2, Allowable Rate Per Ton, Royalty Allowance Amount, and Columns 12 and 13 Completed

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

OMB NO. 1010 - 0074
Expires March 31, 19XX
The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires MMS to inform you that this information is being collected for the purpose of managing its coal transportation allowance program.

COAL TRANSPORTATION ALLOWANCE REPORT

1 PAYOR NAME Butte's Coal Company 2 PAYOR CODE MA720
 ADDRESS 14 18th Street 4 FEDERAL OR INDIAN
 CITY Craig STATE Colorado ZIP 81625 5 REPORTING TYPE

Public reporting burden for this form is estimated to range from 1 to 40 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form including suggestions for reducing this burden to the Information Collection Clearance Officer, Mail Stop 2300, Minerals Management Service, 381 Elden Street, Herndon, Va. 22070; and the Office of Management and Budget, Paperwork Reduction Project (1010 - 0074), Washington, DC 20503.

6 REPORTING PERIOD 01 19 90 to 12 19 90

FOR MMS USE ONLY:

3 FOR PAYOR USE ONLY:

7	8	ACCOUNTING IDENTIFICATION NUMBER (AID)	9	PRODUCT CODE	10	SELLING ARRANGEMENT CODE	11	ARM'S-LENGTH/PAYOR-OWNED INDICATOR	12 PRIOR PERIOD ACTUAL DATA			13 CURRENT PERIOD ESTIMATED DATA		
									a	b	c	a	b	c
									ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT
1		M75-0088888-000		EC		200		5	102,976	11.930125	1,228,516	110,000	12.500000	1,375,000
2														
3														
4														
5														
6														
7														
8														
9														
10														
11														

14	PAGE TOTAL		102,976	XXXXXXXXXXXX	1,228,516	110,000	XXXXXXXXXXXX	1,375,000
15	REPORT TOTAL (Last Page Only)		102,976	XXXXXXXXXXXX	1,228,516	110,000	XXXXXXXXXXXX	1,375,000

IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4293

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.

NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed) Edward M. King DATE: 3/22/91
 AUTHORIZED SIGNATURE: [signature] DATE: _____
 NAME OF PREPARER: James King TELEPHONE NUMBER: (303) 411-2222

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FORM MMS-4293 (REV. 3/91) THIS INFORMATION SHOULD BE CONSIDERED (Please check one) PROPRIETARY NONPROPRIETARY Page 1

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

Schedule 1 (fig. 10-25) includes the following information for Example 2:

1. Data for column (d) for each of the two non-arm's-length segments 1 and 2 are taken from the Schedules 1A (figs. 10-26 and 10-28, respectively).
2. Data for column (d) for the arm's-length segment (segment 3) is based on the cost of \$8.25 per ton to transport coal over a railroad. The total cost is \$6,796,408 ($\$8.25 \times 823,807$).
3. Data for columns (e) and (g) for each of the two non-arm's-length segments 1 and 2 are taken from the Schedules 1B (figs. 10-27 and 10-29, respectively).
4. Entries for part B, columns (d), (e), and (h), are added and the sums entered on line 11. These totals are added and the sum is entered on line 12, part B Total Cost.
5. Column (f) entries are taken from the depreciation schedules (tables 10-9 and 10-10).
6. No deferred tons of coal were sold during 1990.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-25--Schedule 1, Example 2, Transportation Costs for all Segments and Computation of Allowable Amount

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program
SCHEDULE 1 -- COAL TRANSPORTATION SYSTEM SUMMARY SHEET

1 PAYOR NAME AND CODE Butte's Coal Company / MA720 2 AID NUMBER: M75-0088888-000
 ADDRESS 14 18th Street SELLING ARRANGEMENT CODE: 200
 CITY Craig STATE Colorado ZIP 81625 FACILITY NAME/ID NUMBER: Butte's Mine
 PRODUCT CODE: EC
 LINE NUMBER(S) FROM PAGE 1: 1
 PERIOD: 01 19 90 to 12 19 90

(a) Segment of Transportation	(b) Mode of Transportation	(c) Arm's-Length/ Payor-Owned Indicator	(d) Arm's-Length Contract/ Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Beginning-of-Year Undepreciated Capital Investment	(h) Return on Investment (f) x (g)		
A. TRANSPORTING COAL TO A REMOTE WASHING FACILITY.									
From Mine	To Wash Plant	Truck	4	\$ 1,544,624	\$ 320,000	10.29%	\$ 2,340,000	\$ 240,786	3
									4
									5
Totals				\$ 1,544,624	\$ 320,000			\$ 240,786	6
Allowance rate = (6d + 6e + 6h) / Tons of production transported from the mine to the washing facility, expressed in terms of clean coal tonnage.				\$ 2,105,410	÷	823,807	=	\$ 2.555708	7
				Part A Total Cost		Part A Total Clean Tons		Cost per Ton	
B. TRANSPORTING COAL TO A REMOTE SALES POINT.									
Wash Plant	Rail Loadout	Truck	4	\$ 568,496	\$ 205,000	10.29%	\$ 1,485,000	\$ 152,806	8
Rail Loadout	Power Plant	Rail	6	6,796,408					9
									10
Totals				\$ 7,364,904	\$ 205,000			\$ 152,806	11
Allowance rate = (11d + 11e + 11h) / Tons of coal transported from the mine/plant to the sales point.				\$ 7,722,710	÷	823,807	=	\$ 9.374417	12
				Part B Total Cost		Part B Total Tons		Cost per Ton	
Total Unit Allowance Rate = line 7h plus line 12h.								\$ 11.930125	13
Royalty Allowance Amount for coal transported and sold during the reporting period = Allowance rate (line 13) times lease tons transported and sold during the reporting period (<u>823,807</u> tons) times the lease ad valorem royalty rate (<u>12.5</u> %).								\$ 1,228,516	14
Royalty Allowance Amount for coal transported during a prior period and sold during the reporting period = Allowance rate for deferred tons (<u>0</u>) times lease tons of deferred coal sold during the reporting period (<u>0</u> tons) times the lease ad valorem royalty rate (<u>0</u> %).								\$ 0	15
Total Royalty Allowance Amount = line 14 plus line 15.								\$ 1,228,516	16

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10. COAL PRODUCT VALUATION

Schedule 1A (fig. 10-26) contains the following information for Example 2:

The lessee's actual non-arm's-length costs for segment 1 (mine to wash plant) consisted of:

Operating costs: Supervision and engineering = \$50,129
 Labor = \$225,000
 Utilities = \$300
 Materials and Supplies = \$280,315
 Rent = \$620

Maintenance costs: Supervision = \$20,124
 Materials = \$105,012

Overhead costs: Corporate overhead allocation = \$863,124

NOTE

The costs accumulated are only for segment 1, mine to wash plant.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-26--Schedule 1A Costs Accumulated for Segment 1
(Mine to Wash Plant), Example 2

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1A -- NON-ARM'S-LENGTH
TRANSPORTATION SYSTEM/
SEGMENT OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES

PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Butte Coal/MA720
AID No:	M75-0088888-000
Selling Arrangement Code:	200
Facility ID No:	Butte's Mine
Segment ID No:	Mine to Wash Plant (Seg. 1)
Period:	01 19 90 to 12 19 90

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for System / Segment

Operations Supervision and Engineering	\$ 50,129	1
Operations Labor	225,000	2
Utilities	300	3
Materials and Supplies	280,315	4
Ad Valorem Property Taxes		5
Rent / Leasing	620	6
Other (specify). Attach Supplemental Schedule 1A as necessary		7
Total Operating Costs -- Subtotal	\$ 556,364	8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ 20,124	9
Maintenance Labor		10
Materials	105,012	11
Other (specify). Attach Supplemental Schedule 1A as necessary		12
Total Maintenance Costs -- Subtotal	\$ 125,136	13

C. Lessee's Overhead Allocation (specify)

Corporate overhead allocation	\$ 863,124	14
		15
Other (specify) use Supplemental Schedule 1A		16
Total Overhead Allocation	\$ 863,124	17

D. Total Operating and Maintenance Costs

\$ 1,544,624 18

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AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-27 is Schedule 1B for segment 1, from mine to wash plant. The data for this schedule were taken from table 10-9.

Table 10-9--Depreciation Schedule for Figure 10-27

Calendar year	Investment	Beg. of year undeprec. capital investment	Annual deprec.	End of year undeprec. capital investment	Annual return on undeprec. capital investment
1987	\$3,300,000	\$3,300,000	\$320,000	\$2,980,000	\$320,760 @ 9.72%
1988	\$3,300,000	\$2,980,000	\$320,000	\$2,660,000	\$328,694 @ 11.03%
1989	\$3,300,000	\$2,660,000	\$320,000	\$2,340,000	\$285,152 @ 10.72%
1990	\$3,300,000	\$2,340,000	\$320,000	\$2,020,000	\$240,786 @ 10.29%

Figure 10-27 is based on the following information:

1. Total investment was \$3,300,000.
2. Salvage value is estimated at \$100,000
3. Estimated life of the equipment is 10 years.
4. Annual return rates are the S&P's Bond Guide rates for industrial bonds rated BBB for the first month of each reporting period.
5. Annual depreciation is based on the estimated life of the equipment (10 years) and the total investment less salvage.
6. The salvage value is included when calculating the return on investment.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-28--Schedule 1A Costs Accumulated for Segment 2
(Wash Plant to Rail Loadout), Example 2

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1A -- NON-ARM'S-LENGTH
TRANSPORTATION SYSTEM/
SEGMENT OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES

PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Butte's Coal/MA720
AID No:	M75-0088888-000
Selling Arrangement Code:	200
Facility ID No:	Butte's Mine (Segment2)
Segment ID No:	Wash Plant to Rail Loadout
Period:	01 19 90 to 12 19 90

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for System / Segment

Operations Supervision and Engineering	\$ 20,128	1
Operations Labor	131,200	2
Utilities	150	3
Materials and Supplies	165,241	4
Ad Valorem Property Taxes		5
Rent / Leasing	435	6
Other (specify). Attach Supplemental Schedule 1A as necessary		7
Total Operating Costs -- Subtotal	\$ 317,154	8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ 9,200	9
Maintenance Labor		10
Materials	40,201	11
Other (specify). Attach Supplemental Schedule 1A as necessary		12
Total Maintenance Costs -- Subtotal	\$ 49,401	13

C. Lessee's Overhead Allocation (specify)

Headquarters allocation	\$ 201,941	14
		15
Other (specify) use Supplemental Schedule 1A		16
Total Overhead Allocation	\$ 201,941	17

D. Total Operating and Maintenance Costs

\$ 568,496 18

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AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Schedule 1B (fig. 10-29) is for segment 2, from wash plant to rail loadout. The data for this schedule were taken from table 10-10.

Table 10-10--Depreciation Schedule for Figure 10-29

Calendar year	Investment	Beg. of year undeprec. capital investment	Annual deprec.	End of year undeprec. capital investment	Annual return on undeprec. capital investment
1987	\$2,100,000	\$2,100,000	\$205,000	\$1,895,000	\$204,120 @ 9.72%
1988	\$2,100,000	\$1,895,000	\$205,000	\$1,690,000	\$209,018 @ 11.03%
1989	\$2,100,000	\$1,690,000	\$205,000	\$1,485,000	\$181,168 @ 10.72%
1990	\$2,100,000	\$1,485,000	\$205,000	\$1,280,000	\$152,806 @ 10.29%

Figure 10-29 is based on the following information:

1. Total investment was \$2,100,000.
2. Salvage value was estimated at \$50,000.
3. Estimated life of the equipment is 10 years.
4. Annual return rates are the S&P's Bond Guide rates for industrial bonds rated BBB for the first month of each reporting period.
5. Annual depreciation is based on the estimated life of the equipment (10 years) and the total investment less salvage.
6. The salvage value is included when calculating the return on investment.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-29--Schedule 1B Depreciation and Capital Expenditure Summary (Segment 2), Example 2

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Butte's Coal/MA720
AID No:	M75-0088888-000
Selling Arrangement Code:	200
Facility ID No:	Butte's Mine (Segment 2)
Segment ID No:	Wash Plant to Rail Loadout
Period:	01 1990 to 12 1990

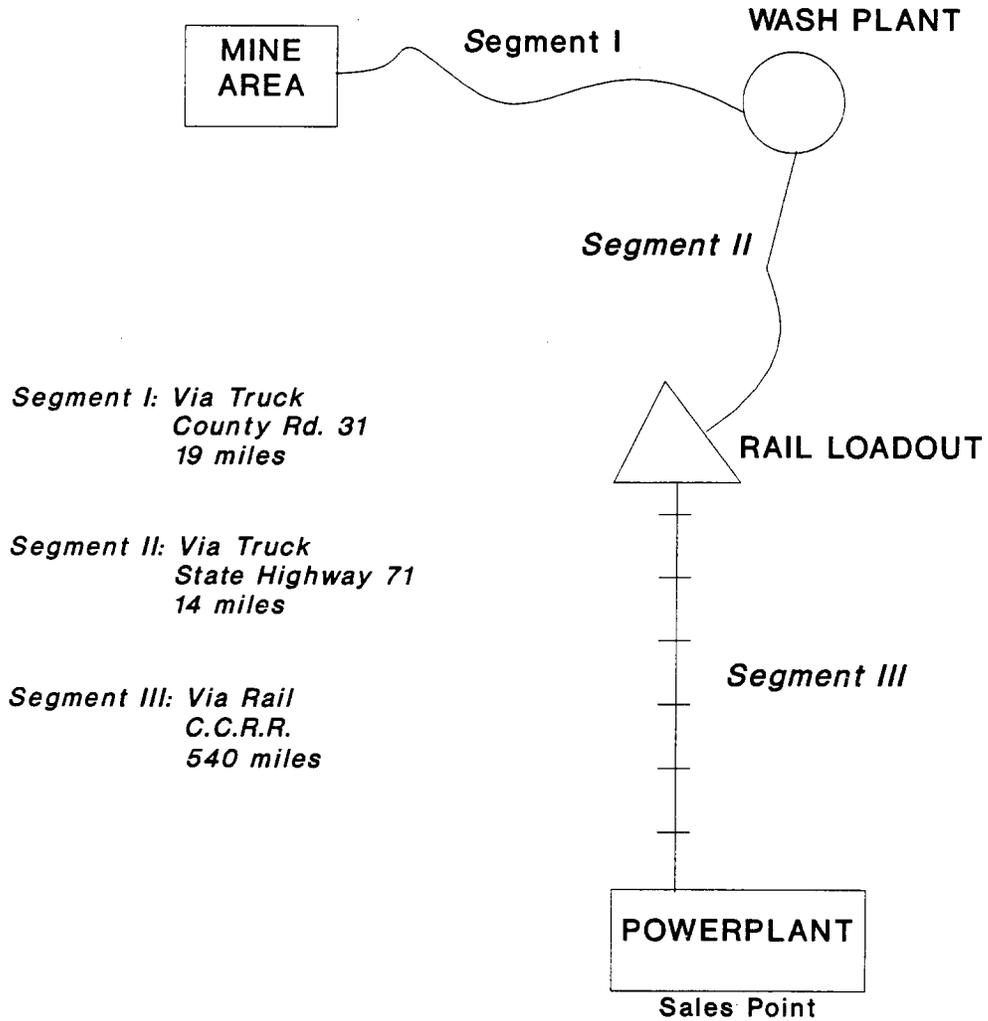
SCHEDULE 1B -- NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/SEGMENT DEPRECIATION AND CAPITAL EXPENDITURE SUMMARY

1 Expenditure Item	2 Initial Capital Investment and Date Placed in Service	3 Salvage Value	4 Depreciable Life/Years of Depreciation Taken to Date	5 Beginning-of-Year Undepreciated Capital Investment	6 Depreciation	7 End-of-Year Undepreciated Capital Investment
Truck (Equipment)	\$ 2,100,000 1/1/87	\$ 50,000	10 3	\$ 1,485,000	\$ 205,000	\$ 1,280,000
8 Totals				\$ 1,485,000	\$ 205,000	

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10. COAL PRODUCT VALUATION

Figure 10-30--Schematic Diagram of Transportation Routes,
Example 2 (Required Submittal With Allowance Forms)



NOT TO SCALE

10. COAL PRODUCT VALUATION

Example 3. Transportation Allowance Involving Deferred Tonnage

Figures 10-31 and 10-32 illustrate Example 3.

Situation

1. Transportation allowance is non-arm's-length.
2. The lessee sells to one customer.
3. A total of 5,000 tons of coal was transported in 1989 at a cost of \$5.600000 per ton.
4. Coal transported in 1989 is sold in 1990.
5. A total of 823,807 tons is sold and transported in 1990.
6. The cost is \$11.911389 per ton.

For simplicity, only Schedule 1 and Page 1 are illustrated. Schedule 1 should be completed before Page 1.

10. COAL PRODUCT VALUATION

Schedule 1 (fig. 10-31) includes the following information for Example 3:

1. For simplicity, only lines 13 through 16 are filled out.
2. Transportation cost for 1990: \$11.911389 per ton (entry for line 13).
3. Tons transported in 1990: 823,807.
4. Lease royalty rate: 12.5 percent.
5. Entry for line 14 = $11.911389 \times 823,807 \times 0.125 = 1,226,586$.
6. Deferred tons: 5,000.
7. Cost of transportation for deferred tons: \$5.60 per ton.
8. Lease royalty rate for deferred tons: 12.5 percent.
9. Entry for line 15 = $5,000 \times 5.60 \times 0.125 = 3,500$.
10. Entry for line 16 = $1,226,586$ (line 14, column (h)) + $3,500$ (line 15, column (h)) = $1,230,086$.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-31--Schedule 1, Showing Calculation of Deferred Tons and Allowance Rate, Example 3

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- COAL TRANSPORTATION SYSTEM SUMMARY SHEET

1 PAYOR NAME AND CODE Butte Coal Company / MA720 2 AID NUMBER: M75-0088888-000
 ADDRESS 14 18th Street SELING ARRANGEMENT CODE: 200
 CITY Craig STATE Colorado ZIP 81625 FACILITY NAME/D NUMBER: Butte's Mine
 PRODUCT CODE: EC
 LINE NUMBER(S) FROM PAGE 1: 1
 PERIOD: 01 19 90 to 12 19 90

(a) Segment of Transportation	(b) Mode of Transportation	(c) Arm's-Length/ Payor-Owned Indicator	(d) Arm's-Length Contract/ Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Beginning-of-Year Undepreciated Capital Investment	(h) Return on Investment (f) x (g)	
From	To							
A. TRANSPORTING COAL TO A REMOTE WASHING FACILITY.								
			\$	\$		\$	\$	3
								4
								5
		Totals	\$	\$		\$	\$	6
Allowance rate = (6d + 6e + 6h) / Tons of production transported from the mine to the washing facility, expressed in terms of clean coal tonnage.			\$	÷			\$	7
			Part A Total Cost		Part A Total Clean Tons		Cost per Ton	
B. TRANSPORTING COAL TO A REMOTE SALES POINT.								
			\$	\$		\$	\$	8
								9
								10
		Totals	\$	\$		\$	\$	11
Allowance rate = (11d + 11e + 11h) / Tons of coal transported from the mine/plant to the sales point.			\$	÷			\$	12
			Part B Total Cost		Part B Total Tons		Cost per Ton	
Total Unit Allowance Rate = line 7h plus line 12h.							\$ 11.911389	13
Royalty Allowance Amount for coal transported and sold during the reporting period = Allowance rate (line 13) times lease tons transported and sold during the reporting period (<u>823,807</u> tons) times the lease ad valorem royalty rate (<u>12.5</u> %).							Cost per Ton	
							\$ 1,226,586	14
Royalty Allowance Amount for coal transported during a prior period and sold during the reporting period = Allowance rate for deferred tons (<u>\$5.60</u>) times lease tons of deferred coal sold during the reporting period (<u>5,000</u> tons) times the lease ad valorem royalty rate (<u>12.5</u> %).							\$ 3,500	15
Total Royalty Allowance Amount = line 14 plus line 15.							\$ 1,230,086	16

FORM MMS-4293 SCHEDULE 1 (REV. 2/89)

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

Page 1 (fig. 10-32) contains the following information for Example 3:

1. In column 12a, the Royalty Tons are obtained by adding the tonnage amounts from Schedule 1 (fig. 10-31) and multiplying the sum by the lease royalty rate: $(823,807 + 5,000) \times 0.125 = 103,601$ tons.
2. In column 12c, the Royalty Allowance Amount is obtained from Schedule 1, line 16, column (h) (fig. 10-31): \$1,230,086.
3. In column 12b, the Allowance Rate Per Ton is calculated by dividing column 12c by column 12a. The result is a weighted average allowance rate for 1990 tons transported and deferred tons transported: $1,230,086 \div 103,601 = \11.873302 .

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-32--Page 1 Showing a Summary of Costs for Coal Sold in 1990 but Transported in 1989 and 1990, Example 3

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

OMB NO. 1010 - 0074
Expires March 31, 19XX
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COAL TRANSPORTATION ALLOWANCE REPORT

1 PAYOR NAME Butte Coal Company 2 PAYOR CODE MA720
ADDRESS 14 18th Street 4 FEDERAL OR INDIAN
CITY Craig STATE Colorado ZIP 81625 5 REPORTING TYPE

Public reporting burden for this form is estimated to range from 1 to 40 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form including suggestions for reducing this burden to the Information Collection Clearance Officer, Mail Stop 2300, Minerals Management Service, 381 Eden Street, Herndon, Va. 22070; and the Office of Management and Budget, Paperwork Reduction Project (1010-0074), Washington, DC 20503.

6 REPORTING PERIOD 01 19 90 to 12 19 90
3 FOR PAYOR USE ONLY:

FOR MMS USE ONLY:

7	8	9	10	11	12 PRIOR PERIOD ACTUAL DATA			13 CURRENT PERIOD ESTIMATED DATA		
					a	b	c	a	b	c
ACCOUNTING IDENTIFICATION NUMBER (AID)		PRODUCT CODE	SELLING ARRANGEMENT CODE	ARMS-LENGTH PAYOR-OWNED INDICATOR	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT	ROYALTY TONS	ALLOWANCE RATE PER TON	ROYALTY ALLOWANCE AMOUNT
1	M75-0088888-000	EC	200	5	103,601	11.873302	1,230,086	105,000	13.500000	1,417,500
2										
3										
4										
5										
6										
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9										
10										
11										

14 PAGE TOTAL	103,601	XXXXXXXXXXXX	1,230,086	105,000	XXXXXXXXXXXX	1,417,500
15 REPORT TOTAL (Last Page Only)	103,601	XXXXXXXXXXXX	1,230,086	105,000	XXXXXXXXXXXX	1,417,500

IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4293

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.

NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed) Edward M. King DATE: 3/25/91
AUTHORIZED SIGNATURE: [signature] DATE:
NAME OF PREPARER: James King TELEPHONE NUMBER: (303) 411-2222

WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations, or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s).

FORM MMS-4293 (REV. 3/91) THIS INFORMATION SHOULD BE CONSIDERED (Please check one) PROPRIETARY NONPROPRIETARY Page 1

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

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10. COAL PRODUCT VALUATION

Example 4. Situation for Transportation Allowance Involving Non-Arm's-Length Transportation, Which Includes Arm's-Length Costs for Leasing Equipment

Figure 10-33 illustrates Example 4.

Situation

1. Transportation is performed by the lessee entirely; however, some of the equipment used by the lessee is leased under an arm's-length lease contract.
2. There is one segment transportation from the mine to the sales point.
3. The lessee incurs non-arm's-length operating, maintenance, and overhead expenses. One component of operation costs is the contractual expense for leased equipment.

10. COAL PRODUCT VALUATION

For simplicity, only Schedule 1A is illustrated (fig. 10-33); it contains the following information for Example 4.

The lessee's actual non-arm's-length costs consisted of:

Operating costs: Supervision and engineering = \$19,900
 Operations labor = \$90,900
 Utilities = \$4,000
 Materials and supplies = \$84,700
 Ad valorem property taxes = \$1,100
 Leasing = \$1,836,100

Maintenance costs: Supervision = \$3,100
 Labor = \$21,700
 Materials = \$5,000

Overhead costs: District office = \$13,400

The arm's-length leasing costs are entered on line 6 of Schedule 1A even though the schedule is intended to be used to compile only non-arm's-length costs.

When completing Schedule 1 and Page 1, the entry for Arm's-Length/Payor-Owned Indicator is 5, indicating total costs consist of non-arm's-length costs. The fact that the coal lessee incurs arm's-length leasing expenses does not alter the non-arm's-length status of the allowance. The lessee is still performing the transportation for itself. The only difference is that the equipment is leased rather than owned.

AFS PAYOR HANDBOOK--SOLID MINERALS

10. COAL PRODUCT VALUATION

Figure 10-33--Schedule 1A, Example 4

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1A -- NON-ARM'S-LENGTH
TRANSPORTATION SYSTEM/
SEGMENT OPERATIONS,
MAINTENANCE AND OVERHEAD
EXPENDITURES

PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Ed's Coal Co./MA400
AID No:	M50-0024720101
Selling Arrangement Code:	100
Facility ID No:	Mine to Sales Point
Segment ID No:	Mine to Sales Point
Period:	01 1990 to 12 1990

Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for System / Segment

Operations Supervision and Engineering	\$ 19,900	1
Operations Labor	90,900	2
Utilities	4,000	3
Materials and Supplies	84,700	4
Ad Valorem Property Taxes	1,100	5
Rent / Leasing	1,836,100	6
Other (specify). Attach Supplemental Schedule 1A as necessary		7
Total Operating Costs -- Subtotal	\$ 2,036,700	8

B. Lessee's Maintenance Costs

Maintenance Supervision	\$ 3,100	9
Maintenance Labor	21,700	10
Materials	5,000	11
Other (specify). Attach Supplemental Schedule 1A as necessary		12
Total Maintenance Costs -- Subtotal	\$ 29,800	13

C. Lessee's Overhead Allocation (specify)

<u>District office</u>	\$ 13,400	14
		15
Other (specify) use Supplemental Schedule 1A		16
Total Overhead Allocation	\$ 13,400	17

D. Total Operating and Maintenance Costs

\$ 2,079,900 18

FOR ILLUSTRATIVE PURPOSES ONLY

10. COAL PRODUCT VALUATION

10.12.13 Exceptions to Compute Actual Costs (30 CFR 206.262(b)(3))

A lessee may apply to MMS for an exception from the requirement to compute actual non-arm's-length transportation costs pursuant to 30 CFR 206.262(b)(1) and (2). The MMS considers the exception only if the lessee has a transportation rate approved by a Federal agency (for Federal and Indian leases) or by a State regulatory agency (for Federal leases only).

The procedure necessary for obtaining an exception from the allowance cost calculation procedures consists of two distinct requirements:

1. The lessee must demonstrate that its transportation allowance approved by a Federal agency (for both Federal and Indian leases) or by a State regulatory agency (for Federal leases), such as a PUC, is not excessive compared to arm's-length transportation costs charged by the lessee or by others offering similar transportation services. If no comparable arm's-length transportation situations exist, MMS makes the comparison against the non-arm's-length actual cost allowance rate that is computed under MMS regulations at 30 CFR 206.262(b)(1) and (2). If the rate permitted by the Federal or State regulatory agency is not excessive when compared with the rate computed pursuant to MMS allowance calculation procedures, then MMS may approve an exception to MMS allowance calculation procedures, contingent on the lessee's successfully meeting the second requirement.
2. The second requirement is that the lessee must show there has been a Federal or State regulatory agency cost analysis of the transportation rate. The analysis must be specifically for the transportation costs and does not refer to any Federal or State regulatory analysis concerning the reasonableness of the delivered cost of fuel (including the price of the fuel itself).

The MMS grants exceptions to the non-arm's-length allowance computation procedures if the lessee can show that its transportation costs have been analyzed and approved by a Federal or State regulatory agency, and that the transportation rate is not excessive when compared with the rate calculated under MMS regulations.

If MMS grants an exception to the MMS regulatory allowance calculation procedures, then MMS will furnish instructions to the lessee for reporting the allowance using Form MMS-4293, Coal Transportation Allowance Report.

10. COAL PRODUCT VALUATION

10.13 Gasification and Liquefaction (30 CFR 206.264)

Normally, for surface coal gasification or liquefaction, ROM coal in marketable condition is transferred to the processing facility. In these cases the value for royalty purposes equals the gross proceeds from the sale of lease production to the facility if the sale is at arm's-length. If a non-arm's-length transaction is involved, value is determined in accordance with 30 CFR 206.257(c). However, this regulation allows for unforeseen circumstances that may arise in the future whereby standard valuation methods are not appropriate. In these cases the lessee should propose a valuation procedure to MMS for approval; the lessee would be allowed to use the proposed valuation method until it is approved or modified by MMS. However, royalty underpayments resulting from the use of the proposed method would be subject to late-payment interest assessments.

In situ gasification and liquefaction operations have not occurred using Federal coal, and valuation procedures have not been developed. The MMS expects to develop in situ valuation procedures on a case-by-case basis. If a lessee is contemplating in situ operations involving Federal or Indian coal, then the lessee should contact MMS and submit a proposed valuation procedure to MMS for review and approval before operations begin.

10.14 Value Enhancement (30 CFR 206.265)

Title 30 CFR 206.265 was included in the January 1989 final rulemaking in order to address concerns regarding how MMS would value coal that has had its quality enhanced by new beneficiation technologies. This section's application was explained in the July 15, 1988, Federal Register release of Further Notice of Proposed Rulemaking, which states at 53 FR 26955 and 26956:

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.

10. COAL PRODUCT VALUATION

As stated above, this section would apply to situations in which 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.



As the Nation's principal conservation agency, the Department of the Interior has responsibility for most of our nationally owned public lands and natural resources. This includes fostering sound use of our land and water resources; protecting our fish, wildlife, and biological diversity; preserving the environmental and cultural values of our national parks and historical places; and providing for the enjoyment of life through outdoor recreation. The Department assesses our energy and mineral resources and works to ensure that their development is in the best interests of all our people by encouraging stewardship and citizen participation in their care. The Department also has a major responsibility for American Indian reservation communities and for people who live in island territories under U.S. administration.



As a bureau of the Department of the Interior, the Minerals Management Service's (MMS) primary responsibilities are to manage the mineral resources located on the Nation's Outer Continental Shelf (OCS), collect revenue from the Federal OCS and onshore Federal and Indian lands, and distribute those revenues.

Moreover, in working to meet its responsibilities, the **Offshore Minerals Management Program** administers the OCS competitive leasing program and oversees the safe and environmentally sound exploration and production of our Nation's offshore natural gas, oil, and other mineral resources. The MMS **Royalty Management Program** meets its responsibilities by ensuring the efficient, timely, and accurate collection and disbursement of revenue from mineral leasing and production due to Indian tribes and allottees, States, and the U.S. Treasury.

The MMS strives to fulfill its responsibilities through the general guiding principles of (1) being responsive to the public's concerns and interests by maintaining a dialogue with all potentially affected parties and (2) carrying out its programs with an emphasis on working to enhance the quality of life for all Americans by lending MMS assistance and expertise to economic development and environmental protection.