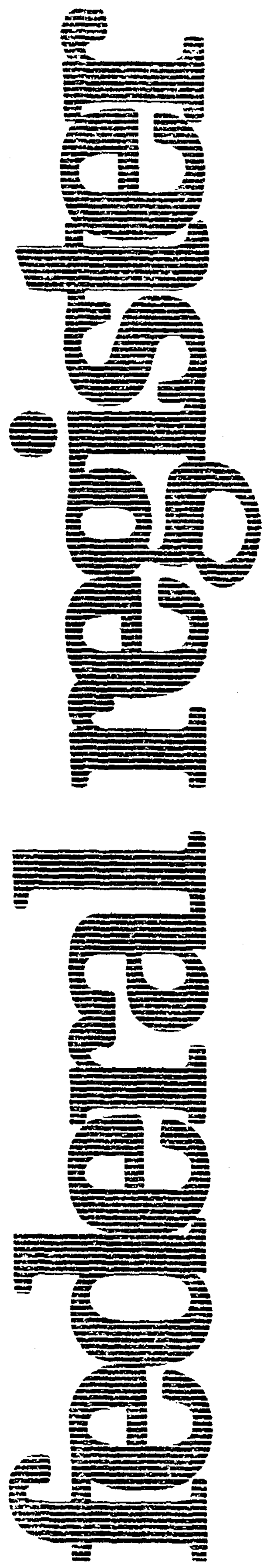

Friday
January 13, 1989

Part II

Department of the Interior

Minerals Management Service

30 CFR Part 202, 203, 206, 210, and 212
43 CFR Part 3480
Revision of Coal Product Valuation Regulations and Related Topics; Final Rule

DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Parts 202, 203, 206, 210, and 212

43 CFR Part 3480

Revision of Coal Product Valuation Regulations and Related Topics

AGENCY: Minerals Management Service (MMS), Interior.

ACTION: Final rule.

SUMMARY: This rulemaking provides for the amendment and clarification of regulations governing the valuation of coal for royalty purposes. The amended and clarified regulations govern the methods by which value is determined when computing coal royalties under Federal coal leases and Indian (Tribal and allotted) coal leases (except leases on the Osage Indian Reservation, Osage County, Oklahoma). The revised regulations will result in consistent and uniform guidance to industry relative to the valuation of coal for royalty computation purposes.

EFFECTIVE DATE: March 1, 1989.

FOR FURTHER INFORMATION CONTACT: Dennis C. Whitcomb, Chief, Rules and Procedures Branch, (303) 231–3432, (FTS) 326–3432.

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

I. Introduction

A notice of proposed rulemaking for coal product valuation regulations was published in the **Federal Register** on January 15, 1987 (52 FR 1840), with a 90-day comment period. The public comment period was reopened on July 9, 1987. Additional comments were accepted through July 23, 1987 (52 FR 25887). A total of 136 comments were received from industry representatives, elected members of Congress, State governments, local governments, Indian Tribes, Indian organizations, and other persons.

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

On August 12, 1987, MMS published a notice in the **Federal Register** (52 FR 29868) reopening the public comment period for 69 days primarily to obtain public comments on a proposal submitted jointly on behalf of the coal and electric utility industries. This proposal included a comprehensive, section-by-section set of revisions to the January 1987 proposed rulemaking. The MMS received 48 comments on the industry proposal which are discussed in more detail below.

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

On June 7, 8, and 9, 1988, MMS held open meetings with representatives of the Western States, Indian Tribes, and the coal and electric utility industries to discuss a draft of this proposed rule. Several suggested changes and additions offered at those meetings were incorporated in a Further Notice of Proposed Rulemaking for coal product valuation regulations published in the **Federal Register** on July 15, 1988 (53 FR 26942) with a 60-day comment period. A total of 51 commenters comprised of representatives of State and local governments, other Federal agencies, the coal and electric utility industries, Indian Tribes, Indian Tribal organizations, individuals, and other organizations responded.

A public hearing on the proposed rulemaking was held during the 60-day comment period following the July 15, 1988, notice. Minutes of that September 7, 1988, meeting are included as comments on the proposed rulemaking.

Except for the addition of the severance tax exclusion from coal value at § 206.257(b)(5), the regulatory provisions in this notice have not changed significantly from the July 15, 1988 proposal. Therefore, we are not repeating the preamble discussion in this notice. Interested parties should refer to the July 15, 1988, notice (53 FR 26942).

II. Purpose and Background

These rules supersede all currently effective coal royalty valuation directives, such as those contained in numerous Secretarial, MMS, and U.S. Geological Survey Conservation Division (now Bureau of Land Management Onshore Operations) decisions and orders. These rules apply to production on or after the effective date of the final rule for all leases.

Structurally, these rules add sections to 30 CFR Parts 202, 203, and 206, revise §§ 206.10 and 210.10, revise subpart titles in Part 212, and remove paragraphs from 30 CFR 203.250 and 43 CFR 3485.2. Paragraph (b) of § 203.250 is redesignated to Part 202 at § 202.250.

For the convenience of coal lessees, payors, and the public, the following chart summarizes the regulation changes:

Regulation changes (all from 30 CFR, except as noted)	Descriptions
I. Redesignations	
1. Paragraph (b) of § 203.250 is designated to Part 202 as § 202.250	This administrative action more appropriately locates within 30 CFR the information contained in this paragraph.
2. Paragraph (a) of § 203.250 is redesignated as § 203.250	This administrative action removes the paragraph designation.
3. Paragraph (j) of 43 CFR 3485.2 is redesignated to 43 CFR 3485.2(d)	This action resulted from the deletion of paragraphs (d) through (g) of 43 CFR 3485.2(d).
II. Deletions	
1. Paragraph (c), (d), (e), (f), (g), (h), (i), (j), and (k) of § 203.250 are removed	This action eliminates the existing coal product valuation regulations.
2. Paragraphs (d), (e), (f), (g), (h), (i), and (k) of 43 CFR 3485.2 are removed	This action eliminates the existing coal product valuation regulations found at section 3485 of 43 CFR. These regulations are redundant with those at § 203.200 of 30 CFR Part 203, and would conflict with the new regulations intended to replace those in § 203.200.
III. Additions	
1. New section numbers 250 through 265 are added to Subpart F of Part 206	The addition of these sections provides new coal valuation regulations to replace those currently found at 30 CFR 203.200 and 43 CFR 3485.2.
2. The following new subparts are added to Part 212:. Subpart H—Geothermal Resources—[Reserved]. Subpart I—"OCS Sulfur [Reserved].".	This administrative action creates new subparts for future rulemaking requirements.
IV. Amendments	
1. Section 206.10 is amended to reference 30 CFR 210.10 for information collection requirements contained in 30 CFR Part 206	This administrative action places the information collection requirements in 30 CFR 210.10.

Regulation changes (all from 30 CFR, except as noted)	Descriptions
2. Section 210.10 is amended to include all information collection requirements, except for the Production Accounting and Auditing System (PAAS) and Royalty-In-Kind (RIK)	This administrative action places most information collection requirements in 30 CFR 210.10.
3. The titles of Subparts C, D, F, and G under Part 212 are revised to read: Subpart C—Federal and Indian Oil—[Reserved]. Subpart D—*Federal and Indian Gas*—[Reserved]. Subpart F—Coal—[Reserved]. Subpart G—Other Solid Minerals—[Reserved]	This administrative action creates new subparts for future rulemaking requirements.
4. Paragraph (b) of § 212.200 under Part 212 is amended	This technical amendment deletes the obsolete reference to the "District Mining Supervisor" and replaces the word "Associate Director for Royalty Management" with the word "MMS" for consistency with other parts.

These rules largely continue past practice for coal valuation. Two exceptions to this generalization are notable. Under these rules, lessees may deduct from gross proceeds their costs of Federal Black Lung excise taxes, abandoned mine lands fees, and severance taxes. However, these deductions are only available to Federal lessees, and are not available to lessees of Indian tribal or allotted lands. Secondly, Indian cents-per-ton royalty provisions are included in these rules. Royalty provisions also appear in Title 25 of the Code of Federal Regulations at 25 CFR 211.15(c), 212.18(c), 213.23(c), and 214.10(b).

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

The Mineral Leasing Act (MLA), as amended specifically by the Federal Coal Leasing Amendments Act of 1976 (FCLAA) requires that:

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

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

Valuation has long been described as the process of determining the worth of, or setting a price upon, anything. In the U.S. economic system, value has often been closely associated with market value. This means that the value of any good or service in terms of economics is defined by its ability to command other goods or services in exchange. The most common medium of exchange is money. Therefore, many economists signify the value of a good or service by the amount of money which it will command, in other words its value in terms of the commonly accepted medium of exchange.

The concept of establishing values based on the transactions of the marketplace and the benefits of market competition are well known. The Supreme Court summarized the positive effects of competition when it said: "Basic to faith that a free economy best promotes the public weal is that goods must stand the cold test of competition; that the public, acting through the market's impersonal judgment, shall allocate the nations's resources and thus direct the course its economic development will take." *Times-Picayune Co.* v. *United States,* 345 U.S. 594 (1953).

The regulatory approach to royalty valuation of the these final rules recognizes the existence of a market economy and subscribes to the premise that the private sector is presumed to be the most appropriate economic agent vis-a-vis Government planning and direction. Hence, in deference to the market concept, MMS accepts the principle that the most effective and efficient value-setting mechanism is the value set by competition in the free market.

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

III. Response to General Comments Received on Proposed Coal Product Valuation Regulations and Related Topics

The notice of proposed coal valuation regulations was published in the **Federal Register** on January 15, 1987 (52 FR 1840). The public comment period was reopened from July 9, 1987, through July 23, 1987. On August 12, 1987 (52 FR 29868), MMS reopened the public comment period for 60 additional days to receive public response on a comprehensive alternative valuation proposal, which was submitted jointly by representatives of the coal and electric utility industries. On November 17, 1987 (52 FR 43919), MMS gave notice that it intended to issue a further notice of proposed rulemaking. In that notice, MMS explained that it had received many comments throughout the comment periods. The MMS also stated that some comments had been received after the close of the 60-day period following the August 12, 1987, notice. The MMS concluded by stating that all comments received since the January 15, 1987, proposed rulemaking and until the deadline of the planned further notice of proposed rulemaking would be accepted. On July 15, 1988, MMS published the further notice of proposed rulemaking (53 FR 26942). All comments postmarked by September 13, 1988, which was the closing date of the comment period, were accepted and included in the rulemaking record.

The MMS received many diverse comments on the principles underlying the proposed valuation methodology. Some comments were directed to proposing alternative valuation methodologies. These comments did not address specific sections of the proposed regulations. The general comments were categorized into 7 issues plus a section on other miscellaneous comments, which are addressed first. Following that discussion, MMS will discuss comments received pursuant to specific sections.

General Issue 1: The Ad Valorem Royalty Rate

Comment: One issue that permeated many of the comments, but which is unrelated to coal valuation, concerns the royalty rate. Several commenters from industry and States concluded that the 12½ percent royalty rate was too high thus placing an unfair financial burden on lessees, which in turn places them at an economic disadvantage. One State commented that royalty rates, in concert with valuation of deep-mined coal, place underground mines at a disadvantage,

and the 8-percent royalty rate "should be lowered accordingly to a maximum rate of 5 percent, but more equitably, a lower rate should be adopted by legislative action."

MMS Response: The royalty rate is not a valuation issue. The 12½ -percent royalty rate imposed on surface coal operations is required by statute. The Mineral Leasing Act (MLA), as amended by the Federal Coal Leasing Amendments Act of 1976 (FCLAA), requires the Secretary of the Interior to determine a royalty "of not less than 12½-per centum * * * except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations." The Bureau of Land Management (BLM) regulations at 43 CFR 3473.3–2 require a royalty rate of 8 percent for coal from underground mines, with the provision to determine a lesser rate if conditions warrant, but in no case less than 5 percent. It is now well settled that BLM has the authority to readjust Federal coal leases and that FCLAA and its implementing regulations apply to pre-FCLAA leases.

Coastal States Energy Co. v. *Hodel,* 816 F.2d 502 (10th Cir. 1987); *FMC Wyoming Corp.* v. *Hodel,* 815 F.2d 496 *(10th Cir. 1987);* Ark Land Co., 97 IBLA 241, 244 (1987); *Coastal States Energy Co.,* 94 IBLA 352 (1986); *Gulf Oil Corp.,* 91 IBLA 93, 96 (1986); *Ark Land Co.,* 90 IBLA 43, 45 (1985). The MLA at 30 U.S.C. 209 provides statutory authority to reduce royalty rates for those lessees that cannot successfully operate their leases under the prevailing terms and conditions. The MMS notes that BLM has been attentive to industry's concerns regarding royalty rates. The BLM issued a procedural document concerning guidelines for royalty rate reduction on June 26, 1987 (52 FR 24347, June 30, 1987). By **Federal Register** notice dated August 5, 1988 (53 FR 29586), BLM gave notice of its intent to expand royalty rate reduction guidelines to accommodate and facilitate expedited administrative handling of certain reduction applications. By **Federal Register** notice dated July 29, 1988 (53 FR 28822), BLM announced a proposed rulemaking to amend royalty rates for underground mining operations.

General Issue 2: Valuation of Coal Under Some Form of a Cents-per-Million British Thermal Units (Btu) Valuation Procedure

Comment: During the initial comment period following the January 15, 1987, proposed rules, MMS received several comments from industry that advocated a royalty valuation procedure based exclusively on the coal's heat content. That value would be expressed in cents-per-million Btu. Additional comments were received after the July 15, 1988, notice, which further clarified how the procedure was envisioned to function. Other comments were received expressing either support or opposition to this alternative valuation procedure.

Simply stated, the cents-per-million Btu valuation that industry proposed would operate as follows: (1) An initial average value of all Federal surface-mined coal would be established by dividing the monies received for Federal surface-mined coal—less transportation and washing expenses, Federal fees and taxes, State and local taxes, and royalties—by the total number of million Btu's sold. No price adjustment would be made for the sulfur, ash, or moisture content of the coal. (2) This average value would be tied to a current economic index and would fluctuate annually with the rise and fall of that index. (3) Thereafter, a Federal lessee would pay a set royalty, adjusted to compensate for the index fluctuation, based only on the number of Btu's contained in the coal sold or consumed. (4) Metallurgical coal, which is not sold on a heat content basis, would be exempted from the cents-per-million Btu method. (5) No recommendation has been made as to how coal sold under a non-arm's-length contract, or coal consumed by the Federal lessee, would be valued to establish the initial cents-per-million Btu figure. Further, no recommendation has been made for valuing underground-mined coal.

One State commenter agreed with and three other industry commenters supported the cents-per-million Btu valuation procedure. These commenters generally rationalized that the procedure was preferable to MMS's "gross proceeds approach" because it is easy to administer and is more equitable because it separates value from the cost of mining.

MMS Response: The MMS has thoroughly examined this proposed procedure and has concluded the proposal may not represent the market value. The following table illustrates the result of adopting a standardized coal value of $1.00 per million Btus, which would be applicable to all leases.

Field/Area	Btu/lb	Standardized value/short ton at $1/MMBtu	Average market value/short ton (1985)
Fort Union (ND)	6,500	$13.00	$9.30
Powder River (WY)	8,400	16.80	8.67
Uinta (CO, UT)	11,000	22.00	27.69

As shown in this brief example, this procedure derives values that to not accurately represent the coal market. From this example, it appears that the procedure is biased against low Btu coal.

Apart from the inherent flaws embedded in the pricing mechanism, it fails to recognize that coal has never been, or likely ever will be, valued solely for its heat content. Moisture, ash, and sulfur often represent critical quality factors that must be taken into account by electric utilities prior to the purchase and consumption of coal. For example, the January 1987 issue of *Energy* (Volume XI), published by Sun-Progress Inc., states, "Scrubbers placed in the stacks at generating plants are needed to remove the pollutants from the emissions and, depending on the quality of sulphur and ash, can account for up to a third of a generating plant's expenses."

The MMS also concluded that the development and selection of a single dollar amount per million Btu would not be easy and could gravitate into a highly complex, labor intensive exercise. For instance, detailed procedures would have to be developed to explain how the base value is to be derived. To be equitably, other indexes would have to be developed to compensate for variables such as moisture content, ash, sulfur, and so forth.

General Issue 3: Grandfathering of Certain Agreements and Arrangements Under the Final Rules

Comment: Some industry comments received after the initial January 15, 1987, proposed rulemaking stated that all existing coal sale contracts or supply agreements should be "grandfathered" under any new royalty scheme. Under this approach, any such coal sales contracts would be subject to the royalty requirements in effect at the time the coal supply contract was executed. One of these comments cited the Interior Board of Land Appeals (IBLA) support for this position by quoting *Kanawha & Hocking Coal & Coke Co.,* 93 IBLA 179, at 183 as follows: "The method of calculating the value of coal for royalty purposes shall be that method set forth in the regulation on the effective date of readjustment, and any subsequent regulatory change will not alter that method." Similarly, two industry commenters requested that only leases readjusted after these rules become effective should be subject to these regulatory requirements. Other respondents raised this issue again in comments submitted specific to § 206.250(b).

In the preable to MMS's July 15, 1988, notice, MMS explained that it was its intent that absent specific lease terms that set forth valuation criteria, the proposed rules, when final, would govern the valuation of coal from Federal and Indian leases. However, MMS noted that there are some lessees with contracts that pre-date the Federal Coal Leasing Amendments Act (FCLAA) of 1976 and that do not have reimbursement provisions common to contracts after FLCAA's enactment. The MMS requested comments on whether there is a way to grandfather these contracts that would be consistent with the requirements of FCLAA and the MLA.

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

The MMS received comments that included examples of situations that the commenters believed should not be subject to royalty under the final rules. These examples are:

1. *Transfer of water rights.* One comment stated that the mine transferred water rights as part of the consideration included in the negotiated coal sales contract. The commenter asserted that the water rights represented 8.3 percent of the coal's sale price and should be royalty exempt.

2. *Services provided by the purchaser that are typically the responsibility of the lessee.* Several lessees explained that because of the proximity of the mine to the power plant and because of long-standing operating relationships between the mine and power plant, the utility was crushing the coal on behalf of the lessee. In other instances the commenter explained there exists shared ownership of coal mine equipment such as draglines or coal mine facilities such as loadout facilities and primary crushers. The commenters insisted that these services, which represent noncash elements of value and would be subject to royalty under these final rules, should be royalty exempt since these agreements precede the effective date of these rules.

3. *Lump sum prepayments.* One commenter explained that a lump sum prepayment had been received to cover mine start-up capitalization costs. This commenter stated that since the payment was made prior to these rules, it should not be subject to royalty. This comment further explained that the lump sum payment "had nothing whatsoever to do with royalty avoidance," and that the payment does not affect the sales price.

On a more general note, one State commenter offered the suggestion to pay under the final regulations only if those royalties would be less than that payable under the prior regulations. This commenter stated that this procedure should be used in those situations where the lessee's sales contract has not pass-through provisions.

MMS Response: The State commenter's proposal is administratively infeasible and would constitute an extreme audit burden. Moreover, the lessee's royalty reporting burden would effectively be doubled, because each reporting month the lessee would be required to perform an accounting under two sets of regulations to determine its royalty payment.

The MMS's position with regard to any form of consideration paid under a coal supply contract, for the sale of produced coal, is that such consideration is part of the value of coal and is therefore subject to royalty. In this regard, the final rules represent a continuation of existing policy, except for the exclusion from royalty value for costs of Federal Black Lung excise taxes, abandoned mine lands fees, and severance taxes, as provided for at § 206.257(b)(5). The MMS has an established record under prior royalty valuation rules of aggressively pursuing royalty collections in those situations where the lessee has been receiving noncash benefits from its customer under coal sales agreements. Likewise, MMS has operated under a long-standing policy of accepting nothing less than the gross value received by the lessee for the sale of coal. With regard to the comment which referred to the lump-sum payment received to cover mine start-up capitalization costs, if the commenter's representation that the payment did not affect the contract sales price for each ton of coal were in fact true, then the payment may not be royalty bearing. However, it is MMS's experience that in most situations these kinds of costs are recovered through the contract sales price and therefore are in fact consideration for coal production. In such a situation, MMS would require royalty to be paid on some or all that lump sum. The reason for MMS's position is that a royalty is due on the value of production in marketable condition. The lessee is obligated to incur all costs to bring the coal production to that point, inlcuding all of the mine development costs, production costs, and costs of making the production marketable. If the buyer receives coal and in exchange transfers consideration to the lessee to reimburse it for any of the above-described costs, then that payment is part of the value of the production. Hence, it is subject to royalty.

A corollary issue is whether all or only a portion of such a one-time payment is royalty bearing. First, no royalty would be payable unless and until there is coal production. Once there is production, the lump-sum payment must be equitably pro-rated. If the contract includes a repayment clause or other applicable provision, that would be used. This would require an examination of the contract terms on a case-by-case basis.

However, if the contract does not contain a repayment clause or other applicable provision, MMS will develop a schedule to amortize the payment over the full tonnage deliverable over the life of the contract. If the contract terminates prematurely, royalty may not be due on the full lump-sum payment. By way of illustration, assume a $12 million lump-sum payment for start-up capitalization costs. Assume further that the contract is for 12 years and the anticipated take, based on full utilization of the customer's installed capacity, is 1 million tons/year. One possible equitable allocation method could be to allocate $1 of the lump-sum payment to each ton of production. If the contract were to terminate after 8 years, royalty may be due on only two-thirds of the lump-sum payment.

Therefore, MMS generally considers payments under a contract to be payment for coal production and royalty bearing. However, the lessee has the opportunity to rebut that presumption and demonstrate that the payment was not for coal production. *See* discussion below regarding § 206.257(b)(6).

With regard to the language quoted above from the IBLA in *Kanawha & Hocking Coal & Coke Co.*, the discussion was with respect to a particular lease provision. Therefore, the IBLA's statement is not relevant to the vast majority of coal leases which do not have the same provision.

General Comment 4: Valuation of Coal Under the Joint Proposal by Coal and Electric Utility Industries

Comment: The industry comments were submitted as a joint proposal by six groups representing the coal producers and electric utilities. This proposal included a comprehensive, section-by-section set of revisions to the January proposed rulemaking, including a justification for the suggested modifications. The most significant

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

The Department received a considerable number of comments on the joint industry proposal. A letter from the Governor of Montana, representing personal views and those of the Governors of Colorado, New Mexico, and Wyoming, generally opposed the joint industry proposal and supported continued reliance on the proposed valuation procedures. Several Governors subsequently wrote individual letters to express personal opinions where their views differed from that of the consensus view. The Governor of Wyoming and the Governor of Colorado indicated they could support exclusion of royalty reimbursements from gross proceeds to address the "royalty on royalty" issue. The Governor of Utah suggested that a depletable income method may be incorporated into the hierarchy of MMS's gross proceeds valuation framework. However, he stated that the depletable income method "should not reduce the fair market value or the royalty amount derived from the coal."

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

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

The Assistant Attorney General for Natural Resources, The Navajo Nation, offered comments to the Subcommittee on Mineral Resources Development and Production during the Oversight Hearing on Proposed Coal Product Valuation Rules on November 16, 1987. The Assistant Attorney General opposed the joint industry proposal, stating: "Industry's deletion of the concept of 'gross proceeds' for royalty payment purposes is inconsistent with the concept underlying the present valuation regulations—that royalties from ad valorem leases be based on a percentage of gross proceeds. We urge MMS to retain the 'gross proceeds' methodology for valuation."

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

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

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

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

2. The Joint Industry Proposal Creates New Auditing Problems

The Joint Industry Proposal would be a new and complex approach to coal royalty valuation determinations. It is significantly different from the existing valuation methodology used for coal and other minerals. As a result, MMS (as well as State and Indian) auditors would be required to relearn an entirely new system. This necessarily would delay many audits.

General Comment 5: The Advice of the Royalty Management Advisory Committee Was Ignored

Comment: Some commenters stated that in the January 1987 proposed rulemaking, MMS neither acknowledged nor adopted the Royalty Management Advisory Committee's (RMAC's) recommendations concerning coal product valuation. These commenters also stated that MMS did not provide its reasoning for not accepting RMAC's recommendations. Several commenters reiterated this position following the July 15, 1987, notice.

MMS Response: These comments are not supported by the record. The January 15, 1987, (52 FR 1840) **Federal Register** notice states that "MMS also has considered the written and oral comments from the public on the draft rules and the resolution presented to the Secretary by RMAC." The MMS also noted with appreciation the dedicated efforts of all participants who worked on the problems of coal valuation. The MMS considered the section-by-section analysis that preceded the proposed rules adequate explanation and notice to the public, including RMAC, of the substantive reasoning and motivation that guided the formulation of the proposed rules.

General Comment 6: Royalty On Take-Or-Pay and Other Similar Type Payments

Comment: The MMS received many comments concerning the inclusion of take-or-pay payments in the proposed gross proceeds definition. Four commenters, two Indian and two States, expressed support for the inclusion of take-or-pay payments as part of gross proceeds. One commenter reasoned that the inclusion was proper "since the other contractual terms may be affected by inclusion of such language in the

selling agreement." Another commenter stated that gross proceeds "does not simply mean the amount received by the lessee. Rather, it must have an expansive definition to include any consideration * * * including any minimum payments, stand-by fees, or take-or-pay payments." Other commenters recommended that the gross proceeds definition stand as proposed with respect to including take-or-pay payments, but offered no additional reasoning or support.

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

With regard to the comments citing MMS's lack of statutory support to collect royalties on take-or-pay payments, one commenter noted that "The plain language of FCLAA (30 U.S.C. 207) ties royalty assessment to the value of recovered coal." Other commenters echoed this view. Another commenter stated that the MLA does not allow royalty collection "on coal not mined, produced and sold." Another commenter stated that "The statutory authority to include in production royalties payments made on 'take-or-pay' provisions as if they were 'advance royalties' is certainly subject to question." The commenter further noted that payment of advance royalties is controlled by 30 U.S.C. 207(b). The commenter concluded: "Since advance royalties can only be accepted in lieu of continued operation—one percent of commercial quantities of recoverable coal reserves * * * if an operator is producing the required one percent, section 6 [of FCLAA] would prohibit the lessee from reducing his production royalty payment by the amount of his 'take-or-pay' payment, since these payments are not, by statute, considered 'advance royalties.' "

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

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

In the July 15, 1988, notice (53 FR 26951), MMS requested further comments as to whether the following payments identified by industry should be subject to royalty:

1. Damages recovered under a court judgment for the purchaser's breach of the sales contract;

2. Payments made under a force majeure clause;

3. "Settlement" payments made to terminate a sales contract before the contractually-specified termination date; this includes situations where there may or may not be a follow-on contract;

4. Payments for assignment of an interest in the lease;

5. Payments not designated as part of the purchase price but made on a periodic or regularly scheduled basis under the contract;

6. Payments not designated as part of the purchase price, which may or may not vary with the amount of coal delivered, and paid on a one-time or not regularly scheduled basis under the contract in a specific sum or calculated under a prescribed formula;

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

Many industry and several State comments agreed that absent any physical removal of the resource from the leased property, no royalty should be due on any type of payment received by the lessee. Five comments advocated the assessment of royalty on take-or-pay or similar type payments. Some commenters suggested that take-or-pay type payments should be royalty bearing but that royalty collection should be deferred until the time of production. One State commenter also suggested that interest should accrue on take-or-pay payments beginning at the time those payments are received by the lessee and until royalty is paid. One State commenter maintained that take-or-pay and similar type payments should remain in gross proceeds but its specific application causing an assessment of royalty would be contingent upon a finding that such payments are consideration for the sale of coal.

While industry commenters contended that most take-or-pay payments are to reimburse the lessee for the risk involved in the lessee's investment of capital into his mining operation, a Tribal representative stated that the lessor is also at risk. The lessor has committed his reserves to the mining operation and thus has a sizable risk and commitment to the operation. Therefore, for sharing in the risk inherent in the mining operation, the lessor should also share in all proceeds received by the lessee, including all take-or-pay payments.

Many comments cited the August 17, 1988, Fifth Circuit Court of Appeals decision in *Diamond Shamrock Exploration Co. et al v. Hodel*, 853 F.2d 1159 15th Cir. 1988), where the Court ruled in the context of natural gas royalties that royalty payments are not due on receipt of take-or-pay payments, but are only due when the purchaser takes so-called "make-up" gas (gas taken in excess of minimum quantities in later periods against the purchase price of which previous take-or-pay payments are credited).

MMS Response: The Department has not further appealed the Fifth Circuit's decision in *Diamond Shamrock*, and will apply the rationale of that decision for purposes of coal royalty valuation.

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.

For consistency within the body of the rules, 30 CFR 206.257(g) has been amended in part by deletion of the sentence, "If take-or-pay payments are a part of gross proceeds, no additional royalty shall be due if future make-up deliveries are taken, unless the purchaser is required to pay any additional amount because only a partial payment was previously made or as a result of price increases during the make-up period."

The MMS will not extend the Fifth Circuit's ruling beyond its holding to exclude from value and gross proceeds any payment received by the lessee not specfically denominated as purchase price, a position which the Fifth Circuit decision neither implies nor supports. Instead, the regulations at 30 CFR 206.257(b)(6) will provide lessees the opportunity to rebut the presumption that payments received by the lessee are not part of the total consideration paid for coal and, hence, are not royalty bearing. 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.

General Comment 7: Marketable Condition Requirement

Following the January 15, 1987, proposed rulemaking, MMS received numerous comments regarding the definition of marketable condition. Some commenters stated that the definition was so vague and subjective as to be meaningless. Some commenters advanced alternative approaches to the term marketable condition. Many industry commenters concurred with the alternative valuation proposal submitted jointly by the coal and electric utility industries. Under that proposal, royalty would be computed at the earlier point of either when coal has been extracted, crushed, and sized or when the coal is loaded for delivery. In actual application, royalty would typically be assessed after coal had been processed through the crushing and sizing circuit, since the alternative to sell run-of-mine uncrushed coal does not constitute common industry practice.

Several commenters expressed concern that MMS's valuation approach would assess royalty on beneficiated products such as coal that has been subjected to "deep thermal drying," or "coal pelletization."

In order to address these concerns, MMS added § 206.265 to the July 15, 1988, notice and specifically requested in the preamble that commenters respond as to whether the definition of marketable condition requires further development. Commenters were asked to propose specific changes to the proposed regulatory language.

No commenter responded directly to MMS's request for specific alternative language designed to clarify the definition of marketable condition. Several commenters stated that freeze-proofing and dust suppression were not elements of marketable condition but instead provided a service for the purchaser. One commenter stated that the sale of run-of-mine coal constituted coal in marketable condition because the purchaser accepts the coal in that condition. In this situation, it is the buyer (utility) that owns and operates the crushing facilities.

One Indian commenter stated that it is the buyer's specifications that establish marketable condition and, therefore, the value of all beneficiation should be included in the royalty value.

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

Other Miscellaneous General Comments

Comment: Several commenters expressed concern that deletion of redundant royalty provisions from 43 CFR 3485.2 would create confusion because of cross-references found in other sections of 43 CFR Part 3480.

MMS Response: The MMS agrees that some potential confusion could result if certain sections of 43 CFR Part 3480 continue to refer to portions of 43 CFR 3485.2 which would be deleted under a final rulemaking. The BLM will, as part of its normal ongoing housekeeping duties, ensure that 43 CFR Part 3480 is appropriately modified to eliminate cross-references to nonexistent sections.

Comment: The MMS received ten comments from industry and one comment from a State requesting that the proposed rules be withdrawn and that new rules be written. Eight other industry commenters stated MMS's proposed rules were too complicated and urged MMS to adopt simple rules. As one commenter explained, "there's no reason for excessively complex administrative procedures to determine what should be paid." In that same vein, three other industry commenters stated that the general intent of MMS's rules was not clear and that MMS should take additional measures to explain what the regulations would accomplish.

MMS Response: The MMS believes there is great public interest to be served by issuing updated, consolidated, and clarified regulations. With reference to the comment that the rules propose excessively complex procedures, MMS knows of no other procedure to communicate the necessary cost accounting and computation procedures imbedded in coal washing and transportation allowances other than the furnishing of detailed instructions and explanations. The MMS concludes that absent the detail furnished in these proposed rules, lessees would be placed at increased risk of applying improper coal valuation methods and of deducting erroneous coal washing and transportation allowances.

Comment: Twelve industry commenters, two State commenters, and one Indian commenter stated that the proposed rules constitute a major rulemaking as described under Executive Order 12291. The contention is that the proposed rules represent a significant change from the existing regulatory standard, thus, as one commenter described, mandating "a full and complete regulatory impact analysis." One comment from a State provided an opposite view stating, "I do not see these proposed regulations for valuation of coal as a profound change in the regulations already in effect or in the practice which is being used by the MMS * * *"

MMS Response: The Department has determined that these rules do not constitute a major rulemaking under Executive Order 12291. This determination obviates the need for a full and complete regulatory impact analysis.

Comment: Several commenters stated that MMS has not described the monetary impact associated with the proposed rules.

MMS Response: During the period from August 1987 to January 1988, the Department conducted an extensive review of monetary impacts associated with this rulemaking. The Department did not work in isolation but rather consulted extensively with several western coal States and with several industry representatives.

The Department recognizes that the exclusion of Federal and State production taxes will result in less royalty collections than if royalty were payable on the tax payments. It should be recognized, however, that future royalty collections are expected to continue to increase in both nominal and real dollars. Moreover, several factors act to reduce the negative impact on royalty, so that the ultimate reduction in the increase in future royalty collections is less than might first appear. Finally, the offsetting benefits attendant to excluding production taxes from the royalty base are sufficiently compelling that the Department believes the public interest is ultimately served by the exclusion.

The production tax exclusion applies only to ad valorem coal production, and has no impact on the cents per ton royalties paid prior to lease readjustment. Federal coal royalty collections increased from $6.4 million in 1976 to $101.1 million in 1986, a 1,480 percent increase because of increases in price and production (including the development of the Powder River Basin), and lease readjustments. Federal coal royalty collection increased by another 40 percent between 1986 and 1987, with little change in production (less than 2.5 percent). This large revenue increase was due to readjusting leases from the former cents per ton basis to the new ad valorem basis. Readjustments coupled with continued price decreases may increase 1987 revenues by more than 50 percent, reaching 220 percent of the 1986 collections level in 1990 when the readjustment process is expected to be largely complete. Rather than reducing royalties below current collection levels, the effect of the exclusion is to make the increase less dramatic—likely, 2,850 percent of the 1976 level rather than 3,350 percent, or 187 percent of the 1986 level rather than 220 percent.

The actual difference in Federal and State revenue collections, however, will be less than the potential difference in royalty collections. Royalties paid reduce taxable income for Federal and State income tax purposes. To the extent a coal lease is more profitable than it would otherwise be at higher royalties, a significant portion of that profit is absorbed by higher Federal and State income taxes. Moreover, it is expected that this increased profitability will also be reflected in higher bonus bids for coal leases. Finally, as discussed below, the exclusion is expected to make Federal coal more competitive in the market, resulting in some increase in production. This increased production will act to broaden the Federal and State royalty and tax base, resulting in higher revenue collections.

To the extent increases in royalties are "pass through" items in existing long-term coal supply contracts, the decreased collections will be reflected, on a dollar-for-dollar basis, in reduced electric utility generating costs and customer bills. To this extent, the ultimate beneficiary of the tax exclusion will be the consumer.

The Department believes that any remaining impact on royalty collections is more than offset by other local, regional, and national benefits. To the extent demand responds to price, the exclusion is expected to result in some increase in Federal coal production, as well as a reduction in the royalty related development delay. Similarly, the exclusion also results in a tendency to expand the geographic market for Federal coal, which may further increase production. Some of this increased Federal coal production may well come at the expense of increased oil consumption, thus fostering objectives of energy supply diversification and reduced dependence on foreign oil, with the attendant balance of payments benefits.

Additional local and regional employment and income benefits would

be realized to the extent that lower royalty payments contribute to making unprofitable operations marginally profitable. This would result in maintaining mines that otherwise might shut down. Since coal mining is part of the regional economic base in areas where it occurs, employment and income changes in coal mining affect jobs and incomes elsewhere throughout the region. For example, several studies have shown that for every 10 jobs in coal mining, between 6 and 10 additional jobs are created elsewhere in the region. Similarly, a recent study at the University of New Mexico shows that an increase in regional income of $2.46 would be expected for every dollar increase in net income from coal mining.

The MMS also conducted a similar analysis for Indian lands. However, this study is no longer relevant since under the final rules Indian leases will not be subject to the AML fee, Black Lung excise tax, or severance tax exclusions.

Comment: One Indian commenter asserted, "The Assumption that the Lessee will Advance the Interest of the Royalty Owner is Not Grounded in Fact." The comment supported this position by stating that the underlying assumptions such as an open marketplace for coal, the existence of arm's-length sales contracts, and that the lessee always acts to maximize its revenues, are "simply not true."

MMS Response: The MMS disagrees with the assertions of this comment.

There is an operative open marketplace for coal in the United States. The existence of arm's-length coal sales contracts between coal producers and electric utilities, steel mills, export coal buyers, and other coal users is a commonplace occurrence. Business literature is replete with explanations of goals and objectives of American business. Typically a firm will endeavor to maximize the value of a business by obtaining as great a price for its product as the marketplace will permit.

Comment: Many industry commenters stated that MMS had written the proposed coal product valuation regulations based on oil and gas industry principles. As stated in one comment, "By attempting to overlay existing oil and gas valuation concepts on the federal coal royalty program, MMS has arbitrarily ignored the physical properties of coal, realities of coal production, and basic business principles." Many commenters followed these objections by asking that MMS withdraw the proposed regulations and rewrite regulations more specific to coal.

MMS Response: The MMS considers the coal product value rulemaking as adhering to fundamental mining, preparation, and marketing precepts common to the entire extractive minerals industry.

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

MMS Response: The final rules are a rational policy choice within the bounds of the Secretary's discretion. Since Congress did not specify how the royalty value should be determined, the Secretary has discretion to adopt a reasonable set of standards for royalty valuation. "[I]f the statute is silent or ambiguous with respect to the specific issue, the question * * * is whether the *agency's answer is based on a* permissible construction of the statute." *Chevron, U.S.A.* v. *Natural Resources Defense Council*, 467 U.S. 837, 843 (1964). A reviewing court will need not conclude that the agency's interpretation of the statute was the only permissible one, only that it was reasonable, and not arbitrary, capricious, or contrary to law.

In the case of *Motor Vehicle Manufacturers Association of the United States* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42 (1983), the court stated that "[r]egulatory agencies do not establish rules of conduct to last forever, and that an agency must be given ample latitude to adapt their rules and policies to the demands of changing circumstances." The agency is obliged to articulate a reasonable basis for its current position. The MMS has done so in this rulemaking.

Comment: Two State and one Indian commenter stated that the manner in which the proposed regulations are constructed essentially eliminates the protection of the existing regulations, and the self-implementing aspects of the proposed regulations invite industry abuse. These commenters further charge that MMS was abrogating its monitoring, review and audit responsibilities with respect to coal product valuation. On the other hand, one industry comment stated an objection to the "subjective determination elements [which] indicate a significant distrust by the government of the coal industry's past practices of valuation and accounting for royalty purposes."

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

Comment: After industry commenters stated that MMS lacked statutory authority to maximize the rate of return for "the public's resources" and that the regulations are "greedy," two State commenters took the opposite position, "demand[ing] that the Department establish royalty policies which do not undermine state and federal revenues, particularly at a time when revenues are already curtailed."

MMS Response: The MMS's acceptance of values established under arm's-length contracts cannot be characterized as "greedy." The arm's-length valuation standard is the most commonly utilized and the most accurate representation of any good's true worth and does not constitute an unusual valuation theory design to maximize the rate of return for the public's and Indian's resources at the expense of the coal industry. The use of arm's-length contract values maximizes the return to the public or the Indians to the extent that the lessee is also striving to sell coal at the highest profit it can attain. In this respect, MMS is sharing in the proceeds of contracts that are the results of the free will of coal lessees and their coal purchasers. Hence, the maximization of return to the lessor is

normally an unintended yet unavoidable result.

Comment: Many industry commenters stated that the proposed regulations do not promote development of Federal coal resources. An area of concern to these commenters is that these regulations discourage conservation of Federal coal. Two industry commenters stated that the proposed regulations would influence the economic behavior of the coal industry. One commenter offered its rationale for this position by stating, "The economic forces of the marketplace would move mine plans away from high royalty/high cost coal to lower royalty/lower cost coal or would hasten the closure or cessation of the mining of such federal coal reserves." One commenter also stated, "that MMS or BLM, is party to the ups and downs of the coal business and as such should work with the industry to improve market share as well as profitability." One comment stated that MMS failed to take into consideration the Mining and Minerals Policy Act of 1970, which states in part, "The Congress declares that it is the continuing policy of the Federal Government * * * to foster and encourage private enterprise in (1) the development of economically sound and stable domestic mining * * *." One State commenter and one Indian commenter suggested MMS should ignore any potential economic impacts that may result from the final coal valuation regulations. Opposing this viewpoint, one industry commenter concluded that MMS should consider the plight of the electric utility rate payer, who ultimately bears the full burden of any royalty increase.

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

Comment. Two industry commenters concluded that MMS is attempting to accomplish through administrative rulemaking what Congress should be doing through legislation. One industry commenter further explained that MMS's proposed valuation regulations "fly in the face of the clear congressional resolve and would properly be viewed as an 'end run' around Congress."

MMS Response. The MMS is not usurping the power of Congress. To the contrary, Congress' absence of specification on the issue of value reveals Congress' clear invitation to the Department of the Interior to measure the application of value by the needs of later days. The MMS, like all administrative agencies, is empowered to administer Federal statutes and prescribe necessary rules to place into effect the will of Congress. Title 30 U.S.C. 189 authorizes the Secretary of the Interior to "prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of this chapter * * *."

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

MMS Response. The MMS agrees that royalty terms in leases between private land owners and coal operators, or between States and coal operators, may differ significantly from Federal lease royalty terms. However, the applicability of these proposed rules is limited to Federal and Indian Tribal and allotted coal leases. See § 206.250. Similarly, valuation procedures or instructions contained in private or State leases do not pertain to Federal or Indian leases. It is the lessee's obligation to ensure that in situations of mixed mineral ownership, coal production is properly allocated between Federal, Indian and non-Federal and non-Indian leases.

IV. Section-by-Section Analysis and Response to Comments

Comments were not received on every section of the proposed regulations. Therefore, if any of those sections were not changed significantly from the proposal, there generally is no further discussion in this preamble. The preambles to the proposed regulation published on January 15, 1987 (52 FR 1840), and on July 15, 1988 (53 FR 26942) may be consulted for a full description of the purposes of those sections. For other sections, this preamble will address primarily the extent to which the final rule was changed from the proposal. Again, a complete discussion of the applicable sections may be found in the preamble to the proposed regulation.

Section 202.250 Overriding royalty interest.

Comment. Two comments, one from industry and one from a Federal agency, were received concerning overriding royalties. One commenter stated, "[A]lthough regulations limiting overriding royalties are in existence, the wholesale treatment of 43 CFR Part 3400 to override royalties cannot be done without violating express contractual rights of the owners of the overriding royalty interests." The other commenter asked, "[W]hat are the procedures for handling a case where the company grants an overriding royalty to another individual or company?"

MMS Response. Regulations pertaining to overriding royalty interests are presently found at both 30 CFR 203.200(b) and 43 CFR 3485.2(b). This rulemaking eliminates the redundant regulatory provisions from 30 CFR 203.200(b) (redesignated as 30 CFR 202.250) and clarifies that BLM is the proper agency to approve overriding royalty interests. See 43 CFR 3473.3–2 (1987). The specific provisions of 43 CFR 3485.2(b) are unaffected by these rules. Questions regarding procedures for obtaining approval of overriding royalty interests or similar types of production payments should be directed to BLM.

Section 206.250 Purpose and scope.

Comment. Following the January 15, 1987, proposed rulemaking, MMS received 18 comments from nine industry respondents and two Indian respondents on proposed § 206.250. One industry commenter recommended no change to the language of this proposed section. Four industry commenters agreed with paragraph (a). However, these same commenters also stated MMS had lost sight of the goals of valuing production stated in paragraph (a) later in its regulations by requiring royalty to be paid on take-or-pay payments. Two Indian commenters disagreed with the thrust of paragraph (a) stating that coal production from Indian tribal and allotted leases should

not be valued under the same criteria as Federal coal production. One Indian commenter stated that MMS had neglected to set forth in the proposed regulations MMS's trust responsibilities to the Indians. One industry commenter requested that the MMS "explain in the preamble to the final rules that coal must be allocated to each particular lease in the course of product valuation and royalty assessment."

MMS Response. In response to the concerns expressed by the Indians, MMS modified § 206.250 by adding paragraph (d) to this section to explicitly acknowledge the United States' trust responsibilities to the Indians. That modification was published in the July 15, 1988, notice.

In response to this modification MMS received several comments from Indians expressing approval.

The MMS believes the new valuation regulations, with the changes discussed in more detail below, are one way of meeting with the Secretary's obligations to Indian lessors.

With respect to industry comments regarding royalty on production, MMS has revised its position with respect to take-or-pay payments. See discussion above.

Comment: The MMS received two comments, one industry and one Indian, on proposed § 206.250(c). One commenter agreed with the proposed rule, finding that all royalty payments should be subject to audit and adjustment. The Indian commenter stated that "MMS' past audit record does not reassure the tribes that all royalties due will be collected."

MMS Response: The issuance of more detailed and clarified valuation regulations, as intended by these rules, will further enhance the productivity of MMS auditors.

Section 206.251 Definitions

The MMS received several comments on the proposed definitions in § 206.251. Not all of the definitions received significant additional comments. Also, comments on definitions already were addressed in the July 15 notice. Following are most of the original comments and MMS's responses.

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

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

"Allowance" *Comment:* The phrase "Coal washing allowance" appears in these proposed rules as an integral part of the definition of "Allowance." Many industry respondents recommended expanding the scope of the definition and changing the term "coal washing allowance" to "coal processing allowance." One commenter stated that this change was necessary to be consistent with the proposed revisions to § 206.260 [redesignated in the July 15, 1988, notice as §§ 206.258 and 206.259]. Many other commenters supported the proposed expansion for various similar reasons including the suggestions that "an allowance should be extended to all processing costs incurred downstream from the point of royalty determination" and to "other methods of beneficiation which may increase the value of coal * * *." Examples provided as other forms of processing included pelletizing, treatment with chemicals or oil, drying, crushing, and sizing.

MMS Response: The MMS acknowledges the existence of developing coal quality enhancement techniques other than the commercially available coal washing process. However, rather than transplant coal washing allowance procedures to other coal beneficiation technologies, MMS believes it is preferable to provide a rule that recognizes coal beneficiation processes other than coal washing for royalty valuation purposes. Section 206.265 was added to the July 15, 1988, notice to address these comments. The discussion of § 206.265 appears later in this preamble.

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

MMS Response: Coal washing is not necessarily practiced as an exclusive conservation measure. It is feasible for coal operators to wash coal to upgrade a first marketable product. Because the net effect of coal washing is to increase heat content and to provide a cleaner burning product by removal of ash and sulfur, an operator may desire to wash coal to extend its market reach or expand its potential customer base. The MMS considers any attempt to differentiate between washing as a conservation measure (to develop a first marketable product) and washing as a marketing tactic to be a needless expenditure of MMS's limited manpower resources. Allowances have been provided to coal lessees that wash Federal coal since the inception of ad valorem royalty rates. Indian coal washing has never occurred. However, allowances for washing Indian coal would equally apply. These rules increase the level of detail necessary to obtain coal washing allowances but otherwise would continue existing policy.

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

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

Comment: A few industry respondents recommended substituting the word "value" for the word "cost," because, as stated by one commenter, "it is the *value* of the coal processing activity that should be allowed by MMS—not just its cost."

MMS Response: The MMS believes these commenters have misconstrued the thrust of the regulations. The royalty owner and the lessee share in the value-enhancing of coal washing or coal transportation. As a matter of policy MMS has determined that it is appropriate to continue participation in the costs of washing or transporting the production from either Federal or Indian coal leases. Participating in washing or transportation costs in the form of

allowances results in a net reduction of the royalty payment, which is in itself a cost to the lessor. Therefore, the value of coal washing or transportation to the royalty owner is the increased value of the product sold, less the incurred costs to wash and/or transport coal.

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

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

One industry commenter recommended that the rules should provide that "a lessee may claim a transportation allowance * * * if a lessee is compelled for geographical, topographical, or other reasons to transport coal from a lease to mine facilities off the lease where it is sold." This comment also suggested granting a transportation allowance under any circumstances where coal is transported more than one mile from the Federal lease. One State commenter suggested that all transportation operations, on or off the lease, even if it is in-mine haulage, should be granted transportation allowances if the transportation occurs after the coal is in marketable condition. Another State commenter concluded that MMS should ensure that transportation allowances are not granted for in-mine haulage.

One industry commenter recommended that the transportation regulations should take into account the situation where in-mine transportation occurs, but the coal being transported is from another adjacent, but distinct, mine. This commenter concluded that transportation in this situation should be eligible for an allowance. Two other commenters, one State and one Indian, similarly recommended inserting the word "necessary," such that the affected portion of the regulation would read "means an allowance for the reasonable, actual, necessary costs incurred by the lessee * * *."

A few industry commenters recommended that the term "remote" is ambiguous and requires clarification. Two of these commenters also claimed the term "mine" required clarification. No suggestions as to additional clarifying language were offered.

MMS Response: The MMS recognizes that transportation costs resulting from the movement of coal throughout the mine complex can be a significant cost. Transportation costs are, in fact, a large factor in determining whether a coal deposit can be mined.

The lessor has historically not participated in the cost of mining, including the costs of normal mine processing operations and any necessary movement of mined material about the mine area. The lessor has historically shared in the cost of outbound (long-distance) transportation where sales occur at the destination rather than the mine. This existing policy is proposed to be continued with further clarification to distinguish those situations where the lessor should participate in the cost of transportation.

The following questions are posed to implement a clarified policy regarding transportation allowances.

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?

An affirmative response to this question would constitute de facto mine haulage and would not qualify for a transportation allowance. Coal movement outside the lease boundary from where it was extracted but inside a larger encompassing mine boundary is not unusual. Any coal movement about the mine premise and between mine processing facilities is at the direction of the mine manager, who ultimately exercises control over the flow of coal from the point of extraction through all processing circuits and loadout facilities.

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

Coal movement from the pits (in the case of a surface mine) or the portals (in the case of an underground mine) to crushing facilities, preparation plants, surge bins, stockpiles, silos or other storage, loading, or sales facilities of the mine is common trade practice and considered part of the mining operation.

The Minerals Management Service recognizes that it is not only a necessary industry practice to move coal to and from the various processing facilities but to also arrange for coal to enter the stream of commerce and for possession to transfer to the buyer. Transportation recognized as necessary to the operation of the mine would not qualify for transportation allowances.

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

The mine operator is responsible for arranging for the sale and transfer of coal to buyers in the marketplace. 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 buyers. This point is normally the mine loadout facility.

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 eligibility criteria invalid?

Under normal mining conditions, all transportation occurring prior to an f.o.b. (free-on-board) mine sales point would be born exclusively by the lessee. However, under unusual arrangements or circumstances that create transportation costs that are uncommon or which are beyond the established norm for that area, a transportation allowance could be granted.

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

The requirement of a lessee to perform this normal in-mine haulage at no cost to the lessor is sometimes lost because the nature of mineral occurrence does not always lend itself to convenient clustering of mine facilities. Other competing factors such as access to electrical power, water, and long-distance transportation corridors, e.g., railroads, highways, or political or topographical constraints often require compromised mine design.

The MMS has surveyed the various types of minerals produced from mines on Federal and Indian leases and have found that all lessees engage in some degree of mine haulage and normal processing to produce a marketable product at no expense to the lessor. The MMS routinely considers these activities as occurring "at the mine," even though the mine's facilities are not necessarily near the point of extraction.

"Area" *Comment:* Two industry respondents stated that the definition was neither relevant nor precise.

MMS Response: The MMS finds the term "area" to be relevant because of its use in §§ 206.257(c)(2) (i) and (ii), which sets forth the first two valuation criteria for non-arm's-length sales. Under the approach, lessees will use values established under comparable arm's-length coal sales contracts for coal with similar economic and quality characteristics found in the same geographic region. Therefore, for example, a lessee in North Dakota seeking to establish a value for its non-arm's-length coal sales could not resort to coal sales contracts in Colorado as a means of establishing a royalty value.

"Arm's-length contract" The definition of "arm's-length contract generated numerous comments following the January 15, 1987, original proposed rulemaking. The definition in that earlier proposal would have found a controlling interest regardless of how small the ownership between the two persons was. The July 15, 1988, notice amended the earlier proposed definition.

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

Alternatively, if two parties were affiliated and executed a non-arm's-length contract, but subsequently divested ownership in one-another, that contract would continue to be regarded as non-arm's-length until such time that the contract terminates or is replaced by a contract negotiated at arm's-length.

Comment: One State commenter proposed an alternative definition that would not include the issue of control. This commenter also stated that regardless of which definition is adopted, "MMS should retain the ability to review contracts [for their arm's-length status] as they relate to current sales."

A few industry commenters stated that MMS's "Arm's-length contract" definition was too reliant on form rather than substance. These commenters asserted that where a contract was agreed upon when the parties were nonaffiliated and that contract has continued unamended even though the parties have since become affiliated, the contract should be viewed as "arm's-length."

MMS Response: The July 15, 1988, proposed definition is retained unchanged in the final rules. The arm's-length test must be met each production month. Contracts entered into by independent parties lose their arm's-length status when the contracting parties become affiliated. Clearly, any contract signed by former unaffiliated parties would only continue to operate under the permission of the controlling entity, if the entity's best interest is served. The MMS does not consider such a contract to be arm's-length.

"Audit" *Comment*: Several industry respondents and one Indian respondent submitted numerous comments regarding the January 15, 1987, proposed definition of this term. Three industry commenters requested clarification regarding who conducts audits of royalty payments and on what date an audit would be deemed final. Two industry commenters stated a need to clarify this definition's relation to the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA). One Indian commenter stated that the phrase "production verification" should also be defined. One commenter stated that MMS should be required to disseminate audit findings to Indian tribes and allottees "as their needs arise."

MMS Response: The MMS is the prime auditing authority of coal royalty payments from either Federal or Indian coal lessees. States and Indians may also audit coal royalty payments under the provisions of individually executed cooperative agreements. The results of an audit are normally considered final when the lessee accepts the audit findings or its appeal rights are exhausted. The Federal Government is not prevented from reopening an audit if there is evidence of substantial omission or fraud. The definition in the July 15, 1988, notice modified the January 15, 1987, proposed definition by deleting all language following the first sentence of the definition. The deleted material was only intended to be explanatory. These final rules contain the July 15, 1988, proposed definition unchanged from that proposal.

"Coal washing" *Comment:* Several respondents provided comments concerning this definition. Several industry commenters recommended revising this definition from "Coal washing" to "Coal processing." Support for this modification provided in these comments followed the same rationale as stated earlier: Other methods of beneficiation besides coal washing may increase the value of coal. One commenter further explained, "The definition of coal washing should be rewritten to clarify that these processes are included and provide incentives to develop new technologies for increased or different federal coal use." One Indian commenter recommended deleting the definition entirely but offered no reasoning.

MMS Response: The MMS responded to these issues earlier at the discussion of the term "Allowance."

Comment: The MMS received many comments from industry respondents stating that all preparation costs should be excluded from the royalty value.

MMS Response: The details of these comments and MMS's response to them were published in the July 15, 1988 (53 FR 26942), notice. The reader should refer to the referenced issue of the **Federal Register.**

The final rules maintain the longstanding requirement for the lessee to place the mined product in marketable condition at no expense to the lessor. An extensive discussion of the "marketable condition" requirement is contained earlier in this preamble.

"Contract" *Comment:* Several industry respondents provided comments recommending deletion of the phrase "that with due consideration creates an obligation" from the proposed definition. Two commenters stated the phrase was "unnecessary and confusing."

MMS Response: The MMS considers the elements of consideration and obligation to be fundamental elements of coal sales contracts. These rules retain the language of the January 15, 1987, proposed rulemaking.

"Gross proceeds" *Comment*: Following the original January 15, 1987, proposed rulemaking, MMS received many comments on the definition of "Gross proceeds." Many comments were concerned with the proposal to exclude the AML fee and Black Lung excise tax from the value of coal. An extensive description of those comments appeared in the preamble to the July 15, 1988 (53 FR 26942), notice. Readers should refer to the referenced issue of the **Federal Register** to review those comments and MMS's response.

Comments received since the July 15, 1988, notice regarding the inclusion or exclusion of the AML fee, Black Lung excise tax, and other taxes or fees are

addressed in the discussion of § 206.257(b).

MMS Response: There is no doubt, for example, that when the purchaser pays $10/ton for coal, that is the lessee's gross proceeds. Whether all of that $10 is royalty-bearing is a separate issue and is addressed below in § 206.257(b).

Comment: Many commenters including States, Indians, and industry, commented that they favored recognizing all forms of consideration received by the lessee for purposes of valuing Federal and Indian coal. Several industry respondents opposed the concept of including noncash forms of consideration such as providing crushing or loading services to the lessee. One commenter maintained: "There may be occasions when there truly is significant consideration given to the seller which is not included in the actual sales price of the coal. When that is the case, then there is justification to collect royalty on such consideration." This commenter concluded, however, that the proposed rules do not define what is significant.

MMS Response: The MMS partially responded to this issue as it was raised in the discussion of "grandfathering." The MMS's policy is restated again to be very clear on this issue. The MMS has always required royalty to be paid on all components of produced coal value, including those components of a coal sales agreement that are not in the form of cash and are not imbedded in the price. As stated in the January 15, 1987, proposed rulemaking, "The definition of gross proceeds is intended to be expansive to ensure that it includes all the benefits flowing from the purchaser to, or on behalf of, the seller for the disposition of the coal * * *."

The rationale for this policy is that a mine operator can benefit equally from transactions involving noncash as well as cash benefits. In other words, cost avoidance can contribute as much to overall firm profitability as incoming revenues can. However, the royalty owner likewise is entitled to receive a share of the noncash value components received by the lessee. Any other proposition is unacceptable because the outcome would clearly represent royalty assessed on an amount that represents less than the full value of coal.

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

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

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

MMS Response: For arm's-length contracts, MMS does not believe that there is any justification for receiving a royalty based on less than a contract sales price regardless of when the contract was signed. The lessee receives the benefit of a higher price and the royalty owner is entitled to share in that benefit. Non-arm's-length situations are addressed later in this preamble. Interestingly, a similar issue was raised several decades ago. The conclusion was as follows: "Prices specified in contracts made years ago, but still effective, are just as significant a part of present markets for natural gas as those made yesterday, or those which may be made tomorrow." (Federal Power Commission, Natural Gas Investigation 222 [Docket No. G-580, 1948]).

Many comments were received on the take-or-pay issue prior to the July 15, 1988 (53 FR 26942), notice. Those comments were summarized in this referenced notice and will not be repeated here.

Numerous comments on the take-or-pay issue were received since the July 15, 1988, notice. The MMS responded to the issue of take-or-pay payments and similar type payments earlier in this preamble. The MMS's response also explains changes to the "gross proceeds" definition that have been made to conform to the Fifth Circuit Court of Appeals decision regarding take-or-pay.

The remaining definition of gross proceeds remains unchanged from the July 15, 1988, notice.

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

"Lease" *Comment:* Seven industry and one Indian respondent submitted comments regarding this proposed definition. One commenter stated that the definition was too broad, and six other commenters advocated redefining the term to exclude arrangements that are not leases, such as profit-sharing arrangements or joint ventures. Three other commenters suggested that MMS should adopt BLM's definition of lease as found at 43 CFR 3400.0-5(r), stating that there was no need for two bureaus of the same Department to have different definitions of the same term.

MMS Response: The definition of "Lease" is largely a restatement of the definition of that term as defined by various statutes.

"Lessee" *Comment:* Ten industry commenters stated that the definition was too broad and "subject to misconception," and that MMS should redefine this term to eliminate persons who pay royalties but have no interest in the lease. As explained by one commenter, "It [the definition] could, for instance, include as a 'lessee' a coal buyer who in the coal sales contract agrees to reimburse the coal miner for royalties payable."

MMS Response: The term "lessee" as defined in these rules does not extend to an unaffiliated coal buyer, which under a coal sales contract agrees to reimburse the lessee for royalty expenses. The lessee cannot contract away an obligation created by the taking of a lease. Further, failure of a coal buyer to render payment to the lessee does not relieve the lessee of its obligation to submit royalty payments for coal sold from a Federal or Indian coal lease. The definition does, however, include a coal buyer who agrees to report and pay the royalty to the MMS.

"Like-quality coal" *Comment:* One industry respondent questioned the meaning of the word "similar." Specifically, the comment asked how much variation in the chemical and physical characteristics would be allowed within the term "similar."

MMS Response: In general, MMS would consider two coals to be similar if they fall within the same coal classification, as set forth by The American Society for Testing Materials (ASTM) Standard D-388. However, MMS cautions that these general tolerances for the similarity test are not conclusive. Btu, ash, sulfur, and moisture content, and in specific situations other tests such as washability, drop shatter test, test for water soluble alkali or other tests may be necessary to conclude similarity.

"Net-back method" *Comment:* Numerous industry respondents submitted comments on the proposed definition that was contained in the January 15, 1987, proposed rulemaking. Two commenters advocated taking into consideration only the actual cost of transportation, thus eliminating costs such as coal handling, washing, etc., from the net-back calculations. One commenter suggested changing the definition to mean a procedure for valuing produced coal at the mine-mouth when a sale has taken place downstream from the lease or mine. Similarly, other commenters who advocated the "depletion income" valuation method offered an alternative proposal by defining the term to mean "a procedure for valuing coal downstream from the lease or mine working back from the point of gross royalty valuation to arrive at net royalty value at the first point of marketable condition." Any transportation, washing, or handling services would not be included in the "net royalty value." One commenter stated that the definition should be deleted as it is unnecessary under its proposed alternative "fair market value approach." One commenter stated that the "point of measurement for royalty purposes" is not specified in the definition and questioned how that point would be determined. One commenter recommended modifying the definition "to recognize that it is a procedure for determining the value of coal at the point of extraction." This commenter advocated also including "all portions of the value added to the coal as a result of post-extractive processes."

MMS Response: The definition in the July 15, 1988, notice which has been carried forward unchanged in these final rules, substantially revised the earlier proposal. The MMS will not permit any expense incurred prior to the point where the mineral is placed in marketable condition to be included in a net-back valuation method. To permit otherwise would contradict long-standing Department of the Interior policy and would deny equal royalty treatment to other lessees, which cannot avail themselves of a net-back valuation procedure. Therefore, the definition contained in this rulemaking has been streamlined but the concept is unchanged. The MMS will use a net-back valuation method only when other methods of determining value, such as those specified in the rules, are inapplicable. In doing a net-back, MMS will start at the first point at which a market value for the product can be determined, and will deduct costs of transportation, washing, handling, etc. to reach a value for royalty purposes.

"Net output" *Comment:* Two industry respondents requested that the term be redefined to mean "the quantity of coal delivered to the purchaser." The commenter supported this change to "make the definition more accurate and readable."

MMS Response: The MMS believes the term "produced" provides more flexibility and accuracy by including such situations as retention of washed coal by the on-site washer for purposes of drying coal or space heating.

"Person" *Comment:* Three industry respondents requested that the definition be revised. Two advocated changing the definition to read " 'Person' means any individual or legal entity." One commenter justified the proposed change by stating that "This revision is intended to make the definition legally sound, less confusing and less subject to being misconstrued."

MMS Response: The MMS's definition of "person" is consistent with sound legal principles and other statutes.

"Selling arrangement" *Comment:* Several industry respondents commented that this definition's meaning and purpose in the regulations are unclear and should be deleted.

MMS Response: The term "selling arrangement" is used in § 206.262 "Transportation allowances-general." The purpose of the term, as it is used in the rule, is to prohibit the transfer of transportation costs incurred under one particular sale to other sales not involving transported coal. It also clarifies that although present royalty reporting requirements for Form MMS-4014 allow aggregated reporting of sales, for purposes of allowances these deductions will be by individual contractual sales arrangement. These final rules adopt the July 15, 1988, notice definition.

"Severance tax"—Because these final rules adopt Recommendation VII-5 of the Commission on Fair Market Value Policy for Federal Coal Leasing that "the base for calculating Federal royalty payments should be the f.o.b. price minus all State and local severance and similar taxes," a definition of "Severance tax" has been added to this section. The intent of this definition is that only State and local production-related taxes may be excluded from the Federal coal lessee's gross proceeds and that other taxes and royalties may not be excluded.

"Spot market price"—The July 15, 1988, notice included a definition of "spot market price." Although no comments were received on this definition, MMS wishes to make clear its intent through the following explanation. The definition provides: "The price received under any sales transaction when planned or actual deliveries span a short period of time, usually not exceeding one year." The term "planned" is used because duly executed spot sales contracts providing for near term future sales would be evidence of market value at that time.

This definition is adopted unchanged in the final rules.

Section 206.262 Information collection

Comment: One industry and one Indian respondent commented on MMS's proposed information collection requirements. The industry commenter stated, "Collection of washing and transportation allowance data is unnecessary with a market value test" valuation, as opposed to a gross proceeds requirement. (The detailed discussion of alternative valuation proposals is contained at § 206.257(b).) The Indian commenter requested that MMS "clarify that this information will be available to Indian tribes on request for use in tribal management programs."

MMS Response: The MMS will respond to the alternative valuation procedures in the responses to comments at § 206.257(b). With respect to the sharing of mineral lease data with Indians, it is MMS policy to provide the Indian lessor any information relevant to its specific Indian leases, provided the Indian lessor agrees to safeguard certain proprietary financial and trade information.

Section 206.253 Coal subject to royalties—General provisions

Comment: The MMS received many comments from numerous industry

respondents and one Indian respondent concerning proposed § 206.253. One industry commenter recommended that no changes be made to this section. Numerous industry respondents submitted many comments objecting to the provisions of paragrpah (a). Five commenters stated that only coal produced under a resource recovery and protection plan should be subject to royalty. One commenter explained that "BLM approves of the lessee's Resource Recovery and Protection Plan and thereby approves of the quality and quantity of that coal which must be recovered * * *." The commenter "urged that the rules provide that so long as the Resource Recovery and Protection Plan is being achieved, no royalties be charged for coal which is not mined pursuant to that plan." Four other commenters stated paragraph (a) was a duplication of BLM's existing authority for Maximum Economic Recovery (MER). One commenter noted, "The BLM's Maximum Economic Recovery regulations already serve to define how the reserve will be produced." One commenter objected to paragraph (a), stating that the requirement to pay royalties "on coal avoidably lost does not take into consideration the real world of mine operation and business." Indian commenters stated royalty should be due on all coal, including that coal unavoidably lost. Five other commenters stated that paragraph (a) was inadequate in other respects. One Indian commenter stated that this paragraph failed to deal with theft. Two other commenters stated it did not adequately define "avoidably lost." One commenter stated this paragraph would impose a royalty on coal too thin to mine or too poor a quality to use at a utility plant. One industry commenter stated that paragraph (a) refers to coal "which is 'unavoidably lost as determined by BLM pursuant to 43 CFR Group 3400' " but noted that "the Group 3400 regulations do not address the concept of 'unavoidably lost.' "

MMS Response: The BLM determines the quantity of coal subject to royalty under its production verification responsibilities. Section 206.253(a) does not duplicate or usurp BLM's responsibilities pursuant to 43 CFR Group 3400. MMS points out, however, that coal avoidably lost is subject to BLM's scrutiny under 43 CFR Group 3400 performance standards. Coal which cannot be produced for various reasons, and is not mined, in compliance with the BLM-approved Resource Recovery and Protection Plan would not be subject to royalty. However, the Federal or Indian lessor does not bear the economic burden of absorbing losses due to the actions of an imprudent operator. In regards to theft, BLM may consider stolen coal avoidably lost and thus subject to royalty.

One industry commenter stated that although MMS uses the word "produced" in paragraph (a), the word is not defined in the proposed regulations. This commenter also offered a definition: "[C]oal is produced for royalty purposes when it is severed and placed in commercially salable condition, and then either sold, consumed, or otherwise disposed of." This commenter further noted that the use of the term "produced" in paragraph (a) was inconsistent with the gross proceeds approach of the regulations.

MMS Response: The MMS accepts the common usage and meaning of the word "produced," and believes no definiton in the regulations is necessary. The MMS discussed this issue in greater depth in the general comments regarding take-or-pay and similar type payments. The MMS agrees with the commenter that coal "produced" is relevant to coal that may be used by the lessee on-lease or off-lease, but not sold.

The intent of paragraph (a) is to make clear that royalty is due when coal is used, sold, or otherwise produced and disposed of by the lessee on or off the lease. These final rules include, unchanged, the regulation as it was proposed in the July 15, 1988, notice.

Comment: One industry comment stated that coal, free-of-charge, is provided to the Indian lessor. This commenter noted that royalty should not be charged on that coal.

MMS Response: The MMS understands that coal provided free-of-charge to the Indian lessor is explicitly provided for by lease terms. These rules explicitly provide for lease terms to govern where specifically inconsistent with these rules. See § 206.250(b).

Comment: Several industry respondents provided comments discussing paragraph (b). Two commenters requested that MMS clarify the language of paragraph (b) to state that insurance payments received by the lessee for losses other than coal would not be royalty bearing. One commenter suggested adding the phrase "for the coal lost" to the end of paragraph (b) as it was proposed.

MMS Response: The regulations published in the January 15, 1987 (52 FR 1840), proposed rulemaking were changed in the July 15, 1988 (53 FR 26942), notice to clarify MMS's intent on this issue. Royalty will be due only on insurance monies received by the lessee for the loss of coal. Royalty will not be due on insurance monies received for replacement of equipment or real estate. The July 15, 1988, notice language has been adopted in the final rules.

Comment: One industry commenter questioned if it were necessary "to determine if the insurance contract is arm's-length and go through the procedures of 30 CFR 206.257?"

MMS Response: The MMS believes that the issue of arm's-length versus non-arm's-length insurance payments is not relevant in this situation. In the instance of coal avoidably lost, MMS would determine the value of the coal pursuant to § 206.257.

Comment: Two industry commenters stated that no royalty was due on insurance proceeds. One commenter explained, "An insurance payment is a contractual agreement between the lessee and a third party by which the lessee has shifted the risk of losses to the third party through the payment of certain insurance premiums." A few industry commenters stated that the lessor should carry its own insurance or share in the lessee's insurance premiums if the lessor wished to indemnify itself from losses.

MMS Response: Royalty is due on insurance proceeds because the insurance payment compensates the lessee for the loss of Federal or Indian coal. If not for the production and loss of the Federal or Indian coal, the lessee would not receive the insurance payment. Once severed from the lease, protecting coal is the responsibility of the lessee until risk of loss has been transferred to the purchaser. Where the protection extends to insurance coverage, that coverage also reduces the lessor's risk on the royalty portion, which represents an undivided interest on all production from Federal and Indian leases.

Comment: Section 206.253(c), which requires royalty to be paid on coal recovered from waste piles or slurry ponds, received several comments from respondents. One commenter agreed with this paragraph. Two commenters stated that the record keeping requirements relating to the allocation of coal "may be difficult since the 'event' at issue may have occurred 10–12 years in the past."

MMS Response: The record keeping requirements are not new. Correct allocation of Federal and non-Federal production (or Indian/non-Indian) is a consistent obligation of lessees. See, for example, 30 CFR 211.63(k) of the July 30, 1982, Minerals Management Service final rulemaking for Coal Exploration and Mining Operations (47 FR 33192). If

adequate records have been discarded over time, production estimates approved by BLM would be sufficient for royalty determination purposes.

Comment: One industry commenter posed the question of how to account for coal in waste pits, which was derived "from multiple Federal leases and both Federal and non-Federal lands?" This commenter further maintained that the requirements of paragraph (c) are both "unreasonable and unenforceable."

MMS Response: Specific cases involving allocation issues will be dealt with on a case-by-case basis. If complete production records were kept by the lessee, correct allocation of coal in waste pits will not be difficult.

Comment: One industry commenter recommended that "there has been no prior obligation to keep such records [as required by paragraph (c)]."

MMS Response: The commenter is incorrect. Production records have always been required to be kept in order to verify coal production removed from a lease. See 30 CFR 211.63(k) (July 30, 1982) (47 FR 33192), Minerals Management Service final rulemaking for Coal Exploration and Mining Operations. Prior to that rulemaking, see 30 CFR 211.66(a) (May 17, 1976) (41 FR 20271), final rulemaking.

Comment: One industry commenter stated that paragraph (c) [§ 206.255(c)] in the January 15, 1978, proposed rulemaking] should be revised to reflect that royalties are due when coal is sold or used, "not at the time of recovery."

MMS Response: This comment is reasonable and the regulations were changed in July 15, 1988, notice to require royalty payments when the coal recovered from waste or slurry ponds is used, sold, or otherwise disposed. This language has been carried through to the final rules.

Comment: One industry commenter stated, "MMS should address the possible situation where waste piles and slurry ponds may contain coal produced using both underground and surface methods."

MMS Response: The MMS will investigate such a situation when or if it occurs; however, MMS is convinced that if proper records were retained by the lessee, correct allocation and royalty calculation is feasible.

Section 206.254 Quality and quantity measurement standards for reporting and paying royalties

Comment: Numerous industry respondents submitted comments relating to § 206.254. One commenter recommended no changes to this section. Nine respondents objected to the quality reporting standards set forth in paragraph (a). Two commenters believed the requirements of paragraph (a) are burdensome and recommended deletion. One commenter continued by asserting that "MMS is requesting a great amount of unnecessary information." Three other commenters similarly stated that there was "no legitimate governmental interest in receiving this information, particularly if the coal is being sold pursuant to a bona fide arm's-length coal supply agreement. Federal coal royalties are calculated on quantity and price."

MMS Response: Such information is necessary so that MMS may perform its oversight functions. The MMS believes that such information should be readily available for purposes of properly analyzing values used for coal sold under non-arm's-length conditions. The valuation of coal sold under non-arm's-length conditions normally requires a comparison to like-quality coal sold in the same area under arm's-length conditions. The requirement to provide such information to MMS is specified at 30 CFR Part 216. The reporting regulations of § 206.254(a) for coal are more specific, but do not impose additional requirements.

Comment: Several commenters requested that MMS clarify paragraph (a) to require that quality information be submitted once a month for a representative shipment providing no extraordinary bonuses or penalties were incurred by the lessee during the month.

MMS Response: Section 206.257 requires lessees to perform coal quality analysis at intervals set forth in their contracts, but in no case less than quarterly. However, the reporting of those analyses to MMS should be consistent with the standards contained in 30 CFR Part 216. The MMS contemplates that the weighted average of all shipments during a reporting period will be reported because coal lessees do not report the details of individual shipments unless only one shipment was made during the reporting period.

Comment: One commenter requested that the provisions of paragraph (a) be revised to address "the circumstance where the sales contract does not provide the intervals at which quality determinations will be made."

MMS Response: The MMS concurred with the comment and accordingly incorporated clarifying language in the July 15, 1988, notice. For the general case in which a sales contract does not provide the intervals at which quality determinations will be made, quality tests will be performed not less than quarterly.

Comment: One commenter recommended amending paragraph (a) such that the quarterly coal quality tests would only be required "if coal on which royalty is due was mined during that period."

MMS Response: Quality tests would be performed at intervals specified in the coal contract but not less than quarterly. The reporting of those quality parameters should be consistent with the reporting requirements of 30 CFR Part 216.

MMS received a few comments concerning paragraph (b). The commenters recommend amending paragraph (b) to exclude "extraneous ash and moisture [from the weight] (i.e., that not found to be inherent in the coal itself) before calculating royalties." The commenter cited *A.J. Taft Coal Co.* v. *U.S.*, 605 F. Supp. 366 (D. Ala. 1984), aff'd 760 F. 2d 279 (11th Cir. 1985) in support of this proposal. Another commenter stated that the weight of water added for dust suppression should be deducted.

MMS Response: Under the valuation rules, coal royalties are based on gross proceeds. Thus, to the extent that ash and moisture penalties effect gross proceeds, the Federal or Indian lessor also shares in the reduced revenues received for the sale of coal containing excessive impurities. Additional discounts for coal weight contributed by impurities are inconsistent with general principles of ad valorem royalty accounting, which principally rely on revenue receipts for the sale of production rather than on the weight of production.

The MMS similarly rejects the latter comment concerning a deduction for water added for dust suppression. Ad valorem royalties are based on value of coal sold in marketable condition. The commenter noted that an average of 2 gallons of water is added to each ton of coal sold. The additional 16 pounds of added water per ton of coal represents a weight increase of about 0.8 percent, an amount which is below the acceptable percentage of error of tolerance present in many certified rail or truck scales. The MMS also suggests that the costs of the additional recordkeeping requirements that would be necessary to support actual water weight applied to coal would easily exceed royalty savings.

Section 206.255 Point of royalty determination

Section 205.257 of the January 15, 1987, proposed rulemaking was redesignated § 206.255 in the July 15, 1988, notice. The language was also

slightly amended. The term "used" was added to the paragraphs (b) and (c) to make it clear that use of coal by the lessee triggers the royalty payment obligation. Section 206.255 of the July 15, 1988, notice is adopted into these final rules without change.

Comment: The MMS received many comments from industry respondents and one Federal agency concerning § 206.255 (formerly § 206.257) published in the January 15, 1987, proposed rulemaking. Nine industry respondents submitted numerous comments related to paragraph (a). One commenter stated that this paragraph was vague; another comment stated inat it was confusing. One commenter specifically recommended deleting the phrase "marketable condition," and explained that the phrase was unnecessary where a specified point of royalty determination is designated. Ten comments offered alternative points of royalty measurement other than that "prescribed by BLM." Three commenters suggested that the point of royalty measurement should be after the coal is crushed and screened. One commenter believed this was a reasonable point since these operations were undertaken by all lessees. One commenter stated that the point of royalty measurement should occur "at the point at which the coal is severed from the mineral estate." One commenter suggested substituting the term "mine" in place of "point of royalty measurement prescribed by BLM." One commenter advocated that the point of royalty determination should be the first of either "the point when coal is produced and first placed in a marketable condition or loaded for delivery." One commenter stated that the point of royalty measurement should be where "ownership is transferred at the point of sale." Two commenters stated that the point of royalty determination should be the point of sale, normally f.o.b. the mine. Another commenter also stated that there was no provision for the lessee to have input into this determination.

MMS Response: The "marketable condition" standard is present for consistency with § 206.257(h). The MMS will not accept, for royalty purposes, the gross proceeds accruing to the lessee for the arm's-length sale of coal which is not in marketable condition, as defined at § 206.251. The point of royalty determination is a joint BLM and MMS function. Often the point of sale specified in a sales contract is the same as the point of royalty determination, which is typically at or near the mine. The MMS expects that extensive consultation would occur between all concerned parties, including the lessee, prior to establishing a point of royalty determination. However, the final decision of a point of royalty determination is not delegable to the lessee. Where unusual selling arrangements exist, BLM and MMS may, at their discretion, assign any point of royalty determination, including a point different from the point of sale contained in the sales contract.

Comment: Six comments from four industry respondents and one Federal agency were received on paragraph (b). The Federal agency suggested that MMS should promulgate a definition for "large coal stockpile." Two commenters requested MMS to clarify what constitutes excessive stockpiles or inventory. Two of these commenters asked that MMS be flexible "in these [excessive stockpiles or inventory] determinations since a 100,000-ton stockpile may be 'excessive' at one operation but may be quite normal at another." One commenter recommended substituting the word "when" for the word "after," stating that the current word is confusing. Two commenters agreed with MMS's paragraph (b). One commenter stated, "Many of the recently readjusted Federal leases specify that royalties will continue to be paid at the time coal is produced. It is suggested that the provisions of this section need to be further strengthened to clarify that this section will prevail over the terms of the lease * * *."

MMS Response: The MMS will be flexible in determining what constitutes an "excessive stockpile." These determinations will be made on a case-by-case basis by BLM. The MMS did not, however, strengthen paragraph (b) to prevail over lease terms. As contractual agreements, leases and their provisions prevail over regulations where leases and regulations are inconsistent.

Comment: Seven comments from six industry respondents were received on paragraph (c). One commenter recommended deleting this paragraph entirely, "since all Federal coal leases contain provisions for royalty rates and frequency of payments." Six other commenters objected to the language "or otherwise disposed of." In lieu of this language, two commenters suggested substituting the word "consumed"; one commenter suggested substituting the word "removed"; and one commenter suggested substituting "or used by the lessee on lease or off lease."

MMS Response: The purpose of paragraph (c) is to refer to 30 CFR 206.256(d), which deals with practical situations for paying royalty when coal is sold, used, or otherwise finally disposed of. The MMS considers the phrase "or otherwise disposed of" necessary to anticipate other dispositions of coal in addition to sale. The MMS does not intend this provision to mean that royalty normally is due when coal is removed from a lease and transferred to a nearby stockpile prior to sale. The word "sold" was added to the provision to be consistent with other parts of these regulations which discuss disposition of Indian and Federal coal.

Section 206.256 Valuation standards for cents-per-ton leases

Comment: Several industry and one Indian respondent submitted nine comments regarding § 206.258 of the January 15, 1987, notice, now redesignated § 206.256. The MMS received no comments on paragraph (a).

Three industry respondents submitted three comments concerning paragraph (b). One commenter recommended that "the word 'volume' be replaced with the word 'quantity' to be consistent with proposed 30 CFR 206.254(b)." The other commenters were concerned with the requirement that royalty would be due on coal avoidably lost. Two commenters questioned the conditions under which royalty would be due on coal left in-place (unmined) and one stated that paragraph (b) was essentially a "duplicate regulation by the Department of Interior [sic] in that BLM already has existing authority to assure maximum economic recovery * * *."

MMS Response: Paragraph (b) was changed in the July 15, 1988, notice by replacing the word "volume" with the word "quantity." "Quantity" is consistent with usage at 30 CFR 206.254(b), because coal is not measured for royalty purposes by "volume." Also, see MMS's response regarding coal avoidably lost at § 206.253.

Comment: Three comments from industry respondents were received on paragraph (c). Two commenters recommended deleting this paragraph completely. The other commenter maintained that both washing and transportation allowances should be available for cents-per-ton leases. The commenter stated that denying allowances for only cents-per-ton leases "create[s] a double standard."

MMS Response: The denial of allowances for cents-per-ton coal lease does not create a double standard of royalty valuation. Cents-per-ton royalty payments are not increased because of the value added benefits of washed coal. The historic practice of collecting

cents-per-ton royalty on the quantity of cleaned coal rather than the quantity of uncleaned coal actually mined is continued. See initial policy at 30 CFR 211.64, May 17, 1976, 41 FR 20271.

Comment: Three industry and one Indian respondent submitted five comments pertaining to paragraph (d). One Indian comment commended MMS for its position "that it will be the policy * * * to convert cents-per-ton leases to ad valorem leases on readjustment dates unless, of course, a cents-per-ton lease would yield greater royalties to an Indian tribe." All other comments were put forth by industry. Two of these commenters recommended deletion of this paragraph. One commenter reasoned "that this entire area [of lease readjustments] is in such a state of turmoil that MMS should probably refrain from addressing this issue at this time." Another commenter stated, "The royalty to be paid for coal depends on the actual date of coal severance (date of being mined) * * *." One commenter noted that the 30-day requirement of paragraph (d) could be in conflict with certain lease terms and MMS should ensure that the "proposition ('lease terms govern') should be constant throughout the rules." One commenter "suggested that the lessee should at least be given some 'force majeure' relief on the 30-day requirement if he is unable to rotate his stockpile due to forces beyond the lessee's control."

MMS Response: There is no confusion in the area of lease readjustment. The policy of the Department of the Interior is to readjust all Federal coal leases to be consistent with the requirements of 30 U.S.C. 207, as implemented by appropriate regulations of 43 CFR Subpart 3451. This policy has been upheld by the courts (citations provided earlier). The purpose of this regulation is to provide the lessee formal written policy regarding the imposition of new ad valorem royalty rates on previously mined coal inventories, which were in existence on the effective date of the lease readjustment.

The language of § 206.256 as published in the July 15, 1988, notice was carried forward into this final rulemaking.

Section 206.257 Valuation standards for ad valorem leases

The final rulemaking adopts the basic valuation approach as it was proposed in the July 15, 1988, notice. However, several changes have been made to conform with the amended definition of gross proceeds and to adopt the Commission on Fair Market Value Policy for Federal Coal Leasing recommendation that State and local severance taxes be excluded from gross proceeds. Other minor changes, which are described below, were made for clarity.

Following the original January 15, 1987, proposed rulemaking, MMS received several editorial-type comments concerning paragraph (a) which were suggested for clarification. Some comments repeated earlier statements that a processing allowance should be used in place of a washing allowance. The MMS clarified paragraph (a) in the July 15, 1988, notice by revising the language and adding the deductibility of an allowance for beneficiation pursuant to § 206.265. No additional comments were received specific to this paragraph. Therefore, this paragraph has no changes from the July 15, 1988, notice.

Paragraph (b)(1) contains no changes from the July 15, 1988, notice. This paragraph essentially continues the existing policy of determining per centum coal royalties on the basis of sales prices obtained pursuant to arm's-length contracts. Acceptance of the sanctity of such contracts remains a fundamental valuation concept. It represents very important ideas about the nature of business in the free marketplace. That is, that businesses have the right, within the bounds of what is legal, to fix a relationship by a binding written agreement. The freedom to write contracts and to abide by their terms represents a fundamental trait of this Nation's economic system. These rules and specfically this paragraph adhere to this feature of the U.S. economic system, because this paragraph states that the lessor agrees to limit its share of royalties to a specified fraction of receipts received by the lessee. In other words, MMS accepts as a proper valuation for the payment of royalties the value negotiated at arm's-length with a purchaser in light of the marketing conditions that existed at the time the contract was entered.

The MMS received several comments suggesting alternative methodologies for valuation. Earlier in this preamble MMS responded to a proposal to value on the basis of heat content. Other commenters suggested establishing "fair market value" through techniques other than by contract sale prices. The MMS rejects all of these alternatives. The MMS maintains that there is nothing wrong with the workings of the competitive marketplace. Accordingly, the marketplace will continue to be the primary determinant of value of coal for royalty purposes.

Comment: Paragraph (b)(2) conditions MMS acceptance of gross proceeds under contracts on whether each contract reflects the total consideration actually transferred from buyer to seller. A number of industry comments objected to this provision and stated that MMS should restrict the value basis to the contract sales price.

MMS Response: MMS recognizes that there must be exceptions to the general rule that the lessee's arm's-length contract price should be accepted without question as the value for royalty purposes.

For example, if a lessee sells coal to the neighboring nonaffiliated utility at reduced prices and in return the utility sells electricity to the lessee at a reduced rate, then the coal sale agreement would not be reflective of the full value of coal.

In the event that MMS becomes aware of consideration that exists outside the four corners of the contract, MMS could accept the lessee's gross proceeds as value, adjusted to reflect the additional consideration when that additional consideration can be converted to a dollar value. However, in some circumstances the additional consideration may not be easily calculable. Thus, even if the parties are not affiliated and the contract is "arm's-length," MMS may require under paragraph (b)(2) that the coal production be valued in accordance with paragraph (c), the standards used to value coal disposed of under non-arm's-length contracts. Under these standards, the lessee's gross proceeds still may determine value, but the lessee will be required to demonstrate comparability to other arm's-length contracts. Thus, despite several industry comments suggesting that this section be deleted, it is retained in the final rules.

Paragraph (b)(2) is not meant to apply to situations where there is intentional misconduct by the lessee. Such circumstances are covered by paragraph (b)(3). Rather, it could be used in situations where a lessee did not consider a particular benefit provided by its purchaser to be a payment for coal, but MMS on review considers it to be part of the consideration for coal production under the contract.

Comment: Many comments were received concerning paragraph (b)(3) following the July 15, 1988, notice. Many industry comments asserted that MMS was attempting to expand its rule beyond the traditional bounds of a lessor, as intended by Congress. One comment stated "MMS is bringing the negligence concept from tort law to a contractual relationship." Many comments stated that this regulation would effectively grant MMS license to second guess the lessee's legal and

business judgment. Other comments stated that paragraph (b)(3) created undue uncertainties in the royalty valuation process and would result in an expansion of litigation.

MMS Response: Even if the contract is between unaffiliated persons and thus "arm's-length," pursuant to § 206.251, if MMS determines that the gross proceeds do not reflect the reasonable value of the production because of misconduct by the contracting parties or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and lessor, then MMS may require that the coal be valued pursuant to the first applicable criterion of paragraph (c)(2).

Thus, MMS first must determine that a price is unreasonable; for example, by looking at comparable contracts and sales. Then MMS must determine that the unreasonably low price was the result of misconduct or a breach by the lessee of its duty to market the production for the mutual benefit of itself and the lessor.

A breach of the lessee's duty to market production for the mutual benefit of the lessee includes, but is not limited to, collusion between the producer/seller and buyer, pricing practices found by a court or regulatory authority to be incorrect or fraudulently manipulated, or negligence in negotiating contracts.

When MMS makes the determination under paragraph (b)(3), the effect is that the arm's-length contract price will not be accepted automatically. Instead, value will be independently determined using the benchmarks in paragraph (c).

Comment: Paragraph (b)(5) excludes the cost of the Black Lung excise tax, the AML fee, and severance tax from gross proceeds to arrive at the value for Federal royalty purposes. These specific exclusions do not apply to Indian leases. In the preamble to the July 15, 1988, notice, MMS provided an extensive accounting of comments that had been received prior to that date. In the July 15, 1988, preamble, MMS requested additional comments on whether the Black Lung excise tax and AML fee should be excluded from the value basis. The MMS requested further comment on whether the concept of excluding certain costs should be extended to include exemption for the costs of State severance taxes and "royalty on royalty." "Royalty on royalty" or "royalty on itself" is a phrase used by commenters to describe the royalty effects of a lessee raising the sales price to recapture the cost of the royalty itself.

The overwhelming majority of industry commenters advocated excluding all Federal and State imposed taxes, fees, and royalties. Most of these commenters stated that the taxes and fees did not add to the value of the coal and therefore should not be subject to royalty. One western coal producing State commenter agreed with the industry consensus. Four western coal producing States recommended rejecting the policy of excluding the Black Lung excise tax and the AML fee from the royalty value. Four western coal producing States also recommended rejecting the policy of excluding State severance taxes from the value basis. Three western coal producing States recommended rejecting the policy of excluding the cost of royalty ("royalty on royalty") from the value basis. One commenter stated: "MMS' algebraic manipulations in the preamble notwithstanding, this proposal boils down to nothing more and nothing less than reducing the 12.5% royalty rate to 11.39%." One western coal producing State chose not to comment on any of these possible exclusions but instead requested an alternative valuation system for low Btu content coal. Several coal consuming States advocated adoption of the alternative valuation proposal that was submitted jointly by representatives of the coal and electric utility industries. That proposal would exclude all production taxes, fees, and royalties.

Several industry commenters stated that the proposed exclusions should extend to Indian coal also. The Indian commenters, on the other hand, expressed agreement with the proposed regulatory provision to exempt Indian coal from any of the exclusions for taxes, fees, and royalties. One Federal agency stated that excluding the Black Lung excise tax and the AML fee from Indian lands "could precipitate an adverse situation, wherein producers would preferentially develop non-Indian lands. This does not seem consistent with the trust responsibility of the Federal Government with regard to Indian mineral resources."

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

Eighteen respondents, consisting of 14 State organizations and 4 Indian groups, opposed the exclusion of any reimbursed taxes or fees from gross proceeds. Most respondents maintained that MMS's explanation of why Black Lung Excise Taxes and AML fees are excluded from gross proceeds was not sufficient or acceptable. One Indian respondent specifically commented that MMS's justification for exclusion was not true with respect to Indians who do not set the rate of either the Black Lung Excise Tax or the AML fee. The respondent further noted that AML fees have not been made available to Indian lands. A State respondent commented: "These fees are essentially a pass-through, the lessee does receive the benefit of the purchaser reimbursing him * * *." These costs would otherwise be borne by the lessee. Another State respondent claimed: "The MMS proposal would have the effect of reducing royalties on coal without going through the findings required under the Minerals Leasing Act, 30 U.S.C. 209." One other State respondent concurred with this statement. Several other State respondents objected to the exclusion of Black Lung Excise Taxes and AML fees on the grounds that it sets a precedent and "opens the door for the exclusion of other items * * *."

The MMS also received comments stating that the value of coal should be reduced by amounts for State and local severance taxes. Most comments maintained that the resulting lower royalty costs would promote development and lower costs to consumers. Other comments stated that severance taxes should be excluded from the value basis because the lessee merely collects these taxes on behalf of the taxing authority. Hence, the lessee obtains no benefit or value from the collection of such pass-through taxes. As one comment explained, "None of these cost [tax] components are part of the 'value' of the raw product, coal, to

the lessee. The lessee receives nothing in return for these payments; i.e., they are true liabilities and to charge a royalty on them is unconscionable." Several commenters pointed out the MMS's proposed rules are not in accord with the February 1984 recommendation of the President's Commission on fair market value policy for Federal Coal Leasing (Linowes Commission). One commenter restated the conclusions of Linowes Commission by stating "[T]he Federal royalty should be based on the value of the coal being produced, not on State and local taxes as well. Federal royalty policies should not create an incentive for higher State and local severance taxes, or similar production based taxes, by increasing the effective total return to a given percentage tax. State and local governments should bear the direct responsibility for the full financial impact of their severance taxes. Accordingly, the Commission recommended that 'the base for calculating Federal royalty payments should be the F.O.B. price minus all State and local severance and similar taxes'."

A definition of severance tax has been added in § 206.251. *See* discussion above.

During the September 7, 1988, public hearing, a difference of opinion surfaced concerning whether exclusions for taxes, fees, or royalties, represents an established industry standard outside of Federal coal leasing. One industry commenter stated unequivocally that all private coal leases in the west contained valuation terms that were net (noninclusive) of taxes, fees, and royalties. The other industry commenter refuted the previous commenter's position by stating that it was not that conclusive. The commenter stated that lease terms often varied by region and often the bargaining strengths of the parties dictated the ultimate lease valuation provisions. This commenter then concluded that his company's leases and other large landholder's leases contained lease terms requiring royalty to be assessed at the gross (no exclusion) level.

MMS Response: The MMS has adopted the provision that amounts for AML fees and Black Lung taxes are excluded from royalty value. The MMS agrees that these fees do not add to the value of the coal. On review, MMS declined to extend the exclusions from royalty value to include "royalty on royalty." The term "royalty on royalty" is somewhat a misnomer. Although various mathematical calculations were submitted to show the effects of purchaser royalty reimbursement on royalty payments, no argument could change the nature of what a mineral royalty is: A share of minerals produced. At a rate of 12.5 percent, one ton out of eight belongs to the lessor, no more and no less. To attribute some intangible addition to the lessor's share destroys the concept of royalty itself. Therefore, the proposal to exclude "royalty on royalty" was not adopted in the final rule.

Paragraph (b)(5) also has been modified to allow for the exclusion of State and local severance taxes from gross proceeds. Additional language was added to clarify that these exclusions refer only to the cost of the tax or fee itself. No additional deduction is allowed because the lessee has incurred interest charges or other monetary penalties arising from the nonpayment or underpayment of the Black Lung excise tax, AML fee, or severance tax.

The Department believes that there are several reasons to exclude severance taxes from the Federal royalty value for coal. First, coal has its own valuation history. Second, but related, are the characteristics of the coal marketplace.

The comment submitted jointly by the National Coal Association, American Mining Congress, Edison Electric Institute and the Western Coal Traffic League, and the comment submitted on behalf of Kanawha and Hocking Coal & Coke Company and Valley Camp of Utah, Inc., focused on the historical valuation of coal. First, as noted earlier, prior to the Federal Coal Leasing Amendments Act of 1976 (FCLAA) revision to the Mineral Leasing Act (MLA), virtually all Federal coal leases had cents-per-ton royalty clauses. Therefore, severance taxes as part of royalty value was not an issue. The first administrative decision dealing with the coal severance tax issue is *Knife River Coal Co.*, 29 IBLA [Interior Board of Land Appeals] 26 (1977), a decision involving one of the few pre-FCLAA leases with an ad valorem royalty clause. The Board concluded that it should follow the decisions involving gas and include severance tax reimbursements as part of the value. However, in deciding that case, IBLA did not address two important concepts. First, the MLA as amended by FCLAA was different for coal than for gas in terms of defining the royalty obligation. For gas, royalty is due on the "value of the production," 30 U.S.C. 226, whereas for coal, royalty is due on "the value of coal as defined by regulation * * *." Second, IBLA did not consider that when the Department adopted regulations to implement the new statutory scheme as for gas. The current coal regulations in 30 CFR 203.200(f) use the term "gross value" whereas the oil and gas rules in 30 CFR Part 206 always used the term gross proceeds. Also, the department did adopt specific rules providing that tax reimbursements are included in gross proceeds. *See* Notice to Lessees and Operators of Federal and Indian Onshore Oil and Gas Leases (NTL-5), 42 FR 22610 (May 4, 1977)). Such a specific requirement was not promulgated for coal.

More important than the historical application of regulatory provisions by the Department, however, is the perception today by both coal producers and coal purchasers of the market for coal. As MMS has consistently emphasized in its product value rulemaking, the best determinant of value is the market. In the coal context, some of the comments maintain that severance taxes are not part of the market value of the coal. For example, in its comments, the Western Fuels Association reiterated testimony that it had previously provided to the Congress:

> The value of a product does not increase because a tax or fee is added to it, only its cost increases. As a matter of fact, the inclusion of these items could well cause the product's value to decline.

The Western Fuels Association, as well as many other commenters, also cited the Linowes Commission, *Report of the Commission: Fair Market Value Policy for Federal Coal Leasing.* Recommendation VIII-5 of that report states: "The base for calculating Federal royalty payments should be the F.O.B. price minus all State and local severance taxes and similar taxes." Thus, this independent commission did not consider taxes to be part of value.

A comment which focused directly on the question of how the market perceives severance taxes was submitted by Utah Power & Light Co. It's comment states:

> The MMS has stated that the cornerstone of the regulations is the interaction of buyers and sellers who are knowledgeable, willing and not obligated to buy or sell. This market concept does not properly consider federal and state taxes and/or fees which are not set in the market place, but arbitrarily set by federal and state agencies for purposes of raising revenues. The states and Federal Government as lessor can manipulate its' [sic] royalty revenue by increasing or decreasing taxes and fees, proving they do not contribute to the value of coal. This not only puts a burden of uncertainty on producers and consumers of federal coal but provides the lessor a mechanism to impact the "1/8 share" of production he is to receive.

Additionally, the inclusion of these fees, which are not market driven, unnecessarily inflate the cost of federal coal in the long-run, potentially making it an undersirable fuel choice.

Utah Power & Light's comments were addressing only AML fees, Black Lung taxes, State severance taxes and Federal royalty—not State or Federal income taxes and similar taxes.

The characteristics of the market for coal also was the subject of considerable comment by the Edison Electric Institute (EEI). It is EEI's conclusion that "Coal is not a commodity like oil. The market for Western coal is user specific and is custom-produced according to quantity and quality." The EEI also noted: "In fact, seldom is the same price paid for Western coal from the same mine where the mine sells coal to several buyers."

It is indeed true that oil and gas and coal are very different commodities. In addition to their obvious physical differences and the differences in production methods, Federal western coal is used in large part only for electric generation, whereas this is only one of many uses for oil and gas. Related to their varied uses is the fact that oil and gas prices are dictated in large part by international market forces. Coal, on the other hand, is affected more by specific markets because it is not a fungible. For example, many large western mines are developed to supply coal to a particular powerplant which is designed specifically to burn that coal. If that purchaser is lost, the coal may not be readily saleable.

The differences in the coal market from that for oil and gas have resulted in different contracting practices, with the value of the coal being established first, and then severance taxes and other reimbursables being treated separately. Again, what purchasers are willing to pay for domestic oil and gas tends to be dictated more by international market forces than by local market needs.

It is the Department's conclusion from the large number of comments it received that consideration of the interaction of the market place supports excluding severance taxes from the value of the coal for royalty purposes. As noted above, coal buyers, and sellers commented that taxes are not part of the coal's value. Many of the comments point that even the states which impose a severance tax recognize that there is a determinable value for the coal before the tax is assessed because the assessment is based on the value of the coal net of any amount representing the tax. Thus, for coal, the Department has concluded that severance taxes increase the cost of the resource but not its value. Consequently, the Department is excluding severance taxes from the value of coal for Federal royalty purposes.

Comment: Paragraph (b) (6) of the proposed rule provided that the royalty value would not include payments received by a lessee pursuant to its contract if the lessee demonstrates to MMS's satisfaction, that such payments were not part of the total consideration paid for the purchase of coal.

Most comments received by MMS were addressed earlier in the general comment response to MMS's position with respect to take-or-pay and similar type payments. However, one comment raissed particular issues that require separate responses here. The commenter stated that the proposed regulation, as worded, appears to defeat judicial review because the demonstration (that a payment is not royalty bearing) is "to MMS's satisfaction," instead of an objective finding of fact. The commenter concluded that "Royalty determinations are subject to judicial review under the Administrative Procedure Act as actions that have not been committed to agency discretion by law, and MMS cannot adopt an unreviewable standard in the face of this congressional mandate for review."

MMS Response: There is no attempt to circumvent the requirements of The Administrative Procedure Act. The MMS decisions generally are subject to the administrative appeal process. Adverse decisions may ultimately be taken to the Federal court system for relief.

The MMS has adopted this paragraph (b)(b) as proposed. Under this section, there is a presumption that payments received by the lessee from its purchaser are payments for coal production. The lessee can rebut that presumption, but the burden is on the lessee to come forward with the justification for its position that the payment was not for coal production. The MMS always has had a consistent policy that royalty is due on no less than the lessee's gross proceeds, which includes all payments for production. Heretofore, that policy resulted in royalty demands on virtually all payments from the purchaser to the seller. However, payments must indeed be payments for coal production before any royalty is owed. Therefore, lessees will have the opportunity to come forward with arguments as to why a particular payment under a coal sales contract is not part of the value of the coal production.

Because there are so many different types of coal sales contract clauses, MMS cannot include in this rulemaking comprehensive criteria which could be considered in deciding whether a lessee has met its burden to demonstrate a particular payment is not royalty bearing. However, 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 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.

The provisions of paragraph (b)(6) will not be applicable to any types of payments which other sections of the rules expressly include as part of the royalty value, such as payments for the costs of placing production in marketable condition.

As MMS gains experience in dealing with these issues, MMS expects to develop criteria which may be included in the regulations at a later date.

Paragraph (c), which contains MMS's valuation criteria when coal is disposed of under non-arm's length conditions, generally is unchanged from the July 15, 1988, notice. The MMS did make one change to clarify the application of the first benchmark in paragraph (c)(2). The proposed rule provided that MMS would accept the lessee's gross proceeds under its non-arm's-length contract if those proceeds were "equivalent" to those

under "comparable" arm's-length contracts. While the proposal included criteria for comparability, no criteria existed for equivalency; therefore, MMS has modified the final rule to provide that the lessee's non-arm's-length gross proceeds will be acceptable if it is within the "range" of gross proceeds paid under comparable arm's-length contracts in the field or area.

Comment: The MMS received numerous comments following the January 15, 1987, proposed rulemaking concerning non-arm's-length valuation. Eight industry, three Indian, and three State respondents submitted 27 comments regarding the non-arm's-length valuation criteria of the regulations. One industry commenter stated MMS should always be notified which valuation criteria is being used. One industry commenter questioned what is a "reasonable value[?]" One industry commenter stated that the value of non-arm's-length sales should always be established using that lessee's arm's-length contracts. The respondent supported its position by stating, "The lessee's arm's-length contracts are the best evidence of the value" had the lessee "sold the coal under an arm's-length contract." One industry commenter suggested using the average price of the lessee's arm's-length contracts. One industry respondent stated that paragraph (c) could be deleted if "the criteria for determining gross royalty [were adopted] as prescribed in 26 CFR 1.6134(b)(2), based on a representative market or field price."

Fourteen comments recommended either revising the application order or revising the language of the valuation criteria. Two State commenters recommended exchanging the sequence of paragraphs (c)(2)(i) and (c)(2)(ii). Two Indian commenters recommended ignoring arm's-length contracts of the lessee and seeking "[t]he highest gross proceeds" in "the same coal field" or alternatively "from other coal fields" as being the first two preferred valuation criteria. One State commenter suggested revising paragraph (c)(2)(ii) because it would be too difficult to implement, and the contracts of other lessees would not be available. Another industry commenter stated that the term "area" as used in paragraph (c)(2)(ii) should be defined. Two industry and one State respondent specifically addressed paragraph (c)(2)(iii), which would use prices reported to a public utility commission as the value for royalty purposes. One State commenter suggested this method was the most accurate because "it is highly unlikely that they [utilities] will understate their coal or fuel costs." One industry commenter stated that the value should be the production costs reported to the public utility commission less taxes and fees but plus a profit. One industry commenter disagreed with the use of paragraph (c)(2)(iii) because the regulation is unclear as to "who is reporting the price of the coal," and the price could include transportation and handling expenses, thus unnecessarily increasing the royalty value of the coal.

MMS Response: The intent of sequenced valuation criteria is to avoid any opportunity to selectively choose a valuation method which minimizes the lessee's royalty obligation, as opposed to correctly establishing royalty value under these rules. Conversely, these rules also offer the lessee the assurance that MMS would not arbitrarily rebut the benchmark that assigns the highest gross proceeds in the area to the lessee unless mandated by the regulatory criteria.

The July 15, 1988, notice contained minor modifications to the non-arm's-length valuation criteria listed in paragraph (c) of the January 15, 1987, proposed rulemaking. Most notable was that criteria (i) and (ii) were combined into a single valuation criterion. The effect from this modification is to increase the number of arm's-length contracts available for review, thus increasing the opportunity for a value via comparable arm's-length contracts. Also, as discussed above, MMS has replaced the term "equivalent" with provisions that clarify MMS's intent that the non-arm's-length price would be acceptable if it is within the range of comparable arm's-length contracts in the field or area. The MMS also removed the term "reasonable" from the phrase "reasonable value," which was stated in the first two sentences of paragraph (c)(2). Any value correctly established under paragraph (b) or (c) is the value for royalty purposes.

With respect to the comment requesting adoption of 26 CFR 1.613-4(b)(2), MMS cannot identify any benefits in administration or simplification in valuation that would occur. The Internal Revenue Service (IRS) rejects the taxpayer's use of representative market or field prices determined by exceptional, insignificant, unusual, tie-in, or accommodation sales. The IRS also disregards any representative market or field price established in transactions between members of a controlled group unless the IRS has determined the price to be a competitive sale price. See 26 CFR 1.613-4(c)(3). The IRS requires any taxpayer that computes its depletable income using representative market or field prices to attach to its tax return a summary statement indicating the price or prices used and the sources of the information as to such price or prices. Also, IRS requires the relevant supporting data to be assembled, segregated, and made readily available at the taxpayer's principal place of business (26 CFR 1.614-4(c)(5)). The MMS considers the IRS provisions more burdensome than the provisions in these rules.

Comment: One State respondent objected to using spot market prices to value coal under paragraph (c)(2)(v), explaining that "our experience with published or publically [sic] available spot market prices for fuels leaves much to be desired." Three commenters disagreed with the mandatory prioritization of the non-arm's-length valuation criteria. One State commented that such a prioritized approach could "be more appropriately referred to as a straight jacket system." Another State commented that "prioritizing the benchmarks constitutes a significant change in long-standing * * * procedures" and would "limit the Secretary's discretionary ability * * *." One Indian commenter maintained that the lessee should not select the appropriate valuation criterion, but instead MMS should apply the correct valuation method.

One Indian commenter stated the non-arm's-length valuation criteria are too subjective and costly to administer. One Indian commenter stated that if the approach of paragraph (c) were to be used (to determine value in accordance with this paragraph), then "[t]he Secretary should determine whether each contract is arm's-length or non-arm's-length * * *."

One industry commenter stated that the net-back approach of paragraph (c)(2)(vi) was ill-defined.

MMS Response: The MMS will review the procedures adopted by lessees to establish non-arm's-length royalty values on a selective basis. The MMS intends to ensure compliance with these rules through vigorous monitoring, review, and audit activity. The MMS will verify that lessees chose the correct valuation method and will be available to assist lessees in calculating net-back royalty values. The MMS agrees that the prioritized valuation criteria procedure is a departure from past practice. The benchmark system has been adopted in order to provide certainty in valuing coal for royalty purposes. The MMS wishes to point out that MMS discretion is not attenuated in making a decision

on whether or not a contract is arm's-length. If a lessee incorrectly maintains that a contract is arm's-length and pays royalty accordingly, the MMS may find otherwise and require royalties be paid according to non-arm's-length criteria.

Comment: In the July 15, 1988 notice, the coal industry had commented that in today's weak coal market MMS should not receive a royalty computed on a cost-based contract that exists between affiliates. These comments were based on the premise that in today's environment mining costs often exceed the price for which coal can be sold in the marketplace. Therefore, MMS specifically requested comments on whether the final rules should include a provision whereby royalty value for non-arm's-length sales in mine mouth or captive mine situations should be based principally on current market determinants such as spot prices.

Several comments were received responding to this specific request. The majority of commenters supported the non-arm's-length valuation procedure as proposed by MMS; i.e., the first applicable benchmark but in no case less than gross proceeds. One commenter stated, "The prices in such [non-arm's-length] contracts nonetheless represent the value of coal to the purchaser, at least to the extent that such contract prices are accepted and passed on to consumers by the appropriate electric utility regulatory body, and they are gross proceeds to the producer. It would be grossly unfair to allow producers to pay a royalty only on the current spot market price of coal when they receive, and electricity consumers pay, far more for the coal."

Another commenter noted that accurate spot market prices are generally unavailable, and, although they are an indication of current market prices, they have no application when compared to long-term captive mine agreements. Only one commenter agreed that the value of coal should be based solely on market value determinants such as spot market prices. In a somewhat different approach, another commenter stated that value for captive mines could be determined by biennial regional rulemaking. In this approach MMS would in some way average current spot and term bids with the average contract price paid during the previous year. In regard to Indian coal, one comment stated, "We recommend that for Indian coal leases, MMS take the higher of the results between the current market determinants and the value as determined by benchmarks. Such dual accounting for Indian leases is consistent with the Secretary's trust responsibility." One other comment was received in regard to the the non-arm's-length benchmarks at § 206.257(c)(2). This comment expressed concern that in a rising market, using a comparative arm's-length value would remove some of the benefits of a long-term arrangement with their subsidiary. This same commenter also cautioned that prices reported to public utility commissions or prices reported to the Energy Information Administration may contain plant handling or transportation costs that should not be subject to royalty.

Another commenter applauded MMS's use of the net-back method as the benchmark of last resort.

MMS Reponse. The MMS has decided not to disturb the arm's-length valuation criteria as listed in the July 15, 1988, notice. Therefore, the first criteria to be applied are market-based value determinants. The lessee would be required to compare its non-arm's-length contract with its comparable arm's-length contracts and to other comparable arm's-length contracts of coal producers in the same area. Using the comparability criteria in paragraph (c)(2) will ensure that long-term contracts are compared only to other long-term contracts and not to spot contracts. Likewise, in valuing a lessee's spot sales contract, only other spot sales contracts will be used.

Failing to establish a value using the arm's-length comparability test, the lessee would then establish the coal's value using the prices approved by a State public utility commission or, following that, prices reported to the Energy Information Administration of the Department of Energy. Setting the coal's value for royalty purposes based on prices approved by public utility commissions is consistent with MMS's gross proceeds concept, because the amount that a utility can pay for its own captive coal production is regulated and approved by the public utility commission. Therefore, in this situation, MMS is limiting its royalty value to that value received by the lessee.

As restated in 1984 by the Supreme Court of the State of New Mexico in a case involving the reasonableness of coal costs:

> The normal burden to be met in making a *prima facie* case regarding costs incurred in transactions with non-affiliates is a demonstration that the costs were, in fact, incurred. However, the normal burden regarding costs incurred in transactions with affiliates is heavier, requiring a showing of the reasonableness of the costs. *Boise Water Corp.* v. *Idaho Public Utilities Commission*, 97 Idaho 832, 555 P.2d 163 (1976).

If the public utility commission is unconvinced of the justness or reasonableness of a utility's costs, including fuel (coal) costs, it can deny incorporation of those costs into the electric rates.

The MMS ranked the use of spot market prices low for minimal application because of dissimilarities between long-term contracts and spot market sales in market purpose and motivation and because of disparities in long-term versus spot sales market share.

Literature published on the domestic coal market states that the domestic coal market is subdivided into two categories: The commercial coal market and the captive coal market.

The commercial coal market is comprised of coal producers that do not use their product and coal consumers that do not produce it. Within this subdivision two types of transactions dominate, which are the long-term contract and spot sales. The purposes of long-term coal contracts have been stated to be:

—Assured quantity (buyer expectation)
—Assured quality (buyer expectation)
—Predictable price (buyer expectation)
—Assured demand (seller expectation)
—Minimized investment risk (seller expectation)
—Guaranteed cashflow (seller expectation)

Only some of the previously listed advantages of security and stability, for the buyer or the seller, are present in the spot market. Because both the supply and demand for spot market coal tends to be short term, the pricing of spot market coal is substantially more volatile than that of long-term contracts.

The volatility of the spot market, for both the coal consumer and coal producer, coupled with the huge investments required to open a western surface mine, relegates the spot sales to a small fraction of the total market. The Department of Energy, Energy Information Administration, publication titled *Coal Data: A Reference* (released March 6, 1987), shows the following historical average relationship between market share of long-term contracts and spot sales.

Year	Long-term contract (million short tons)	Spot sales million short tons	Spot sales tonnage as a percent of total tonnage [1]
1981	500.9	75.5	13.10
1982	540.6	57.0	9.54
1983	523.6	69.2	11.67
1984	584.8	99.3	14.52

Year	Long-term contract (million short tons)	Spot sales million short tons	Spot sales tonnage as a percent of total tonnage [1]
1985	592.4	74.3	11.14

[1] Total tonnage equals long-term contract tonnage plus spot sales tonnage.

The Wyoming Geological Survey publication titled *Wyoming Geo-notes No. 14* (published April 1987) stated that in 1985 spot sales accounted for about 4 percent of total Wyoming coal sales. In 1986 spot sales accounted for about 5 percent of total Wyoming coal sales.

The second major subdivision of the domestic coal market is the captive coal market, wherein the consumers produce their own coal to satisfy their needs. In contrast to the commercial market, captive coal producers do not normally sell captive coal production on the spot market. Instead, captive coal's principal use is to serve internal consumption requirements.

Comment: Prior to publication of the July 15, 1988, notice, several comments were made on § 206.259(d), now designated § 206.257(d). Three industry and two Indian respondents submitted four comments concerning paragraph (d). Three industry commenters suggested amending this paragraph to provide for lessee appeals of MMS valuation determinations. Both comments proposed adding a new section of regulation, with one commenter stating "to provide for an adjudicatory hearing on MMS determinations under 5 U.S.C. 544 [sic]." One Indian commenter recommended "in the case of Indian lands, all non-arm's-length computations of value for royalty purposes * * * should be preapproved [by MMS]." Another Indian commenter agreed, and also stated paragraph (d) "should require MMS to notify the tribe or allottee involved of any change in value determinations."

MMS Response: The right of a lessee to appeal MMS decisions is provided at 30 CFR Part 290. Further right of appeal is provided at 43 CFR Part 4, "Department Hearings and Appeals Procedures." The MMS considers that the current appeal procedures provide appropriate avenues of recourse to the lessee. With regard to the comment of Tribal or allottee notification of value determinations, the MMS finds it reasonable that Tribes or allottees should be provided an explanation when MMS product value determinations affect royalties.

For the July 15, 1988, notice, paragraph (d) was modified from the first proposal. Paragraph (d)(1) provides that value determinations under paragraph (c) do not require MMS's prior approval. However, the lessee would be required to retain all data that would be subject to review and audit. The MMS could direct a lessee to use a different value for calculating royalty if it determines that the lessee's reported value is inconsistent with the requirements of the regulations.

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

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

Paragraphs (d)(1), (d)(2), and (d)(3) are adopted unchanged in this final rulemaking.

Comment: Paragraph (e) was added in the July 15, 1988, notice to clarify that if a lessee improperly determines value, the lessee would be liable for both the additional royalties and interest. A few commenters noted that interest is not actually a penalty, and that penalties should be charged in addition to interest. Comments were also received on the issue of interest after the January 15, 1987, proposed rulemaking. Several commenters stated MMS should pay interest to lessees for royalty overpayments. One commenter explained, "For the sake of consistency and fundamental fairness, the interest payment should either apply in both cases or in neither." One commenter took a different approach, arguing that if "the United States cannot provide or pay interest on judgments without the express consent or approval of the Congress, it does not seem to preclude the government's recognition of such over-payment, along with the interest accrued, through means of an escrow account system with payment of the interest going to the prevailing party." this same commenter provided an alternative recommendation "to allow credits on royalties due in the future, including the interest earned on the original over-payment of royalty." One commenter recommended revising current paragraph (e) to "provide for some allowance for error for which no interest will be assessed on the underpayment, similar to the Internal Revenue Service's allowance for the payment of estimated tax which will be due."

MMS Response: MMS believes that the interest payment required for improperly reporting value, while not a penalty, is a sufficient deterrent to intentional underreporting. In addition, under the provisions of 18 U.S.C. 1001, it is a crime punishable by up to 5 years imprisonment or a fine of $10,000, or both, for anyone knowingly and willfully to submit or cause to be submitted to any Agency of the United States any false or fraudulent statement(s) to any matters within the Agency's jurisdiction.

On the issue of MMS paying interest to lessees for royalty overpayments, Congress has not provided MMS with this option, and MMS cannot authorize which interest payments, without Congress' approval. The MMS also does not have authority to establish escrow accounts.

Comment: Twenty industry and one Indian respondent commented on § 206.257(g), which primarily would require that the value for royalty purposes can be no less than the gross proceeds accruing to the lessee less applicable exclusions. Paragraph (g) was initially proposed as § 206.259(f). Comments pertaining to the "which could accrue" issue have been addressed by MMS at § 206.257(b). Other comments were received concerning take-or-pay payments. The MMS addressed the issue of royalty on take-or-pay payments in the discussion of general comments. Readers are requested to refer to those sections for MMS's discussion concerning these topics. One industry comment was received which specifically objected to a royalty value floor of no less than gross proceeds. One Indian comment was received concerning the paragraph (g) provisions of take-or-pay payments as related to make-up deliveries. The Indian respondent requested that paragraph (g) be clarified such that "a lessee should not be allowed to deduct from royalty payments any return of take-or-pay payments required by the lessee in the event make up quantities are not available. Royalties on take-or-pay payments should be able to be offset only with make-up deliveries, not royalty adjustments."

MMS Response: With respect to the comment requesting clarification of the disposition of royalty payments made on take-or-pay payments subsequently returned, MMS would either refund the royalty overpayment or otherwise provide a credit against further royalties from that lease. The MMS considers the lessee's refund of a take-or-pay payment to the purchaser to be tantamount to a retroactive contract price adjustment, thus precipitating necessary adjustments in previously paid royalties.

For this final rulemaking, MMS has amended paragraph (g), deleting

reference to take-or-pay payments. Please refer to the section on general comments for MMS's policy on take-or-pay payments. Regarding the comment that objected to a royalty floor of no less than the lessee's gross proceeds, MMS responded to this issue in its response at paragraph (c).

Comment: After the January 15, 1987, proposed rulemaking, twelve industry respondents submitted 18 comments concerning § 206.257(h), which was intially designated as § 206.259(g). Two commenters stated that there was no need for MMS to charge royalties on additional imputed values because the contract price normally reflects the fair value for both the coal sold and the services provided in connection with the sale of that coal. Four commenters stated that there could be a need for such a provision, with one particular commenter explaining that "otherwise, an opportunity for abuse could occur and royalty payments could in some isolated instances partially be avoided by manipulation of contracts." Four commenters also urged MMS to apply this regulation prospectively to newly executed contracts, not to existing contractual relationships. These commenters continued to explain that the retroactive application of the provision of paragraph (h) would create a major disruption in the industry, because the coal industry is replete with existing contractual realtionships wherein purchasers are providing certain services or facilities which normally would be the responsibility of the lessee. One commenter objected on the basis that "the rules create some sort of an operational warranty on the lessee's activity under the lease. We know of no authorization of such an express warranty." One commenter objected to paragraph (h) because "MMS should not collect a royalty on the increased value of coal resulting from beneficiation." This commenter further questioned "how the owner of a raw product can value it to a lessee on the basis of what it will be worth after the lessee spends the money to upgrade the product." One commenter claimed, "Paragraph (g) [h] imposes a lease term not presently contained in the existing Federal coal leases, namely that the lessee is required to place coal in a marketable condition." Three other commenters took a similar position, stating that the provisions of paragraph (h) have no basis in law. Three commenters requested that MMS retain the current regulations (30 CFR 203.200) and supported their position by stating that paragraph (h) was unnecessary and what constitutes marketable condition was vague.

MMS Response: The MMS has retained paragraph (h) as originally written (originally designated as paragraph (g)) in the proposed regulations published January 15, 1987. The MMS responsibilities regarding paragraph (h) will be upheld in considering both past and future coal sales contracts. The MMS does not now allow Federal or Indian royalties to be avoided through sales contracts which require purchasers to fulfill services that are normally the responsibility of the lessee. Allowing a sale price to be reduced because the purchaser performs certain normal mine preparation services which typically fall to the lessee or mine operator represents an indirect, but nevertheless just as real, deduction from royalties for the cost of placing coal in marketable condition. The MMS and its predecessor agency have always required that lessees place lease production in marketable condition without cost to the Federal or Indian lessor. This practice has not been changed in these final regulations. Additional discussion of this issue is found in MMS's general comments response regarding "marketable condition" and "grandfathering."

Comment: Numerous comments were received after the July 15, 1988, notice regarding § 206.259(e), now redesignated as § 206.257(i). Twenty-three industry, one Indian, and one State respondent submitted 35 comments. Thirteen industry commenters specifically called for the deletion of this paragraph. Nine industry commenters object to "second guessing" by MMS. One commenter particularly noted this paragraph would make MMS a party to sales contracts. Two commenters stated that paragraph (i) was unworkable, with one commenter explaining that unless MMS increases staffing requirements to analyze contracts "that they [MMS] are not in the position to interpret the contract or any subsequent amendments." Five industry commenters believed this paragraph would prevent compromise between the lessee and the buyer and, as one other commenter explained, "would result in a * * * flooding of the courts with unnecessary litigation merely to justify a position." One industry commenter stated that the third sentence, requiring contract amendments to be in writing, was in conflict with the definition of "contract" in these proposed regulations.

One Indian respondent objected to the provision of paragraph (i) allowing contract amendments to be retroactive. The commenter further stated that "the lessee should not be able to compromise the lessor's right to receive royalty payments pursuant to the original contract and not under any amendments that have compromised the price." Two industry commenters objected to the provisions of paragraph (i) because the provision would be unfair to the consumer. As one commenter explained, "[T]he coal producer will always be able to argue that the consumer or purchaser should agree to some higher price since that is what MMS would set in any event since the producer, under federal regulations, has an affirmative obligation to extract the maximum possible price from the coal consumer." Two industry commenters stated that paragraph (i) was unwarranted, with one commenter further explaining that there is no "reason to presume that a producer will not obtain the maximum consideration allowed under its contracts." One State respondent countered this presumption, stating that "failure on somebody's part to enforce the contract is, according to one auditor's experience, not at all hypothetical. They [the auditors] have found instances where a company has simply neglected to invoice for several years for a payment they were definitely entitled to under the contract."

MMS Response: Paragraph (i) was revised in the July 15, 1988, notice to eliminate the "could receive" language but emphasizes that royalty is due on all benefits to which the lessee is legally entitled. The rule also limits any effect on royalty due to retroactive contract revisions to a two-year historical period.

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

price increases only and" has been deleted from the last paragraph to eliminate excess redundancy. However, if a higher price can be legally enforceable under a contract and the lessee is not diligent in obtaining that price, royalties will be due on that higher price.

Comment: In response to the July 15, 1988, notice, several commenters repeated the allegation that paragraph (i) would allow the MMS to "second guess" industry practices, and suggested that this provision be deleted.

MMS Response: These regulations reflect MMS's willingness generally to accept arm's-length contract prices as value, but there is a concomitant obligation on the part of the lessee to obtain all to which the lessee is entitled under its contract. If it fails to take such reasonable measures, MMS will assess royalty on the prices which reasonably could have been obtained in accordance with the contract.

Comment: Several commenters objected to the requirement that contract revisions or amendments must be in writing and signed by all parties. The commenters stated that this requirement obstructed normal business practices in their day-to-day administration of coal sales contracts and constituted undue interference by the government.

MMS Response: The MMS does not intend to interfere in the day-to-day administration of contracts. The MMS believes that the consideration flowing from buyer to seller is the best measure of the parties' interpretation of their sales agreement. This provision is included in the final rule to ensure that any retroactive price reduction, and thus any claim by the lessee for refunds or credits, is legally enforceable.

Comment: One commenter expressed concern that a two year limitation to retroactively change value could impose an undue burden on the lessee where non-arm's-length value has been determined by prices reported to a public utility commission. The commenter stated that public utility commissions often rule on fuel costs three to five years after they have been included in rates and adjust them retroactively. Another commenter approved of MMS's restriction of limiting retroactive price changes to two years.

MMS Response: Paragraph (i) provides that retroactive adjustments to value will be limited to two years unless MMS approves a longer period. In a situation such as the one described a longer period would be approved.

Paragraph (k) was published in the January 15, 1987, proposed rulemaking, as paragraph (i) and modified slightly in the July 15, 1988, notice to specifically note that the rights to information by Indian lessors are not diminished by this paragraph.

The release of financial and confidential information for Federal solid mineral leases is subject to the Department of the Interior's (Department) regulations for releasing this type of data to the public. See 43 CFR 2.13. It is the policy of the Department to make the records available to the public to the greatest extent possible, in keeping with the spirit of the Freedom of Information Act (FOIA), 5 U.S.C. 552. It is the policy of MMS to make available information requested under the FOIA at the earliest possible date, while, at the same time, protecting the rights of individuals involved, and the administrative processes surrounding such rights. It also is the policy of the Department to withhold information falling within one of the FOIA exemptions only if (1) disclosure is prohibited by statute or Executive Order, or (2) sound grounds exist for not releasing such information. Accordingly, MMS considers certain information submitted by a person or entity privileged and financially confidential. We recognize the critical importance of this information to the success and competitive position of a business. Therefore, MMS does not release this information without the permission of the submitter. However, MMS will, to the extent legally permitted, release proprietary data to any State or Indian tribe upon a satisfactory explanation of why this particular data is necessary and following the execution of a binding written agreement to safeguard the proprietary data.

Section 206.259 Determination of Washing Allowances.

In the July 15, 1988 (53 FR 26942), notice, MMS discussed various changes that had occurred from the January 15, 1987, proposed rulemaking. The MMS noted that the allowance limits had been eliminated. The MMS also provided its rationale for that modification. Another change from the January 15, 1987, proposed rulemaking was the substitution of the interest rate associated with Standard and Poor's industrial BBB rate in place of Moody's Aaa corporate bond rate. This interest rate is used to compute the return on investment component in non-arm's-length allowance calculations. An extensive explanation of this change is provided in the preambles to the final oil and gas product valuation rules published on January 15, 1988 (Oil—53 FR 1212–1214; Gas—53 FR 1262–1263, respectively).

Comment: In the July 15, 1988, notice, MMS also requested comments on providing an exception to the cost-based approach for non-arm's-length allowance computation. The MMS explained that in certain circumstances where the gas plant operator provides the same services under arm's-length contracts as it does for itself, the arm's-length contract processing costs can be substituted in place of actual costs. The MMS requested whether a similar provision should be included for coal washing.

MMS Response: The MMS received no comments on this proposal; therefore, the final rule contains no such provision.

Comment: Many comments received by MMS pursuant to the January 15, 1987, proposed rulemaking were not addressed at the time of the July 15, 1988, notice. To the extent these comments continue to be relevant to the July 15, 1988, publication, they are addressed below.

Two industry commenters specifically recommended that the allowance should be based on the added value, not the cost incurred. One commenter explained, "The lessee's royalty obligations end once the coal is first placed in a marketable condition, and that is the point at which royalty value should be determined."

MMS Response: The MMS believes that determining the value added would be subjective, difficult to implement, and would require additional rulemaking. The reasonable, actual cost of coal washing is the preferred method to arrive at an appropriate allowance.

Comment: Two industry commenters specifically endorsed MMS's proposal to continue coal washing allowances. Eighteen other industry commenters recommended that MMS extend the allowance to include all forms of beneficiation (processing). According to one commenter, coal processing would encompass coal washing, "pelletizing; beneficiation; treatment with substances including chemicals or oil; drying; and subsequent handling which occurs after coal is first placed in a marketable condition." Three Indian and one industry respondent opposed granting any washing allowances, with one Indian commenter going further to recommend that "no allowances be given for any type of coal beneficiation." This commenter reasoned, "To provide for allowances for all types of coal beneficiation will create a bureaucratic nightmare * * *." One industry commenter recommended deleting all allowances as "unnecessary under * * *

market value standards." This commenter explained that market value would be determined "by current sales of comparable unwashed coal." One Indian commenter opposed an allowance because "a practice which is primarily a conservation measure does not belong in regulations to value the product for royalty purposes."

MMS Response: The regulations continue the historic practice of allowing deductions for the cost of coal washing from the sale proceeds of cleaned coal. See 30 CFR 211.63, May 17, 1976, 41 FR 20271, for original policy. The MMS believes that improving the quality of domestic energy resources is in the national interest. The allowance procedure will not be difficult to implement and should be less difficult to administer than the procedure that was in effect under the prior rules. Treating coal with oil or chemicals in order to suppress dust and/or improve handling is considered to be the responsibility of the lessee to place coal in a marketable condition. Any payment for such activities therefore is a component of gross proceeds, if this treatment is required by the purchaser.

Comment: One industry commenter proposed an alternative method for calculating allowances using the previously discussed Internal Revenue Code (IRC) "depletion income" method of valuing coal. A "processing allowance" would be subtracted from the "depletion income" before the royalty rate is applied to the resulting "net royalty value." The allowance would be calculated by multiplying the "depletion income" by a fraction, "the numerator of which is the cost of all post marketable condition processes and handling [after crushing and sizing] and the denominator of which is the total costs of all pre and post marketable condition processes and handling." This commenter justified this method as being more advantageous than the "complex and inadequate concept proposed by MMS" because it is (1) simple to calculate "based on available information and easily audited"; (2) used by other State and Federal "agencies with satisfactory results"; (3) eliminates "potential for excessive deductions"; and (4) results in a "fair" allowance.

MMS Response: The MMS has carefully reviewed the underlying principles and history of the proportionate profits method and has concluded that it has no application for determining washing allowances for royalty purposes.

The proportionate profits formula is a specific procedure under IRS regulations to determine the "gross income from mining" for depletion allowance income tax purposes when representative field or market prices are unavailable or inapplicable.

The outcome of the proportionate profits formula is elimination from the depletion allowance of all nonmining costs. Its purpose is to establish a representative market or field price for integrated miner/manufacturers only when representative prices cannot be obtained in the area. Its intent is to place integrated miner/manufacturers on the same depletion allowance basis as ordinary nonintegrated miners, thus providing no unfair tax advantage to the integrated firms.

The proportionate profits method is premised on the theory that each dollar of total costs, including nonmining applications, earns the same percentage of profits as mining processes. Assuming this principle to be uniformly true, and it is not (for example, see *Hugoton Production Company* v. *The United States*, 349 F. 2d 418 (cl. ct. 1965)), it is improper to extrapolate this principle to situations which involve deductions for the ordinary mining processes. The workings of the marketplace suggest that if a mine product has not been prepared to meet the minimum acceptable conditions that are customary for the market, then that mined product may not be saleable and, hence, would have no value in the normal sense of the term. For these reasons MMS does not accept the proportionate profits formula to determine any allowance for royalty purposes.

Comment: Two Indian commenters stated that the regulations were unclear with respect to when allowances would be approved. One commenter also stated, "The preamble to the rules also states that coal washing allowances will be allowed when they enhance the value of the coal. But the regs * * * do not require any showing that there is an enhancement * * *."

MMS Response: Allowance forms showing recorded costs are to be submitted to MMS. Regulations on the timing of form submittal are provided at § 206.259 (c) and (e). With respect to the latter comments, MMS believes that a prudent lessee would to take up the task and incur the expense of washing coal unless the process ultimately increases the value or marketability of the coal.

Comment: One Indian comment stated "inclusion of ad valorem property taxes in allowable operating costs should not include taxes imposed by the Navajo Nation."

MMS Response: To the extent that property taxes are levied directly upon washing equipment or to the extent that it can be demonstrated that property taxes are allocable to washing equipment, MMS believes that such taxes should be included in the cost basis for allowance calculation. Such taxes represent costs just as real to the lessee as labor, materials, utilities, fuel, or other direct costs.

Comment: One Indian comment recommended that the language of the regulations be clarified such "that no profit can be included in the cost of washing * * *." One State commenter stated "if washing allowances are provided for, we see no reason to factor a profit component into the lessee's cost. A profit is not guaranteed to a lessee mining federal coal * * *."

MMS Response: The return on investment component of non-arm's-length allowances is not a profit component. Rather, this component is intended to represent a fair rate of return to capital. The MMS has solicited and received significant comments on what would constitute a fair return under these circumstances. The MMS believes based on these comments that the Standard and Poors BBB bond rate represents a rational choice among alternatives.

Regarding § 206.258(b)(2), MMS has removed the word "initial" before the phrase "depreciable investment in the wash plant * * *." This term caused confusion. It was not MMS's intent to exclude costs incurred after the original construction of the wash plant. Rather, total investment was the intent.

Comment: Two comments discussed paragraph (b)(2)(iv)(A), which prohibits altering the depreciation schedule initially established by the original owner of a coal wash plant. One Indian commenter agreed with this stipulation. An industry commenter disagreed stating, "A buyer will almost inevitably assign a new and different value to acquired assets. Such value will often exceed the previous owner [sic] book value, and establishes the new basis upon which future depreciation is calculated * * *."

MMS Response: In MMS's judgment, the simple change of capital asset ownership does not create a situation requiring asset depreciation to be repeated. However, any additional retooling, refurbishing, retrofitting, or other capital improvements would necessarily be added to the capital investment base and depreciated accordingly.

Comment: Following the July 15, 1988, notice, several additional comments were received concerning washing allowances. In general, Indian comments opposed allowances for

washing. State commenters expressed support for washing allowances. Industry generally favored washing allowances and in particular expressed support for the elimination of any limit to the allowance cost. However, one industry commenter opposed the granting of washing allowances. Two comments were received that expressed concern over the use of Standard and Poor's BBB industrial bond rate for non-arm's-length allowance determinations. One commenter stated that the "[j]ustification for the use of the rate in 52 FR 1212–1214 concerns the risk associated with mineral-related projects. However, washing and transportation, even transportation using new technologies, are ancillary services. The risk is in the mining of coal."

MMS Response: As stated earlier, MMS has examined the use of the Standards and Poor's BBB industrial bond rate carefully and has concluded that the use of such rate would be appropriate for use as an allowed rate of return for washing and transportation of coal.

Section 206.260 Allocation of washed coal

Comment: Following the January 15, 1987, proposed rulemaking, five industry respondents submitted five comments concerning § 206.261, now designated § 206.260. Two commenters agreed with the procedures to allocate washed coal back to the leases from which it was produced. Four respondents recommended substituting the term "processed" for "washed" in order to be consistent with their other proposals to expand washing allowances to include other forms of beneficiation.

MMS Response: The MMS did not amend § 206.261 when redesignating to § 206.260 in the July 15, 1988, notice and has not changed § 206.260 for this final rulemaking. For the MMS response to the washing/processing issue, please refer to the MMS responses to comments at § 206.265.

Sectin 206.262 Determination of transportation allowances.

In the July 15, 1988 (53 FR 26942), notice, MMS discussed various changes that were made to the January 15, 1987, proposed rulemaking. The MMS noted that the allowance limits had been eliminated. The MMS also provided its rationale for that modification. Another change from the January 15, 1987, proposed rulemaking was the substitution of the interest rate associated with Standard and Poor's industrial BBB rate in place of Moody's Aaa corporate bond rate. This interest rate is used to compute the return on investment component in non-arm's-length allowance calculations. An extensive explanation of this change is provided in the preamble to the final oil and gas product valuation rules published on January 15, 1988 (53 FR 1212–1214 and 53 FR 1262–1263, respectively). In order to be consistent with coal washing regulations at § 206.259(d)(1), identical language has been added to § 206.262(d)(1), and the reference to penalties has been deleted.

Comment: In the July 15, 1988, notice, MMS also requested comments on providing an exception to the cost-based approach for non-arm's length allowance computation, whereby the lessee could apply to MMS for an exception from the requirement that it compute actual costs if the lessee has a transportation rate approved by a regulatory authority and the rate is not excessive as compared to other arm's-length contracts. If there are no other arm's-length contracts to use for comparison, other criteria apply.

MMS Response: The MMS received no comments on this proposal; therefore, the final rule contains no such provision.

Comment: Many comments received by MMS pursuant to the Janaury 15, 1987, proposed rulemaking were not addressed at the time of the July 15, 1988, notice. To the extent these comments continue to be relevant to the July 15, 1988, publication, they are addressed below.

Comment: The MMS received 24 comments from seven industry, five Indian, and two State respondents concerning proposed § 206.261(a)(i). Six industry commenters stated that the term "remote" was ambiguous and should be clarified. One of these commenters specifically stated, "The criteria demands [sic] clear definition." One industry and one Indian commenter requested MMS define the meaning of "transportation."

Four comments were received on paragraph (a) addressing the requirement that the point of sale or washing facility be "remote" from the lease or mine. One industry commenter stated, "It makes no sense to forbid a transportation allowance for sales to the 'mine-mouth' customers * * *." In the same vein, another industry commenter stated, "MMS should consider instances where long distances exist between the point of severance and the washing facility or point of sale which may be located on the same lease or mine area." Two other commenters specifically opposed this notion. One Indian commenter requested that the regulation be clarified to "indicate that no transportation allowance will be allowed except from the lease boundary." Another Indian commenter suggested that an allowance would be appropriate from the lease boundary to the point of sale.

Three comments were received on paragraph (a) concerning what would be considered as transportation to a point of sale or washing facility remote from the lease or mine. Two industry commenters suggested that any transportation to a point of sale or washing facility greater than one mile from the mine or lease boundary should be eligible for a transportation allowance. One of these commenters explained that this standard "provides much greater certainty than under the ambiguous remote standard * * *." One industry commenter stated that all transportation should be eligible for allowance after the coal is "severed from the ground and either is removed from the lease itself or * * * reaches the surface of the ground" in the case of underground mining.

MMS Response: The MMS responded to similar comments earlier in this preamble in the discussion of § 206.251 Definitions, "Allowance."

Comment: Six commenters addressed other aspects of paragraph (a). One industry commenter stated that the word "reasonable" should be deleted as it gives too much discretion to MMS. Two Indian and three State commenters expressed concern that protections to the lessor that exist in the current regulations were being abandoned. Two State comments requested that language be added which would ensure "the value will never be less than what value would have accrued, had the sale been FOB the mine." The other three commenters requested that the word "necessary" be added to this paragraph in order to provide protection against any potential lessee abuse.

MMS Response: The MMS reiterates its belief that lessees are also prudent businessmen and as such are unlikely to undertake operations that are unnecessary or unreasonable. Since most royalty rates are set at or below 12½ percent, is difficult to contrive a situation where any lessee interested in maximizing its allowance would benefit from unnecessary or unreasonable expenditures. For each unnecessary dollar spent the lessee could only recoupe, at most, the amount equal to the lease royalty, which is 12.5 cents or less.

Comment: The MMS received several additional comments following the July 15, 1988, notice. Two comments stated that in no case should a transportation allowance be allowed to reduce the

value to zero. One comment offered an alternative proposal: "Under no circumstances shall the washing allowance and transportation allowance reduce the value to less than the value of like quality and quantity coal being sold from the area under an arm's-length agreement." Another comment stated there should be some absolute limit to the allowance deduction.

MMS Response: The MMS does not believe any threshold or limit to allowances is necessary. The rules provide that the allowances cannot reduce the value for royalty purposes to zero. Limiting transportation allowances to amounts such that the royalty value of destination sales would not fall below the royalty value of f.o.b. mine sales does represent one test available to MMS in reviewing allowances, but it does not constitute the conclusive action that would be taken by MMS. In keeping with the general free-market themes that underpin this rulemaking, MMS believes that the lessee normally is striving to attain the greatest return. When the lessee must incur additional costs to transport coal to remote sales destinations, the presumption is that those additional costs were necessary because the market for f.o.b. mine sales was saturated. The MMS has no intention of second guessing prudent business judgments made by lessees in response to their market assessments.

Comment: One comment advised MMS to exercise caution when reviewing transportation allowances as some lessees may attempt to manipulate the point of sale to benefit from a transportation allowance.

MMS Response: The MMS will diligently review transportation allowances, applying the criteria stated above in MMS's discussion of "Allowance" at § 206.251 Definitions.

Other changes made to the transportation allowance section are the same as those discussed above for washing allowances.

Section 206.263 Contract submission

After the January 15, 1987, proposed rulemaking, the MMS received many comments opposing the requirement to submit contracts to MMS upon request. The MMS responded to those comments and others in the July 15, 1988, notice. In response to the July 15, 1988, notice, several commenters again objected to the contract submittal requirement.

MMS Response: The MMS intends to review contracts during on-site audits. However, the MMS must retain the right to obtain sales contracts or other agreements from Federal or Indian lessees. The MMS will take all necessary precautions to safeguard contracts from unauthorized disclosure. The section has not changed from the July 15, 1988, notice.

Section 206.264 In-situ and surface gasification and liquefaction operations

Comment: The MMS received several comments from industry respondents on this section. Two industry commenters stated that this section provided excessive authority to MMS to determine value. As one commenter explained, "The result [of MMS authority] will be a dampening effect on the development of new technologies."

Three industry commenters recommended that MMS's valuation authority be restricted to in-situ processes only and that post mining processes such as liquefaction and thermal drying be excluded from royalty valuation by applying the provisions of § 206.257 to the value of feedstock coal when it first becomes marketable. One of these commenters explained, "The lessor should share in the benefit of such processes only to the extent of royalty at the prescribed rate on the value of feedstock coal * * *." One commenter recommended that if MMS authority was not restricted by the changes suggested "[i]t would be more appropriate to delete this section, place it in a reserved category and reconsider it in the future."

One industry respondent recommended no changes to proposed § 206.264.

MMS Response: The MMS does not envision that the development of new coal technologies will be dampened by § 206.264, which merely states that MMS will determine the royalty value of production developed by in situ or surface gasification or liquefaction technology. Historically, Federal treatment of developing technologies with reference to federal resources has ben accommodating. As noted previously in the preamble § 206.265 has been added since the January 15, 1987, proposed rulemaking, in response to the comments received.

Section 206.265 Value enhancement of marketable coal

In order to address concerns that MMS would assess royalties on the value added by new beneficiation technologies, such as "deep thermal drying," or "coal pelletization," § 206.265 was added to the July 15, 1988, notice. This section would also apply to surface gasification or liquefaction, if coal is placed in marketable condition prior to processing to a different physical or chemical form.

Comment: Several comments were received that commended the addition of this section. Only one Indian commented that these beneficiation processes were for the purpose of placing lease products in marketable condition and that royalty should be asessed on the total value of products sold. Two comments were received that stated when a net-back valuation was necessary, two times the Standard and Poor's BBB industrial bond rate was appropriate for high risk ventures. Two commenters expressed concern that two times the BBB industrial bond rate may be excessive and requested that the rate be reviewed before publication of final rules.

MMS Response: The MMS has retained the rate of return component in paragraph (b) at two times the Standard and Poor's industrial BBB rate. The MMS does not consider this rate as excessive. It is a well-established economic principle that the incremental cost of funds are a function of both the general economy and the results of operation of the individual company. The results of operation consider prior investments. In this case, we are dealing with new and evolving technologies without much prior experience. Given this reality, it is not appropriate to apply the industry standard for rate of return when the project is known to be complex and a high risk venture. For extremely risky operations such as the Great Plains Coal Gasification Project in North Dakota, the General Accounting Office (GAO) estimated an internal rate of return over the life of the gasification project to be between 14 percent and 19 percent (GAO/RCED-85-92, May 28, 1985). This project also had Government price guarantees. For other more risky projects, higher rates recognize the risk associated with the project and exceed the industry and standard for cost of capital. The MMS therefore concludes that, in net-back valuations, proper rate of return for beneficiation projects should be 2 times the industrial BBB rate.

V. Procedural Matters

Executive Order 12291

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

Regulatory Flexibility Act

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

Paperwork Reduction Act of 1980

The information collection requirements contained in §§ 206.254, 206.257, 206.259, 206.262, and 206.263 of this rule have been approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3501 et seq. and assigned clearance number 1010–0040, –0063, –0064, and –0074.

Public reporting burden for this collection of information is estimated to vary from one-half hour to 3 hours per response with an average of 1.5 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Due to the complexity of the information requested, applications for allowances using Forms MMS–4292 and MMS–4293 in non-arm's-length or no-contract situations may require up to an estimated 40 hours per response. Send comments regarding the burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to the Information Collection Clearance Officer, Mail Stop 632, Minerals Management Service, 12203 Sunrise Valley Drive, Reston, VA 22091; and the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503.

National Environmental Policy Act of 1969

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

List of Subjects

30 CFR Part 202

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

30 CFR Part 203

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

30 CFR Part 206

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

30 CFR Part 210

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

30 CFR Part 212

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

43 CFR Part 3480

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

Date: January 9, 1989.

James E. Cason,

Assistant Secretary—Land and Minerals Management.

For the reasons set out in the preamble, 30 CFR Parts 202, 203, 206, 210, and 212 and 43 CFR Part 3480 are amended as follows:

Title 30—Mineral Resources

PART 202—ROYALTIES

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

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 31 U.S.C. 9701; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

§ 202.250 [Amended]

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

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

§ 202.250 Overriding royalty interest.

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

PART 203—RELIEF OR REDUCTION IN ROYALTY RATE

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

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 31 U.S.C. 9701; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

§ 203.250 [Amended]

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

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

4. Paragraph (a) under § 203.250 is redesignated as a new § 203.250 under Subpart F and retitled "Advance royalty." The new section reads as follows:

§ 203.250 Advance royalty.

Provisions for the payment of advance royalty in lieu of continued operation are contained at 43 CFR 3483.4.

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

§ 203.251 Reduction in royalty rate or rental.

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

PART 206—PRODUCT VALUATION

1. The authority citation for Part 206 is revised to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 31 U.S.C. 9701; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 206 is amended by revising § 206.10 of Subpart A to read as follows:

Subpart A—General Provisions

§ 206.10 Information collection.

The information collection requirements contained in 30 CFR Part 206 have been approved by the Office of

Management and Budget (OMB) under 44 U.S.C. 3501 et seq. The forms, filing date, and approved OMB clearance numbers are identified in 30 CFR 210.10 and 30 CFR 216.10.

3. Subpart F is revised to read as follows:

Subpart F—Coal

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

Subpart F—Coal

§ 206.250 Purpose and scope.

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

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

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

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

§ 206.251 Definitions.

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

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

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

"Arm's-length contract" means a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. For purposes of this subpart, based on the instruments of ownership of the voting securities of an entity, or based on other forms of ownership:

(a) Ownership in excess of 50 percent constitutes control;

(b) Ownership of 10 through 50 percent creates a presumption of control; and

(c) Ownership of less than 10 percent creates a presumption of noncontrol which MMS may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates.

Notwithstanding any other provisions of this subpart, contracts between relatives, either by blood or by marriage, are not arm's-length contracts. The MMS may require the lessee to certify ownership control. To be considered arm's-length for any production month, a contract must meet the requirements of this definition for that production month as well as when the contract was executed.

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

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

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

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

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

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

"Gross proceeds" (for royalty payment purposes) means the total monies and other consideration accruing to a coal lessee for the production and disposition of the coal produced. Gross proceeds includes, but is not limited to, payments to the lessee for certain services such as crushing, sizing, screening, storing, mixing, loading, treatment with substances including chemicals or oils, and other preparation of the coal to the extent that the lessee is obligated to perform them at no cost to the Federal Government or Indian lessor. Gross proceeds, as applied to coal, also includes but is not limited to reimbursements for royalties, taxes or fees, and other reimbursements. Tax reimbursements are part of the gross proceeds accruing to a lessee even though the Federal or Indian royalty interest may be exempt from taxation. Monies and other consideration, including the forms of consideration identified in this paragraph, to which a lessee is constractually or legally entitled but which it does not seek to collect through reasonable efforts are also part of gross proceeds.

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

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

"Lease" means any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States for a Federal or Indian coal resource under a mineral leasing

law that authorizes exploration for, development or extraction of, or removal of coal—or the land covered by that authorization, whichever is required by the context.

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

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

"Marketable condition" means coal that is sufficiently free from impurities and otherwise in a condition that it will be accepted by a purchaser under a sales contract typical for that area.

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

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

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

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

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

"Severance tax" means any tax paid to any government agency based upon the quantity of coal produced as a function of either the volume or the value of production and does not include any tax upon the value of mining equipment, machinery, or buildings and lands, any tax upon a person's net income derived in whole or in part from the value of coal, or any license fee, unless such license fee is based on either the volume or the value of production. Mineral royalties are not tases.

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

§ 206.252 Information collection.

The information collection requirements contained in this subpart have been approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3501 *et seq.* The forms, filing date, and approved OMB clearance numbers are identified in 30 CFR 210.10 and 30 CFR 216.10.

§ 206.253 Coal subject to royalties—general provisions.

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

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

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

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

(a) For leases subject to § 206.257 of this subpart, the quality of coal on which royalty is due shall be reported on the basis of percent sulfur, percent ash, and number of British thermal units (Btu) per pound of coal. Coal quality determinations shall be made at intervals prescribed in the lessee's sales contract. If there is no contract, or if the contract does not specify the intervals of coal quality determination, the lessee shall propose a quality test schedule to MMS. In no case, however, shall quality tests be performed less than quarterly using standard industry-recognized testing methods. Coal quality information shall be reported on the appropriate forms required under 30 CFR Part 216.

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

§ 206.255 Point of royalty determination.

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

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

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

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

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

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

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

(d) When a coal lease is readjusted pursuant to 43 CFR Part 3400 and the royalty valuation method changes from

a cents-per-ton basis to an ad valorem basis, coal which is produced prior to the effective date of readjustment and sold or used within 30 days of the effective date of readjustment shall be valued pursuant to this section. All coal that is not used, sold, or otherwise finally disposed of within 30 days after the effective date of readjustment shall be valued pursuant to the provisions of § 206.257 of this subpart, and royalties shall be paid at the royalty rate specified in the readjusted lease.

§ 206.257 Valuation standards for ad valorem leases.

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

(b)(1) The value of coal that is sold pursuant to an arm's-length contract shall be the gross proceeds accuring to the lessee, except as provided in paragraphs (b)(2), (b)(3), (b)(5), and (b)(6) of this section. The lessee shall have the burden of demonstrating that its contract is arm's-length. The value which the lessee reports, for royalty purposes, is subject to monitoring, review, and audit.

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

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

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

(5) Notwithstanding any other regulations in this subpart, except for Indian leases, the value of coal for royalty purposes shall not include amounts of Federal Black Lung excise taxes authorized by the Black Lung Benefits Revenue Act of 1977 (26 U.S.C. 4121), abandoned mine lands fees authorized by the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1232(a)), and severance taxes. These exclusions include only the costs of the Federal Black Lung excise tax, abandoned mine land fee, and severance tax themselves and do not include late payment charges and/or other monetary penalties which may be levied on coal producers for nonpayment or underpayment of either the Federal Black Lung excise tax, the abandoned mine land fee, or the severance tax.

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

(c)(1) The value of coal from leases subject to this section and which is not sold pursuant to an arm's-length contract shall be determined in accordance with this section.

(2) If the value of the coal cannot be determined pursuant to paragraph (b) of this section, then the value shall be determined through application of other valuation criteria. The criteria shall be considered in the following order, and the value shall be based upon the first applicable criterion:

(i) The gross proceeds accruing to the lessee pursuant to a sale under its non-arm's-length contract (or other disposition of produced coal by other than an arm's-length contract), provided that those gross proceeds are within the range of the gross proceeds derived from, or paid under, comparable arm's-length contracts between buyers and sellers neither of whom is affiliated with the lessee for sales, purchases, or other dispositions of like-quality coal produced in the area. In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: Price, time of execution, duration, market or markets served, terms, quality of coal, quantity, and such other factors as may be appropriate to reflect the value of the coal;

(ii) Prices reported for that coal to a public utility commission;

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

(iv) Other relevant matters including, but not limited to, published or publicly available spot market prices, or information submitted by the lessee concerning circumstances unique to a particular lease operation or the saleability of certain types of coal;

(v) If a reasonable value cannot be determined using paragraphs (c)(2) (i), (ii), (iii), or (iv) of this section, then a net-back method or any other reasonable method shall be used to determine value.

(3) When the value of coal is determined pursuant to paragraph (c)(2) of this section, that value determination shall be consistent with the provisions contained in paragraphs (b)(5) and (b)(6) of this section, as appropriate.

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

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

(3) A lessee shall notify MMS if it has determined value pursuant to paragraphs (c)(2) (ii), (iii), (iv), or (v) of this section. The notification shall be by letter to the Associate Director for Royalty Management of his/her designee. The letter shall identify the valuation method to be used and contain a brief description of the procedure to be followed. The notification required by this section is a

one-time notification due no later than the month the lessee first reports royalties on the Form MMS-4014 using a valuation method authorized by paragraphs (c)(2) (ii), (iii), (iv), or (v) of this section, and each time there is a change in a method under paragraphs (c)(2) (iv) or (v) of this section.

(e) If MMS determines that a lessee has not properly determined value, the lessee shall be liable for the difference, if any, between royalty payments made based upon the value it has used and the royalty payments that are due based upon the value established by MMS. The lessee shall also be liable for interest computed pursuant to 30 CFR 218.202. If the lessee is entitled to a credit, MMS will provide instructions for the taking of that credit.

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

(g) Notwithstanding any other provisions of this section, under no circumstances shall the value for royalty purposes be less than the gross proceeds accruing to the lessee for the deposition of produced coal less applicable exclusions of paragraphs (b)(5) and (b)(6) of this section and less applicable allowances determined pursuant to §§ 206.258 through 206.262, and § 206.265 of this subpart.

(h) The lessee is required to place coal in marketable condition at no cost to the Federal Government or Indian lessor. Where the value established pursuant to this section is determined by a lessee's gross proceeds, that value shall be increased to the extent that the gross proceeds has been reduced because the purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the coal in marketable condition.

(i) Value shall be based on the highest price a prudent lessee can receive through legally enforceable claims under its contract. Absent contract revision or amendment, if the lessee fails to take proper or timely action to receive prices or benefits to which it is entitled, it must pay royalty at a value based upon that obtainable price or benefit. Contract revisions or amendments shall be in writing and signed by all parties to an arm's-length contract, and may be retroactively applied to value for royalty purposes for a period not to exceed two years, unless MMS approves a longer period. If the lessee makes timely application for a price increase allowed under its contract but the purchaser refuses, and the tessee takes reasonable measures, which are documented, to force purchaser compliance, the lessee will owe no additional royalties unless or until monies or consideration resulting from the price increase are received. This paragraph shall not be construed to permit a lessee to avoid its royalty payment obligation in situations where a purchaser fails to pay, in whole or in part or timely, for a quantity of coal.

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

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

§ 206.258 Washing allowances—general.

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

(b) If MMS determines that a lessee has improperly determined a washing allowance authorized by this section, then the lessee shall be liable for any additional royalties, plus interest determined in accordance with 30 CFR 218.202, or shall be entitled to a credit without interest.

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

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

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

§ 206.259 Determination of washing allowances.

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

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

(3) If the MMS determines that the consideration paid pursuant to an arm's-length washing contract does not reflect the reasonable value of the washing because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty

to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the washing allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the value of the washing may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's washing costs.

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

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

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

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

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

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

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

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

(B) The MMS shall allow as a cost an amount equal to the allowable capital investment in the wash plant multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to plants first placed in service or acquired after March 1, 1989.

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

(3) The washing allowance for coal shall be determined based on the lessee's reasonable and actual cost of washing the coal. The lessee may not take an allowance for the costs of washing lease production that is not royalty bearing.

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

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

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

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

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

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

(2) Non-arm's-length or no contract. (i) With the exception of those washing allowances specified in paragraphs

(c)(2)(v) and (vii) of this section, the lessee shall submit an initial Form MMS-4292 prior to, or at the same time as, the washing allowance determined pursuant to a non-arm's-length contract or no contract situation is reported on Form MMS-4014, Report of Sales and Royalty Remittance. A Form MMS-4292 received by the end of the month that the Form MMS-4014 is due shall be considered to be timely received. The initial reporting may be based on estimated costs.

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

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

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

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

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

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

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

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

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

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

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

(e) *Adjustments.* (1) If the actual coal washing allowance is less than the amount the lessee has taken on Form MMS-4014 for each month during the allowance form reporting period, the lessee shall be required to pay additional royalties due plus interest computed pursuant to 30 CFR 218.202, retroactive to the first month the lessee is authorized to deduct a washing allowance. If the actual washing allowance is greater than the amount the lessee has estimated and taken during the reporting period, the lessee shall be entitled to acredit without interest.

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

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

§ 206.260 Allocation of washed coal.

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

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

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

§ 206.261 Transportation allowances—general.

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

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

(2) Transport the coal from a Federal or Indian lease to a wash plant when that plant is remote from both the lease and mine and, if applicable, from the wash plant to a remote sales point. In-mine transportation costs shall not be included in the transportation allowance.

(b) Under no circumstances shall the washing allowance and the transportation allowance authorized by § 206.257 of this subpart reduce the value of coal under any selling arrangement to zero.

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

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

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

(d) If, after a review and/or audit, MMS determines that a lessee has improperly determined a transportation allowance authorized by this section, then the lessee shall pay any additional royalties, plus interest, determined in accordance with 30 CFR 218.202, or shall be entitled to a credit, without interest.

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

§ 206.262 Determination of transportation allowances.

(a) *Arm's-length contracts.* (1) For transportation costs incurred by a lessee pursuant to an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting the coal under that contract, subject to monitoring, review, audit, and possible future adjustment. The MMS's prior approval is not required before a lessee may deduct costs incurred under an arm's-length contract. However, before any deduction may be taken, the lessee must submit a completed page one of Form MMS-4293, Coal Transportation Allowance Report, in accordance with paragraph (c)(1) of this section. A transportation allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-24293 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee.

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

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

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

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

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

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

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

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

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

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

(B) The MMS shall allow as a cost an amount equal to the allowable capital investment in the transportation system multiplied by the rate of return determined pursuant to paragraph (b)(2)(B)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transportation facilities first placed in service or acquired after March 1, 1989.

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

(3) A lessee may apply to the MMS for exception from the requirement that it compute actual costs in accordance with paragraphs (b)(1) and (b)(2) of this section. The MMS will grant the exception only if the lessee has a rate for the transportation approved by a Federal agency (for both Federal and Indian leases) or by a State regulatory agency (for Federal leases). The MMS shall deny the exception request if it determines that the rate is excessive as compared to arm's-length transportation charges by systems, owned by the lessee or others, providing similar transportation services in that area. If there are no arm's-length transportation charges, MMS shall deny the exception request if: (i) No Federal or State regulatory agency costs analysis exists and the Federal or State regulatory agency, as applicable, has declined to investigate pursuant to MMS timely objections upon filing; and (ii) The rate significantly exceeds the lessee's actual costs for transportation as detemined under this section.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(e) *Adjustments.* (1) If the actual transportation allowance is less than the amount the lessee has taken on Form MMS-4014 for each month during the allowance form reporting period, the lessee shall be required to pay

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

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

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

§ 206.263 Contract submission.

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

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

(c) A lessee's or other payor's determination that its contract is arm's-length is subject to future audit to verify that the contract meets the criteria of the arm's-length contract definition in § 206.251 of this subpart.

(d) Information required to be submitted under this section that constitutes trade secrets and commercial and financial information that is identified as privileged or confidential shall not be available for public inspection or made public or disclosed without the consent of the lessee or other payor, except as otherwise provided by law or regulation.

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

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

§ 206.265 Value enhancement of marketable coal.

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

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

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

PART 210—FORMS AND REPORTS

1. The authority citation for Part 210 is revised to read as follows:

Authority: 25 U.S.C. 396 *et seq.*; 25 U.S.C. 396a *et seq.*; 25 U.S.C. 2101 *et seq.*; 30 U.S.C. 181 *et seq.*; 30 U.S.C. 351 *et seq.*; 30 U.S.C. 2101 *et seq.*; 30 U.S.C. 1701 *et seq.*; 31 U.S.C. 9701; 43 U.S.C. 1301 *et seq.*; 43 U.S.C. 1331 *et seq.*; 43 U.S.C. 1801 *et seq.*

2. 30 CFR Part 210 is amended by revising § 210.10 of Subpart A to read as follows:

Subpart A—General Provisions

§ 210.10 Information collection.

This section identifies MMS Royalty Management Program information collection requirements, except for reports required for the MMS Production Accounting and Auditing System (PAAS), which are identified in 30 CFR 216.10, and reports required for the Government's Royalty-In-Kind (RIK) Program, which are identified in 30 CFR 208.3. The information collection requirements identified in this section have been approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3501 *et seq.* The forms and approved OMB clearance numbers are as follows:

Form No., name and filing date	OMB No.
MMS-2014—Report of Sales and Royalty Remittance—Oil and Gas—Due by the end of first month following production month for royalty payment and for rentals no later than anniversary date of the lease	1010-0022
MMS-4014—Report of Sales and Royalty Remittance—Solid Minerals—Due by end of month following sales or production month (unless lease terms specify a different frequency for royalty payments) and for rentals no later than the date specified in the lease terms	1010-0064
MMS-4025—Oil and Gas Payor Information Form—Due 30 days after issuance of a new lease or a change to an existing lease	1010-0033
MMS-4030—Solid Minerals Payor Information Form—Due 30 days after issuance of a new lease or change to an existing account established by an earlier form	1010-0064
MMS-4109—Gas Processing Allowance Summary Report—Initial report due within 3 months following the last day of the month for which an allowance is first claimed unless a longer period is approved by MMS	1010-0075
MMS-4110—Oil Transportation Allowance Report—Initial report due within 3 months following the last day of the month for which an allowance is first claimed, unless a longer period is approved by MMS	1010-0061
MMS-4280—Application for Reward for Original Information—Due when a reward is claimed for information provided which may lead to the recovery of royalty or other payments owed to the United States	1010-0076
MMS-4292—Coal Washing Allowance Report/Application—Due prior to, or at the same time that the allowance is first reported on Form MMS-4014, and annually thereafter if the allowance does not change	1010-0074
MMS-4293—Coal Transportation Allowance Report/Application—Due prior to, or at the same time that the allowance is first reported on Form MMS-4014 and annually thereafter if the allowance does not change	1010-0074

Form No., name and filing date	OMB No.
MMS-4295—Gas Transportation Allowance Report—Initial report due within 3 months following the last day of month for which an allowance is first claimed unless a longer period is approved by MMS....	1010-0075

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

PART 212—RECORDS AND FILES MAINTENANCE

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

Authority: 25 U.S.C. 396 *et seq.*; 25 U.S.C. 396a *et seq.*; 25 U.S.C. 2101 *et seq.*; 30 U.S.C. 181 *et seq.*; 30 U.S.C. 351 *et seq.*; 30 U.S.C. 1001 *et seq.*; 30 U.S.C. 1701 *et seq.*; 31 U.S.C. 9701; 43 U.S.C. 1301 *et seq.*; 43 U.S.C. 1331 *et seq.*; and 43 U.S.C. 1801 *et seq.*

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

Subpart C—Federal and Indian Oil—[Reserved]

Subpart D—Federal and Indian Gas—[Reserved]

Subpart F—Coal—[Reserved]

Subpart G—Other Solid Minerals—[Reserved]

3. The following new subparts are added to Part 212:

Subpart H—Geothermal Resources—[Reserved]

Subpart I—OCS Sulfur—[Reserved]

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

§ 212.200 Maintenance of and access to records.

(a) * * *

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

* * * * *

Group 3400—Coal Management

PART 3480—COAL EXPLORATION AND MINING OPERATIONS RULES

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

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

§ 3485.2 [Amended]

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

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