INTERIOR BOARD OF LAND APPEALS

Black Butte Coal Co.

146 IBLA 296 (November 20, 1998)

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BLACK BUTTE COAL CO.

IBLA 95-431 Decided November 20, 1998

Appeal of a Minerals Management Service decision requiring payment of royalty on interest payments received by the lessee from the coal purchaser to compensate for delays in payment of part of the purchase price. MMS-93-0166-MIN; coal lease No. W-6266.

Affirmed.

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

Interest payments received by a lessee from the purchaser of coal produced from a Federal lease to compensate for late payment of the purchase price of the coal are part of the gross value of the coal produced by the lessee on which royalty is properly paid.

APPEARANCES: George F. Heiden, Esq. and Lon A. Licata, Esq., Omaha, Nebraska, for Black Butte Coal Company; Peter J. Schaumberg, Esq., Howard W. Chalker, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Black Butte Coal Company (Black Butte or Appellant) has appealed from a February 17, 1995, decision of the Associate Director for Policy and Management Improvement (Associate Director), Minerals Management Service (MMS), regarding royalty on Appellant's Federal coal lease No. W-6266. That decision affirmed an Order of the MMS Royalty Management Program assessing royalties on interest payments received by Black Butte as a result of delays in payment of a part of the purchase price of Federal coal produced from the lease.

The basic facts of this appeal are not disputed. On April 1, 1976, the Bureau of Land Management, leased approximately 15,000 acres of coal bearing lands to the Rosebud Coal Sales Company under coal lease No. W-6266. The lease was subsequently assigned to Black Butte. Coal lease W-6266 was issued at a time when the Department of the Interior had placed a moratorium on coal leasing (subject to limited exceptions)

and was using no standard form of lease. Hence, the terms of the lease were negotiated by the lessor and the lessee. See Black Butte Coal Co., 103 IBLA 145, 153, 95 I.D. 89, 93 (1988). 1/ Section 5(a) of the lease provides a "production royalty shall be due on Coal extracted by the Lessee from the Leased Lands" in the amount of 10 percent of the gross value of coal produced by strip mining methods. Gross value is defined in section 5(b) as the price the lessee receives for the coal, adjusted for transportation and processing costs so that it is a measure of the value of the coal at the mine mouth (or in the case of strip mining that point where the coal is delivered from the pit).

Some of the mined coal produced under the lease was sold pursuant to a long-term contract executed in 1976 to the Commonwealth Edison Company (Edison). In 1984, a dispute arose between Black Butte and Edison pertaining to an increase Black Butte imposed on the purchase price of the coal. The price increase ensued after Black Butte's costs of production increased as the result of 1982 and 1986 changes in the Internal Revenue Code which reduced the percentage depletion allowance applicable to coal from 10 percent to 8 percent. The disagreement was resolved on January 8, 1988, when Edison and Black Butte executed an amendment to their sales contract whereby they agreed to terms and conditions under which the price of coal sold under their contract was adjusted for the years 1984 through 1987. As a result of that settlement, Edison agreed to pay Black Butte an additional $3,860,730.99 for coal purchased between 1984 and 1987, as well as $700,001.04 in interest on the amount owed. Edison paid the additional price excluding interest the date the agreement was executed; Black Butte received payment for the interest on January 28, 1988.

The Dallas Area Audit Office, Royalty Management Program, conducted an audit of Black Butte's royalty payments on the lease for the period December 1, 1986, through November 30, 1991, and discovered that Black Butte had paid Federal royalties on the additional payment denominated as purchase price under the settlement, but did not pay royalties on the amount it received from Edison designated as interest. On March 9, 1993, MMS issued a demand letter to Black Butte requiring payment of royalties on Edison's interest payment to Black Butte under the terms of lease W-6266. Black Butte disputed that it owed royalties on this payment, and appealed to the Associate Director.

In her analysis, the Associate Director held that the lessee and the purchaser of the coal had revised the price of coal sold from 1984 to 1987 in executing the 1988 amendment to the contract and recognized that "the

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1/ Coal lease W-6266 has been the subject of several prior decisions of this Board. In addition to the decision at 103 IBLA 145, other Board opinions are found at Black Butte Coal Co., 109 IBLA 254 (1989); Black Butte Coal Co., 111 IBLA 275 (1989); and Black Butte Coal Co., 141 IBLA 190 (1997).

price adjustment paid several years after the coal was delivered must be supplemented by a factor reflecting the time value of the underpayment." (Decision at 3-4.) Thus, her decision stated:

> In their dealings, the parties have recognized that the price of coal delivered in 1984, but not paid for in full until 1988, is a higher price (by the interest factor) than the price of that coal paid for in 1984. In effect, the parties have increased "the price received by the lessee" to compensate the lessee for a measure of the lost earnings on the adjustment proceeds.
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> On the basis of the 1988 Amendment, the price for the coal under the contract is made up of the original price paid, the retroactive per ton settlement adjustment, and the interest paid on the delayed payment. The interest earned in connection with the royalty portion of the production rightfully accrues to the lessor.

(Decision at 4 (citations omitted).) The Associate Director further found that this same result is compelled by the relevant regulations which provide that the value of Federal coal shall be the sale or contract price unless MMS determines the sale is not a bona fide transaction between independent parties. 30 C.F.R. § 203.200(g) (1987).

Further, the Associate Director held that the gross value for royalty purposes must not be less than "the gross proceeds accruing to the lessee." (Decision at 6.) Finally, the Associate Director found that:

> Payments made to the lessee for interest earned on the late payment of royalties for specific coal production are part of "the price received by the Lessee" as prescribed by the subject lease and are part of the royalty bearing gross proceeds pursuant to the applicable regulations. Since the Appellant received both a payment representing the increased price in dispute and also interest thereon, if the lessee did not share with the lessor the interest proceeds, it would be a breach of the lessee's implied covenant to act for the mutual benefit of the lessee and the lessor. Nola Grace Ptasynski, 89 I.D. 208, 63 IBLA 240 (1982); Solicitor's Opinion M-36927, 87 I.D. 616 (1980).

Id. at 7.

In its Statement of Reasons (SOR) for appeal, Appellant contends that the Associate Director erred in relying on the 1989 coal valuation regulations and the 1986 oil and gas valuation regulations to determine the lessee's royalty obligation. Rather, Appellant argues that the language of the coal lease is controlling, citing our decision in Black Butte Coal Co., 103 IBLA at 145, 95 I.D. at 89. Further, Appellant asserts that under the terms of the lease, royalty value is properly based on the "price received"

and not the "gross proceeds." (SOR at 4-5.) Black Butte also claims that the Associate Director has erroneously relied on an "implied covenant," to determine royalty value, when there is an expressed agreement in the lease limiting royalty valuation to the "price received." (SOR at 5.) Finally, Black Butte maintains that the 1988 amendment to the sales contract did not change the coal contract "to make interest part of the price of the coal." Id.

Counsel for MMS has filed an Answer contending that the MMS decision is based on the language of the lease which requires that royalty be paid on the gross value of the coal. The language of both the coal lease at issue and the pre-1989 regulations dictate that royalty is based on the gross value of the coal, MMS argues, citing 30 C.F.R. § 203.200(f) (1987). (Answer at 3.) It is asserted by MMS that the interest payment which is designed to compensate the lost time value of delayed payments of the price of coal is in fact a part of the payment for the coal and, hence, part of the gross value of the coal. Id. at 5.

[1] As we noted in a prior decision involving computation of royalty for this lease, section 5(a) of the lease provides a "production royalty shall be due on Coal extracted by the Lessee from the Leased Lands" in the amount of 10 percent of the gross value of coal produced by strip mining methods and 8 percent of the gross value of coal produced by underground mining. Black Butte Coal Co., 103 IBLA at 146, 95 I.D. at 90. Gross value is the same standard which is mandated by the relevant regulation. 30 C.F.R. § 203.200(f) (1987). It is well established that gross value of coal is generally equated with gross price and properly includes all components of the price received for sale of the coal, including, e.g., reclamation fees reimbursed by the coal purchaser. Knife River Coal Mining Co., 43 IBLA 104, 86 I.D. 472 (1979). In Knife River, another coal lease royalty case involving an obligation under the terms of the lease to pay royalty on a percentage of the gross value of the coal mined, we held that it was proper to include the amount of the reclamation fee as part of the gross value of coal produced when the selling price received is increased by that amount. This precedent is directly relevant to the present appeal. Gross value properly includes all consideration received for the sale of the produced coal regardless of whether it is described as interest to compensate the lessee for the late payment of the purchase price. The lessor was deprived of the time value of the royalty component of the amount of the purchase price which was paid late (in 1988) in the same manner that the lessee was and is entitled to the royalty share of the interest paid to the lessee. 2/

2/ To the extent the MMS decision cited the 1989 revised regulations to support the decision below, we find this to be mere surplusage. The result in this case is clearly compelled by both the language of the lease and the contemporary regulation which require payment of royalty on the gross value of the coal. Further, we must reject Appellant's contention that use of this gross value standard is inconsistent with a proper reading of the language of the coal lease.

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

C. Randall Grant, Jr.
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI CONCURRING SPECIALLY:

The thrust of Black Butte Coal Company's (Black Butte) argument is that, because its lease with the Bureau of Land Management (BLM) provides that "gross value" is the equivalent of the price received for the coal it sold, BLM has no right to collect royalty on the interest component of Black Butte's settlement with the Commonwealth Edison Company (Commonwealth Edison) of the disputed price adjustment, since that payment was made to compensate Black Butte for the loss in the time-value of its money and not as a element of the value (i.e., price) of the coal. Unexpressed, but implicit in its argument, is the assertion that, to the extent that this interest compensation includes the time value of the monies properly due to the United States for its royalty interest, payments which were, themselves, delayed by Black Butte, Black Butte may appropriate these funds to its own account.

The lead opinion rejects this naked attempt at unjust enrichment, affirming the decision of the Minerals Management Service (MMS) that royalties were due on the interest component in the amount of $32,904.70. While I concur with this result, I do so reluctantly since, in my view, an analysis of the underlying transactions indicates that, if anything, this amount understates Black Butte's liability to the United States. Far from bolstering its case, an examination of the documents upon which Black Butte relies not only underlines the brazenness of its claims but actually provides substantial support for a finding that Black Butte may have deliberately attempted to deprive the United States of payments properly due it under the lease in clear violation of Black Butte's obligations of good faith dealing with its lessor. See generally Transco Exploration Co., 110 IBLA 282, 326-43, 96 I.D. 367, 391-400 (1989).

As the lead opinion notes, section 5(a) of coal lease No. W-6266 provides that royalty is assessed on the basis of a percentage of the "gross value" of the coal produced. 1/ While lease W-6266 was signed on April 1, 1976, during a period of time in which there were no coal valuation regulations, 2/ the concept of "gross value" was also employed in the 1976 regulations which were promulgated under FCLAA on May 17, 1976, approximately 1-1/2 months after lease W-6266 issued. See 41 Fed. Reg. 20261 (May 17, 1976); 30 C.F.R. § 211.63(a) (1977). While the term "gross value" varies slightly from the term "gross proceeds" then in use in the general context of leasing under the Mineral Leasing Act, 30 U.S.C. §§ 181-287

1/ This percentage varies dependent upon the method of production. Thus, for strip or auger mining production a 10-percent production royalty is provided, while for coal produced by underground methods the royalty rate is 8 percent. See lease W-6266, section 5(a)(1) and (2).
2/ Prior to the adoption of the Federal Coal Leasing Amendments Act of 1976 (FCLAA), as amended, 30 U.S.C. §§ 201-209 (1994), coal leases had been issued on a cents per ton basis. See generally BHP Minerals International Inc., 139 IBLA 269, 273-74 (1997).

(1994), and ultimately adopted in 1989 within the context of coal valuation, it has been noted that these were analogous terms with similar meanings. See Meadowlark, Inc., 133 IBLA 5, 11 (1995); 55 Fed. Reg. 5025 (Feb. 13, 1990). 3/ Under the regulatory concept of "gross value," there
seems little question that royalty was due on the interest payments involved herein. See, e.g., Enron Corp., 106 IBLA 394 (1989), aff'd Enron Oil and Gas Co. v. Lujan, 978 F.2d 212 (5th Cir. 1992), cert. denied, 114 S.Ct. 59 (1993); Hoover & Bracken Energies, Inc., 52 IBLA 27 (1991), aff'd, 723 F.2d 1388 (10th Cir. 1983); Knife River Coal Mining Co., 43 IBLA 104, 86 I.D. 472 (1979).

Black Butte, however, relies on language in section 5(b)(1) of the lease providing that "gross value shall be considered to be the price received by the Lessee, adjusted for transportation and/or processing costs so that it is a measure of the value of the Coal at the mine mouth" as essentially exempting the late interest payment from royalty assessment. Thus, it argues that only those reimbursements which it receives that involve elements of the price of coal are subject to royalty payments. While "price" is not defined in the lease, Black Butte argues that, inasmuch as under its contract with Commonwealth Edison interest is not listed as a component of the price which it receives, no royalty is due on any interest payments. See Black Butte's Statement of Reasons for appeal before MMS, dated April 9, 1993, at 2-3; sections 9.01 to 9.09 of lease W-6266.

Appellant's argument does not withstand analysis. While it is true that interest is not separately listed as an element in the computation of the price which Commonwealth Edison paid for coal, interest is provided under Article X of the agreement for late payment by Commonwealth Edison of the amounts invoiced. Unless Black Butte is seriously contending that, where Commonwealth Edison was delinquent in transmitting the funds to Black Butte, Black Butte could delay payment to MMS of the price billed without penalty, it is difficult to see the relevance of this point. MMS is not the guarantor of Black Butte's payment and its royalty interest cannot be adversely affected or diminished by Commonwealth Edison's tardiness or refusal to pay.

Moreover, what Black Butte conveniently ignores is that not only was provision made for adjustments of the price to be paid for the coal but express provision was also made for handling disputes over such adjustments; provisions which were essentially ignored by Black Butte to the detriment of the United States. Thus, Article IX of the agreement between Commonwealth Edison and Black Butte provided, in relevant part:

> The price per ton of coal may be increased or decreased from the base price. The increase or decrease, when added to

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3/ Admittedly, at one point the Department seemingly advanced varying interpretations of these two terms, a point discussed in BHP Minerals International Inc., supra, at 291 n.22. This attempted distinction, however, was subsequently abandoned.

> the base price, is the "current price." For the purpose of this contract, the base price date is deemed to be February 29, 1976. Price adjustments shall be computed quarterly or at such other time as may be specified in this article, with Seller sending Buyer a copy of each such calculation within thirty (30) days after the effective date of the adjustment. All price adjustments computed on a quarterly basis shall become effective commencing with coal shipped during the second half of the quarter at the end of which the calculation was performed.
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> Seller shall furnish to Buyer a computation showing the method by which any price changes were calculated pursuant to the provisions of this Article. In the event that Buyer is not satisfied with the computation of the adjustments, Buyer shall promptly notify Seller in writing of those portions of the computations with which it is not in agreement. The parties shall meet within ten (10) days of such notification in an effort to arrive at a mutually satisfactory computation.
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> If the meeting of the parties does not resolve the matter, they shall immediately refer same to a national independent accounting firm, selected by mutual agreement of the parties for the purpose of arriving at the correct computation. Seller agrees to provide the independent accounting firm with all necessary information it requests to enable it to arrive at its computation. The findings made by the independent accounting firm shall be final and binding on all parties. During the period of verification of the computations, Seller shall continue to ship hereunder and neither party shall be required to pay any part of the adjustment in question, provided, however, that when the matter is finally determined by the parties or the independent accounting firm, the paying party shall also pay interest at the rate of 1% above the First National Bank of Chicago prime rate in effect fifteen (15) days after the date of first billing by Seller, to which such adjustment was applicable, for the period beginning on the fifteenth (15) day after such billing and ending on the date of actual payment.

(Emphasis supplied.)

Two relevant points can be made with reference to Article IX of this agreement. First, under the structure of this provision, Black Butte calculated changes which resulted in a new "current price." While Commonwealth Edison was free to challenge these changes and could, during the period of this challenge, decline to pay the amount of the adjustment, the pendency of such a challenge did not effect a new "current price." Rather, it merely suspended the requirement that Commonwealth Edison pay that price "during the period of verification." Thus, since the "current price" for coal delivered during the entire period of the controversy was the price as

adjusted by Black Butte, Black Butte should have been tendering royalties to the United States on that basis, even under its interpretation of the lease. Since it did not, it is properly assessed interest on this ground alone.

Second, while Article IX provided a mechanism for a speedy resolution of controversies which might arise over price adjustments, Black Butte, to the considerable detriment of its lessor, the United States, failed to avail itself of the mechanisms provided therein with the result being that a controversy which could have been settled within a few months dragged on for more than 4 years. Assuming Black Butte's analysis of lease W-6266 was correct, the longer the delay in settling the controversy, the longer the period of time the United States was deprived of the use of the money properly owing to it. Indeed, under Black Butte's interpretation, it was in Black Butte's economic interest to delay settlement of its disagreement with Commonwealth Edison as long as possible since, by doing so, Black Butte would eventually acquire that portion of the interest payments attributable to the royalty interest's percentage of the price adjustment. And, the record would certainly support a conclusion that Black Butte's actions were fully consistent with the attainment of such a result.

We have noted in the past that, where royalty payments are dependent upon the price at which a product is marketed, mineral lessees have an obligation to exercise good faith in obtaining the best price possible. See generally Transco Exploration Co., supra. Where, as under the lease interpretation espoused by Black Butte, the interests of the lessor and lessee diverge, this obligation is strictly enforced. See, e.g., Harding v. Cameron, 220 F. Supp. 466 (W.D. Okla. 1963); Amoco Production Co. v. First Baptist Church, 579 S.W.2d 280 (Tex. Civ. App. 1979). It seems to me clear that, either the lease herein must be interpreted as including late interest payments received by Black Butte within the concept of "gross value" for royalty purposes or that Black Butte has breached its obligations of good faith dealing with its lessor. In either case, Black Butte is properly assessed monies to compensate the Government for its failure to timely receive in full the royalty payment owing to it.

For the foregoing reasons, I concur with the disposition of this appeal.

James L. Burski
Administrative Judge