SODIUM/POTASSIUM SUBCOMMITTEE REPORT ON PRODUCT VALUATION PRINCIPLES

The proposed draft regulations (draft) are consistent with the statutory requirements of the Mineral Leasing Act in valuing sodium and potassium compounds at the point of shipment to market. The draft was developed after consideration of all points of view expressed by interested parties based on the following:

Principles

- The price arrived at in the open marketplace between unrelated parties should form the basis of royalty value.

- All processes before the lessee places the product in marketable condition are production processes, and the cost of these processes should be borne by the lessee.

- Royalty shall be assessed on the value of lease production at the location where the product is placed in marketable condition.

- The basis of these royalty principles is that royalty is due on the first marketable product and not due on other value-added processes or components, such as transportation, packaging, or other raw materials used to produce derivative products.

Unique beneficiation requirements for sodium and potassium minerals

- The subcommittee recognizes that ore bodies differ in mineral composition, depth, purity, etc.; therefore, the techniques that the lessee uses to mine and process ore minerals to finished products must be considered in valuing lease production.

- Unlike most minerals, sodium and potassium minerals require extensive beneficiation prior to point of shipment. Although the majority of the mineral can be processed directly to a finished product ready for shipment to market, some of the mineral is used as feedstock to produce manufactured products. When feedstock is used in these cases, point of shipment is the point at which it is consumed to make the derivative product. Feedstock is valued on a weighted average basis as if it had been processed into a finished primary product at the normal point of shipment to market.

- In order to better understand the steps required for beneficiation, the draft defines primary, derivative, and intermediate products as follows:

A primary product is the first material processed into a marketable condition after the ore mining process. Any beneficiation to improve the quality/grade does not change the primary designation unless dissolution followed by purification and recrystallization occurs. When the process normally used to produce a primary product is interrupted and the in-process product is consumed to make derivative products, the in-process product (feedstock) is termed an intermediate product. When the primary product is dissolved and recrystallized or the chemical composition of the primary product is changed, the primary product ceases to exist and all subsequent products are designated as derivative.

Affiliation--ownership and control, and valuation

- The draft is consistent with the current oil valuation regulations regarding ownership and control, and proposes that the ownership control threshold be at 50%, where ownership in excess of 50% constitutes control; 50% or less creates a presumption of non-control that MMS can rebut. If there is no control, sales between parties are arm's-length. Where ownership is less than 50%, MMS must prove control to prove that a sale is non-arm's-length. Currently the onus is on the company to disprove control.

- The draft addresses valuation when lease production is sold to an affiliate:
  --If the affiliate sells lease production as a primary product, then the affiliate's resale price is the basis for royalty value.
  --If the affiliate sells lease production as a derivative product, then the value of lease production is based on arm's-length sales prices of primary product.

Allowable deductions

- The draft specifically describes what deductions a company may claim—transportation, packaging, and reagent—and describes the methods for claiming the deductions.

- Transportation deductions would be allowed for the actual transportation costs of a finished product in full. Transportation from the point of extraction to the processing facilities and between processing facilities is considered part of processing, and the costs of that transportation are not eligible for deduction.

- Packaging deductions would be allowed for the actual costs of packaging finished product. The lessee would also be given the option to base packaged product royalties on the average sales price of the product sold in bulk.

- Reagent deductions would be allowed on products containing reagents; calculations are based on the weight of the product sold less the weight of the contained reagent. No reagent deduction is allowed if the lessee's reagent replaces a component of the ore that the lessee loses in processing.

Other significant provisions

- To be consistent with other product valuation regulations, the draft replaces the term "bona fide" with the term "arm's-length."

- The draft defines the statutory term gross value and specifies the types of compensation that are included and excluded.

- Royalty payments may be paid either when a product is shipped or sold. Once the lessee has chosen a method, the lessee must continue that method unless MMS approves a change.

- Lessees must submit their sales contracts to MMS when requested. If the lessee sells or transfers lease production to an affiliate (or through an affiliate to another), those affiliates are subject to the same contract submittal requirements. If MMS provides contracts or other records to Federal or State agencies, MMS must inform the lessee.

These regulations are comprehensive yet easy to follow, simple, and specific to the mining, processing, and marketing of sodium and potassium compounds. It has been our desire and goal to specify valuation methods for all current and foreseeable sales and consumption scenarios. The subcommittee has accomplished its goal.