Introduction to Coal Royalty Valuation

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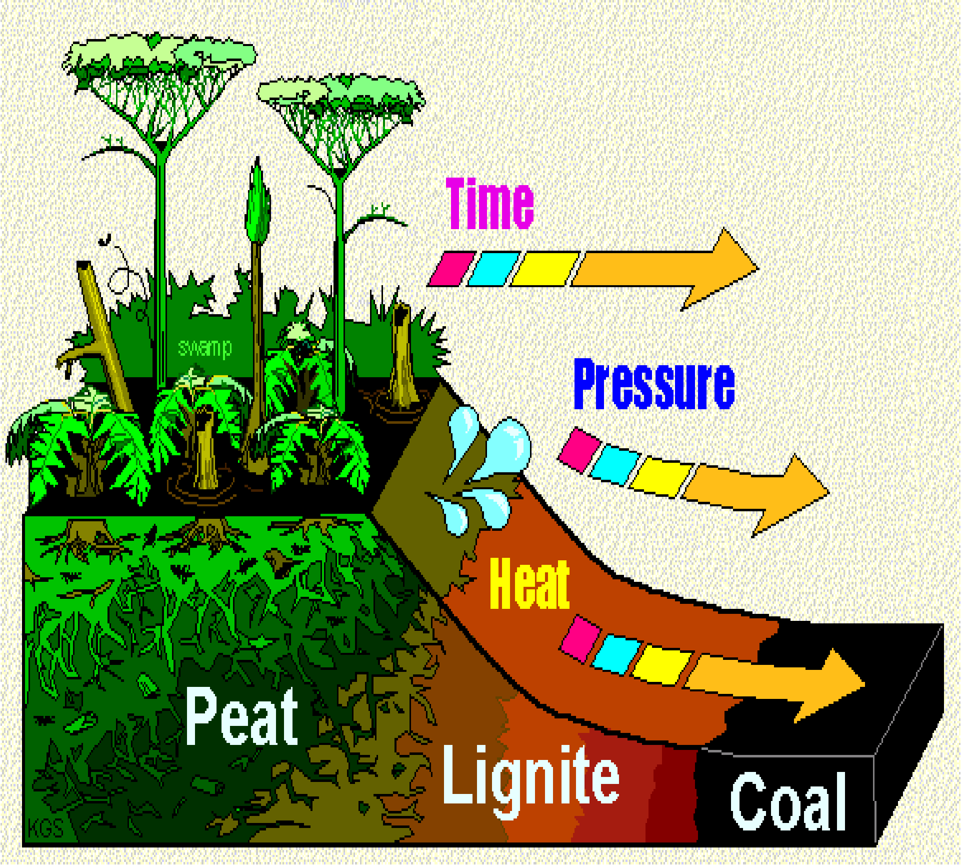
Coal Valuation Agenda

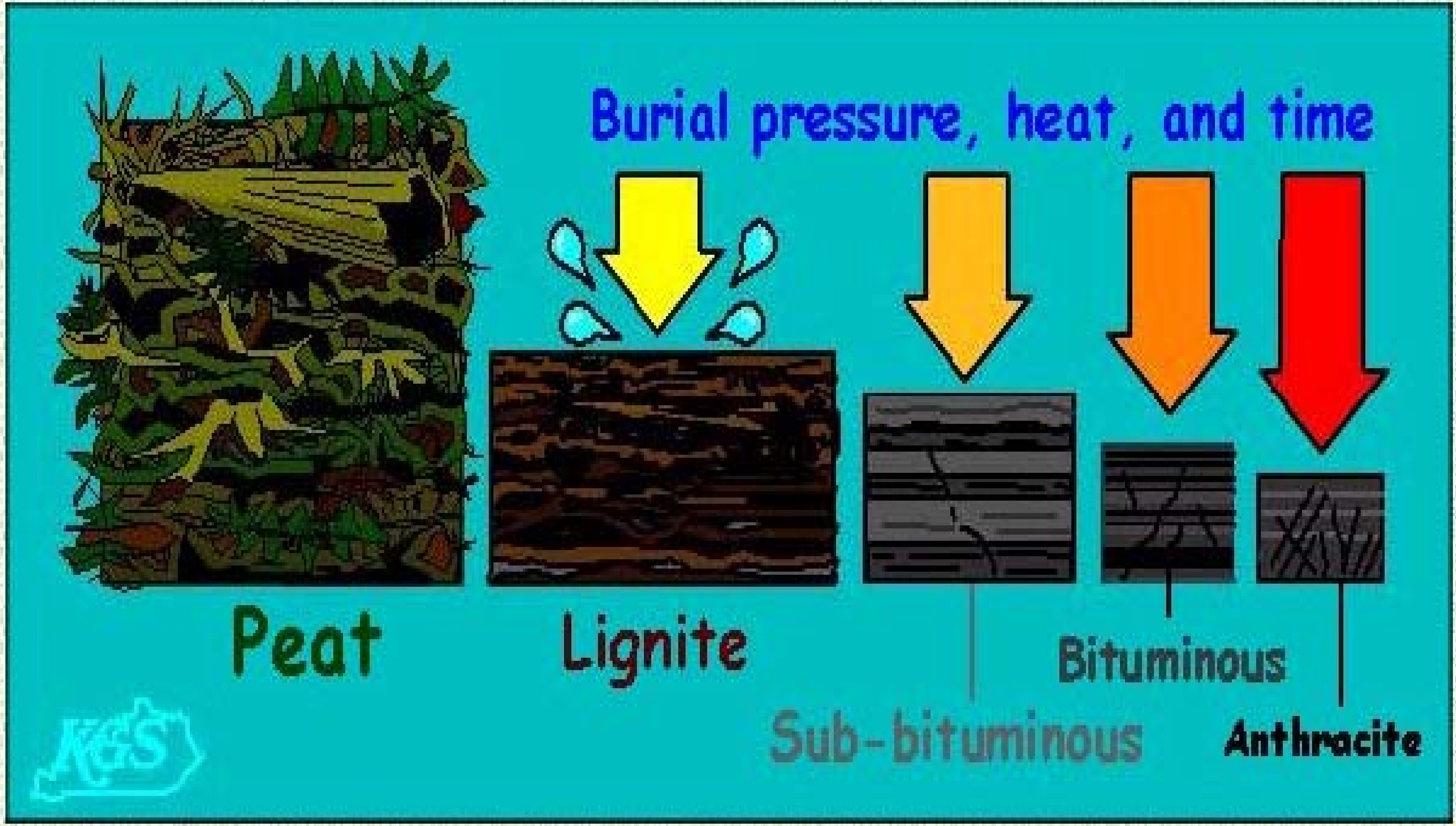
- What is coal?
- Mining operations
- Markets
- Statutory and regulatory authority
- When reporting and royalty payment are due
- Point of royalty measurement
- Marketable condition
- Gross proceeds calculations and reporting
- Valuation under A/L & N/A/L conditions
- Transportation and washing allowances

What is Coal?

- A rock composed of fossilized plant debris and minerals
- More than 50 percent carbonaceous material
- Fossil fuel



Source: University of Kentucky



Types of Coal

Source: University of Kentucky

Types of Coal

- Coal is classified into four general categories, or "ranks:"
  - **Anthracite**
    - (Btu avg. = 12,700 Btu/lb, Carbon = 86 to 98%)
  - **Bituminous**
    - (Btu avg. = 13,100 Btu/lb, Carbon = 45 to 86%)
  - **Subbituminous**
    - (Btu avg. = 9,500 Btu/lb, Carbon = 35 to 45%)
  - **Lignite**
    - (Btu avg. = 6,700 Btu/lb, Carbon=25 to 35%)

Coal Mining, Preparation and Marketing

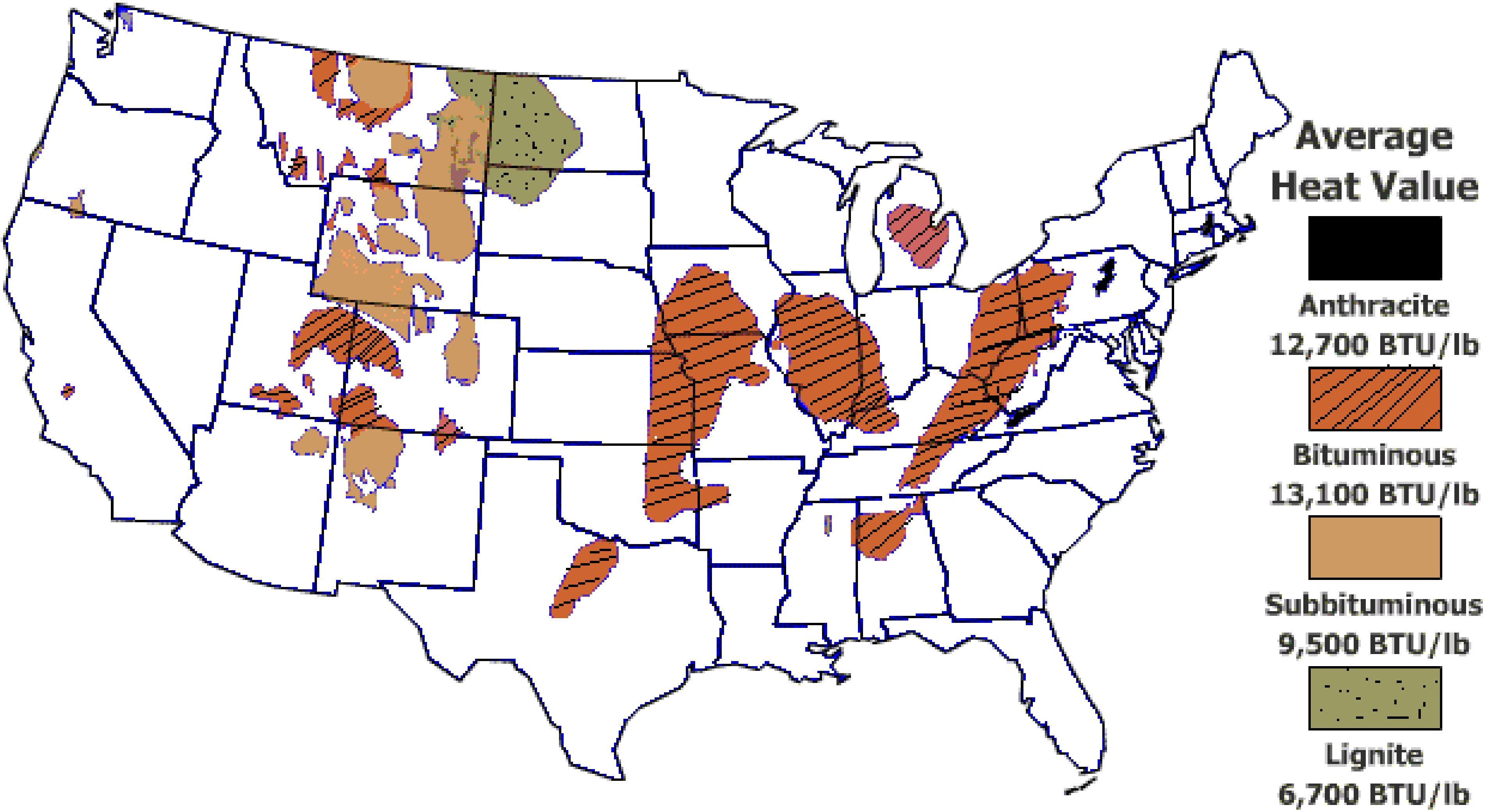
Coal Mining

– Extraction, Haulage, Processing (crushing, screening, blending,) storage, loading, weighing and analysis.

– **Washing** - to wash or not to wash that is the question.

– **Marketing Considerations**

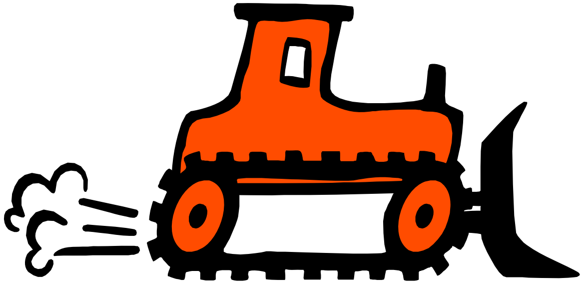
- A/L, N/AL, internal consumption, fob mine, fob destination, discounts volume or payment

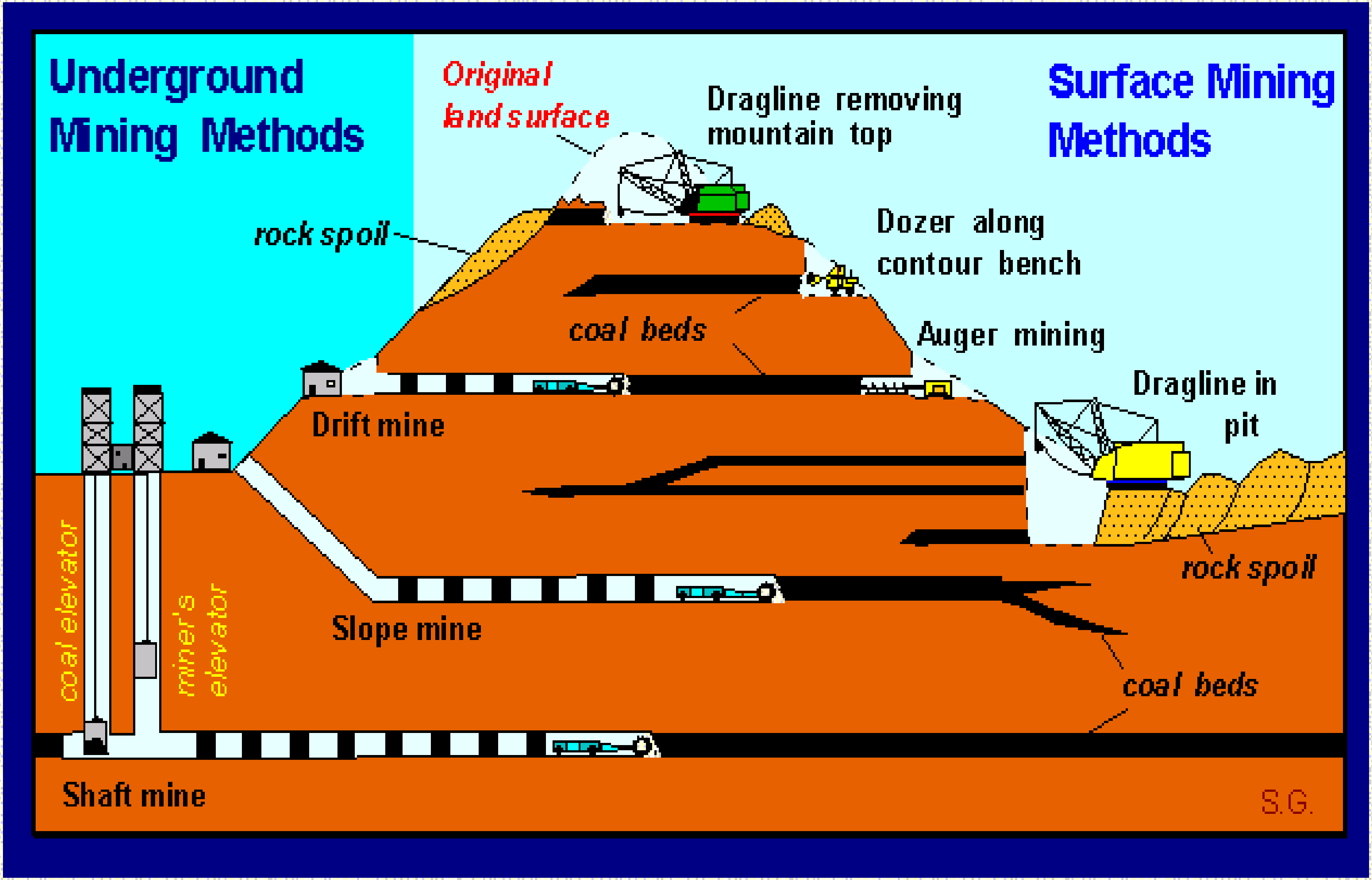


Coal fields of the continental United States

Mining Methods

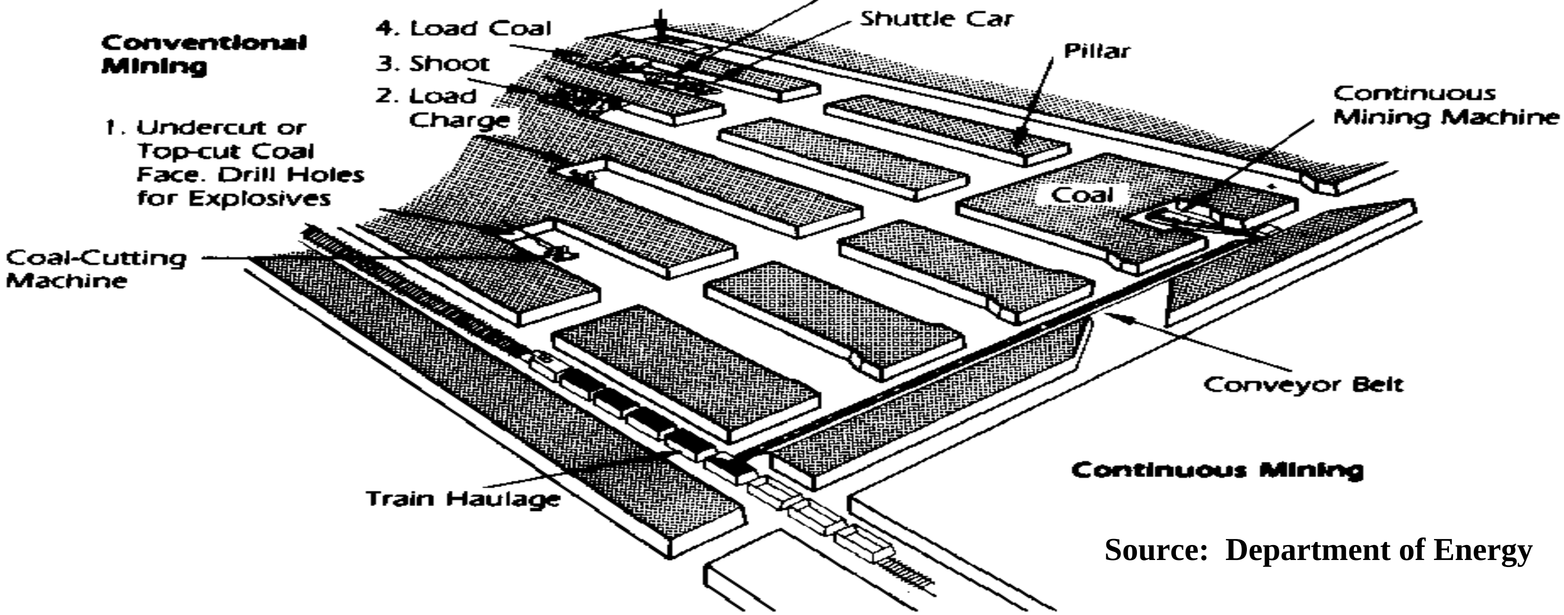
- SURFACE (12.5 percent royalty rate)
  - Area Surface Mining (Strip Mining)
  - Mountain top removal (Bench or Contour Mining)
  - Open Pit Mining (Strip Mining)
- UNDERGROUND (8 percent royalty rate)
  - Longwall
  - Room and pillar: Conventional and Continuous Mining
- HIGHWALL
  - BLM determines royalty rate



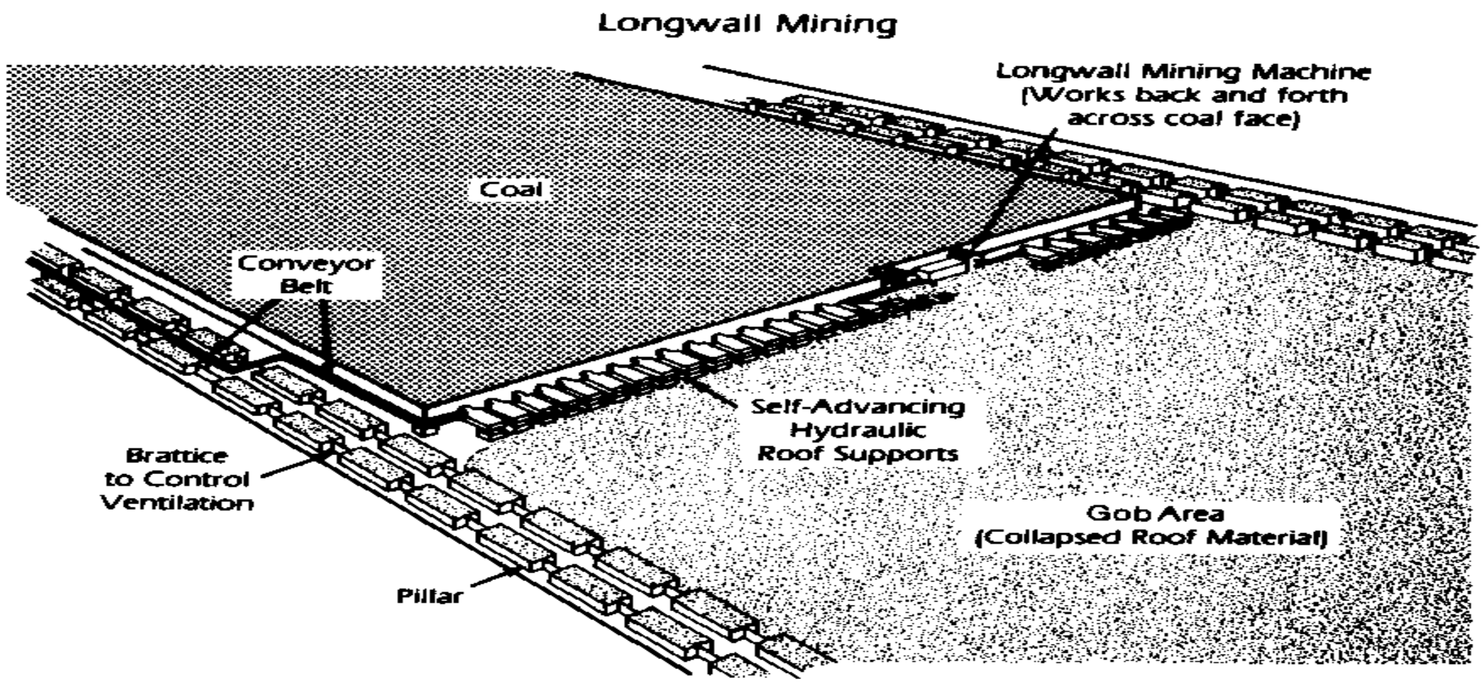


Mining Methods

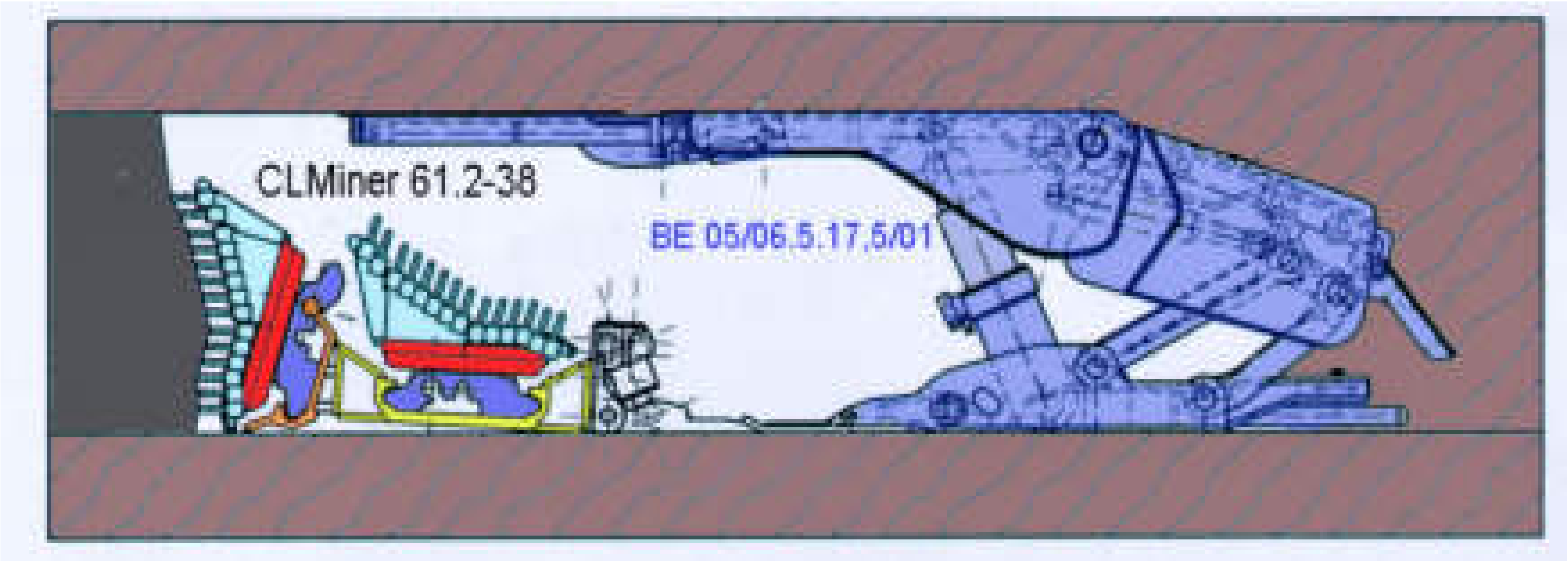
Source: University of Kentucky



Source: Department of Energy



Room-and-pillar mining is the most common way to mine coal undergound. Longwall mining is used to mine large blocks of coal where the bed is relatively flat and thick. A continuous mining operation includes roof bolting equipment and can use a coal-loading machine and shuttle cars (not shown) instead of a conveyor belt.

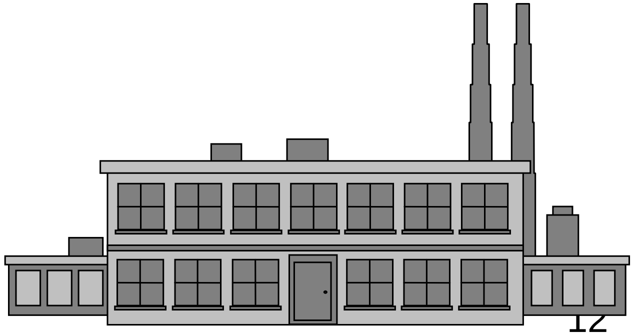


Source: Heintzmann CL

Longwall Miner

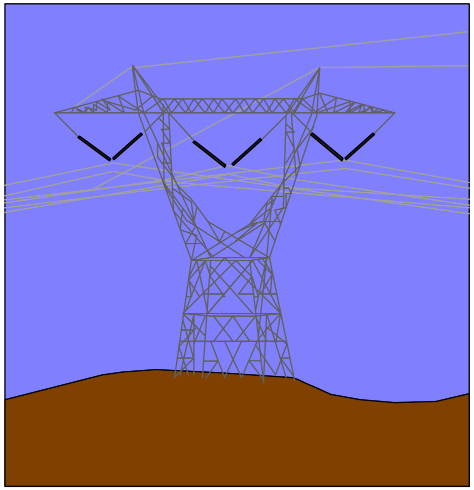
The Coal Market

- Electric utility industry (steam coal) Industrial plants (steam coal)
- Metallurgical (coking coal)
- Specialty markets, stoker, steam locomotives, home heating (lump)
- Exports (met coal/steam coal)



Steam Coal

- Coal typically sized to 2x0 or 3x0 for handling (belt conveyors) and transportation
- Chemical makeup matched to boiler specifications
- Compliance coal must normally be less than 1.2 lb. SO_2/mmBtu
- Industrial use - to generate electricity



Metallurgical Coal

- Coking coal
- Used to make steel
- Must be low ash and sulfur
- Strong enough to support weight of Iron ore
- Bulk of exported coal is Metallurgical
  - According to EIA approx 50 million tons exported last year.

Specialty Markets

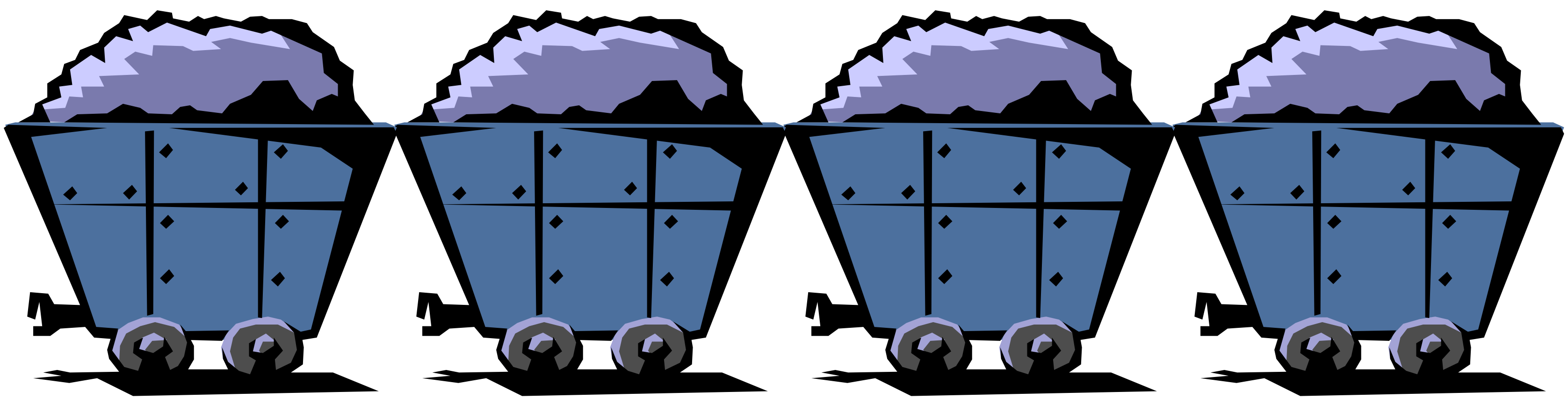
- Stoker
  - Double screened to produce upper and lower size limits,
  - Fines are eliminated
- Steam Locomotive double screened to specified size
- Home heating and other small scale applications (lump)

Federal and Indian Leases: Royalty Is Due On Coal That Is...

- Produced and sold
- Consumed internally—NAL sales
- Avoidably lost (including at remote storage)
- Unavoidably lost and compensated
- Recovered from waste piles
- Feedstock for enhanced coal (beneficiation)

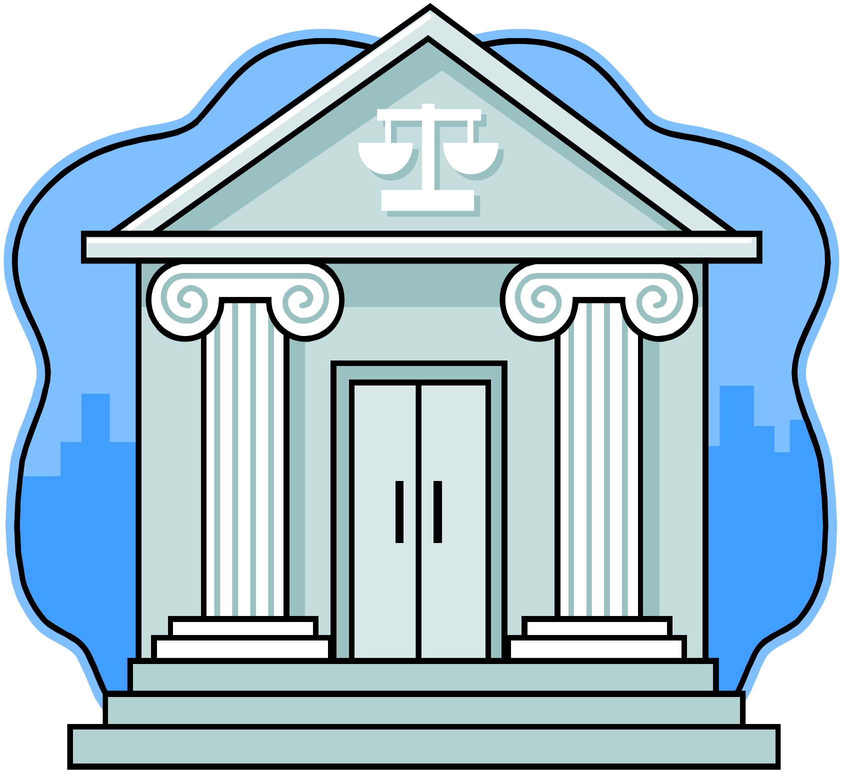
Point of Royalty Measurement

- Determined jointly by BLM and MMS (30 CFR § 206.255)
- The point where value for royalty purposes is normally determined.



Statutory Authority

- Mineral Leasing Act of 1920
- Federal Coal Leasing Amendments Act of August 4, 1976 (FCLAA)



Regulatory Authority 30 CFR Part 206 Product Valuation

- Subpart F - Federal Coal:
  Title 30 CFR §206.250 - 206.265
  Effective March 1, 1989
- Subpart J – Indian Coal:
  Title 30 CFR §206.450 – 206.464
  Effective February 12, 1996

Valuing coal for royalty purposes... …the overriding principles

1. **Coal must be placed in marketable condition prior to sale**
2. **Total (gross) proceeds is the minimum value**
3. **Lessees may claim transportation and washing allowances if applicable**

Marketable Condition- Definition:

- …"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."

Marketable Condition - costs

The lessee is required to place coal in marketable condition at no cost to the lessor. Normally, that point is F.O.B. mine.

- The following are <u>always</u> considered costs of placing coal in marketable condition:
  - **Mining**
  - **Haulage within the mine**
  - **Primary crushing**
  - **Marketing services**
  - **Loadout**
  - **Reclamation**

Marketable Condition-costs

- <u>To the extent</u> these processes are necessary for the sale, the following are considered costs of placing coal in marketable condition:
  - Screening/sizing
  - Blending operations
  - Oiling
  - Freeze proofing

Exceeding Marketable Condition Costs

- Gasification or liquefaction operations
- Beneficiation-above marketable condition
- Lime supply/haulage
- Ash disposal
- Addition of chemicals (soda ash)

Marketable Condition - standards

- MMS does not set the standard - the market sets the standard
- A contract between one buyer and one seller does not necessarily establish a market

Coal Market Standards

- Steam coal

  Run-of-mine crushed coal

- Metallurgical Coal

  Washed and screened to remove partings and sulfur (pyrite)

- Stoker coal

  Double screened run-of-mine

  Oiled (suppresses dust and aid gravity flow)

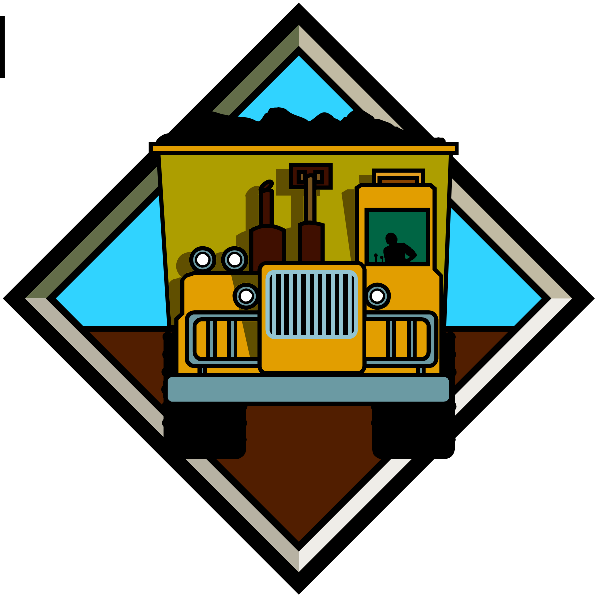
Coal Market Standards

- Specialty Markets

  Washed, screened, and/or blended product (Customized for buyer's requirements)

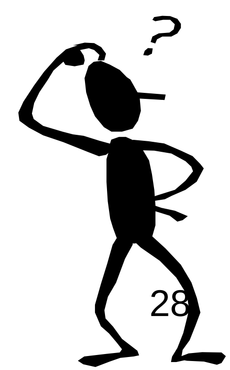
- All markets demand clean coal.

  Washing may be required to meet this standard.



Quiz Time

I sell coal in unprocessed form (that's not in marketable condition) to a completely unaffiliated buyer who processes the coal to marketable condition and then resells the coal. Is this cost to place it in marketable condition added to the sales price to compute royalty?



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Yes, this cost must be added to sales price.

Gross Proceeds - definition

- “…the total monies and other consideration accruing to a coal lessee for the production and disposal of the coal produced.”

Gross Proceeds

- **Under no circumstances can the value for royalty purposes be less than gross proceeds accruing to the lessee from the sale of coal**
- Includes all consideration (including non-cash) received by the lessee, unless the lessee shows to MMS' satisfaction the payment is not related to coal production

Gross Proceeds

- Lessee's gross proceeds generally include reimbursements for the expenses lessee incurs to place coal into marketable condition, including:
  - Price adjustments
  - Crushing/Sizing/Screening
  - Storing
  - Blending
  - Hauling and Loadout
  - Treatment with substances including freeze-proofing chemicals and oils
  - Marketing services
  - Reclamation
  - Taxes and fees

Gross Proceeds

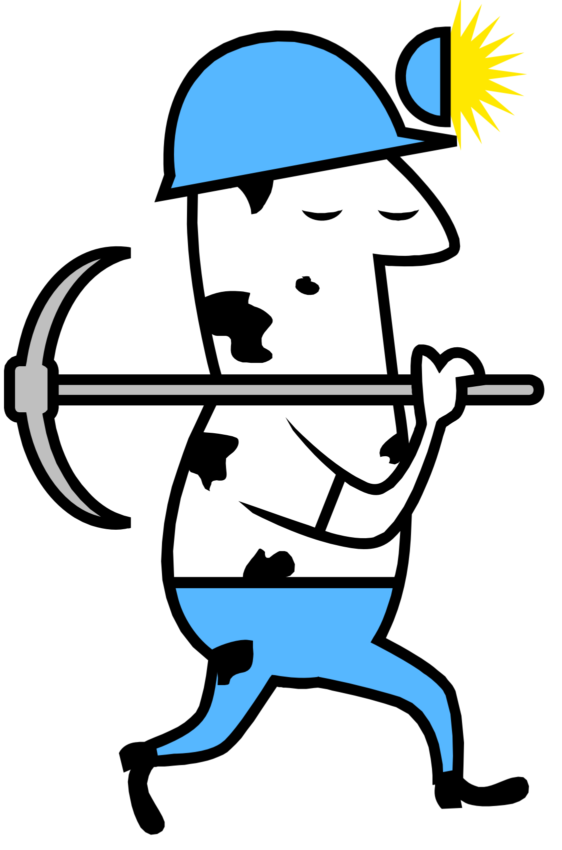
- Reimbursements for taxes and fees include:
  - severance taxes
  - black lung excise tax
  - abandoned mine lands reclamation fees
  - royalties
  - insurance premiums

Gross Proceeds

- Non-cash consideration includes:
  - mining equipment/facilities
  - marketable condition services
  - discounted electricity rates
  - water rights
  - anything else of value

Dollar Equivalent Value…

- Determine the dollar equivalent value of equipment and services provided by the buyer to place the coal in marketable condition



Dollar Equivalent Value…

- Determine total cost by summing operating and maintenance expenses, depreciation, and return on investment. Divide the summed costs by total tons to arrive at the unit value ($/ton) of the equipment or service.

Gross Proceeds

Does not include payments for:

- Transportation costs off the mine site
- Washing beyond marketable condition
- Limestone haulage to power plant
- Ash haulage to pit
- Chemical alteration
- Beneficiation above marketable condition
- Force Majeure
- Liquidated damages (contract breach)
- Buyout

Clarification of the Gross Proceeds Principle

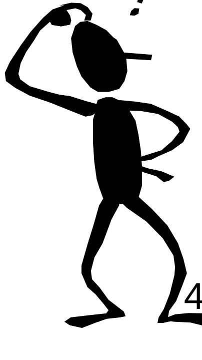
- Gross proceeds for royalty purposes:
  - Payments are for production or
  - Recoupable against future production
- Contract settlements
  - Buydowns—generally royalty bearing
  - Buyouts—generally not royalty bearing

Clarification of the Gross Proceeds Principle

- Pre-1988: MMS considered all payments royalty bearing when received.
- Diamond Shamrock Exploration Corp. v. DOI
- IPAA v. DOI
- Century Offshore Management Corp. v. DOI
- Black Butte Coal Co. v. DOI
- Colowyo Coal Co., LP v. DOI
- Chevron USA Production Co. v. DOI

Quiz Time

You sell coal to a purchaser for $10.80/ton. You add two pounds of soda ash per ton to improve the coal's fluidity during combustion, and your purchaser pays you $0.20/ton for that service. Your total sales proceeds is $11/ton. What is the value for royalty purposes?



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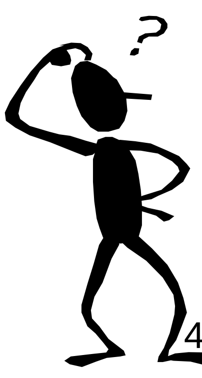
$11.00 - $0.20 = $10.80/ton



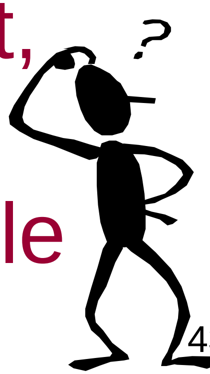
Quiz Time

The point of royalty determination and the point of sale may be different. Is this a problem? If so, what kind of problem?

Quiz Time

The point of royalty determination and the point of sale may be different. Is this a problem? If so, what kind of problem?

This is a concern if there is a significant difference in tonnage. If so, determine if any production was avoidably lost, as it is royalty bearing. As well, ensure that the coal is in marketable condition at the point of sale.



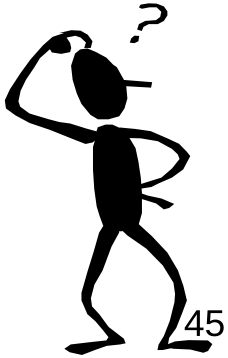
Quiz Time

You sell coal to a northern utility that requires freeze proofing of coal shipments from November through March. The sales price, including freeze proofing, is $5/ton. The freeze proofing cost is $0.05/ton of coal. What is the value for royalty purposes?

Quiz Time

The value is $5/ton.

The $0.05/ton cannot be deducted as freeze proofing does not change the chemistry of the coal product, and the purchaser requires treatment as a condition of sale.



Quiz Time

In order to meet customer contracted quality, you purchase 100 tons of coal in marketable condition in a A/L transaction from a mine for $20 a ton to blend with your coal.

You the sell 200 tons of blended coal to the customer for $17 a ton

Answer the following:

A - How many sales tons do you report to MMS?
B - What is the reportable gross proceeds from this sale?
C - What would the mine you purchased from report

A - 100 Sales Tons
B - $1700 (100 tons @ $17 per ton.)
C - 100 tons at $20

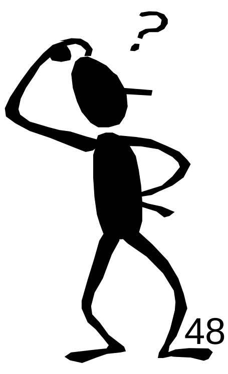
Quiz Time

Extra Credit**: Can you claim the deduction if you apply the freeze proofing material to the rail car instead of the coal?**

Quiz Time

Can you claim the deduction if you apply the freeze proofing material to the rail car instead of the coal?

NO - The treatment is applied to facilitate the sale and is fundamental to marketable condition.



To Review...

- The point where value attaches is normally f.o.b. the mine’s train or truck loadout facility

- Although the market determines what marketable condition is, coal is generally considered to be in marketable condition after it has undergone primary crushing.

Review (Cont.)

- Gross proceeds must be determined (whether the sale is arm's length or non-arm's length) to establish minimum value
- If the sales price includes expenses for transportation or washing, MMS may grant allowances on a case-by-case basis

Other Valuation Considerations

- Valuation under A/L
  - Determination of A/L Sale
- Valuation under N/A/L conditions
  - Five Coal N/A/L Benchmarks
- Washing and Transportation Allowances

Arm's Length Contract

- Definition at 30 § CFR 206.251
- "…means a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract."

Arm's Length Contract

- 30 § CFR 206.257
- Two part test
- Affiliation must not be controlling
- Parties must have opposing economic interest
- Contract must meet <u>both</u> of these conditions

Arm's-Length Valuation Normally Means Contract Gross Proceeds

Unless --

- Lease terms specify otherwise
- Total consideration is not in contract
- Coal is not in marketable condition
- There is misconduct
- Failure to market for mutual benefit of lessor and lessee exists
- Payments are not for production i.e. additional process of coal….

Arm's Length Contract

- Indications that parties are not at arm's length include:
  - shared facilities
  - shared employees
  - shared/common financial or business investments and risk

Arm's Length Contract

- Affiliation is defined in terms of control
- Control is defined through instruments of ownership (for example: ownership of voting securities)

Legal Precedence

- Legal precedence comes from a 1940, 7th Circuit Court decision: (Campana Corp. v. Harrison)

  "A sale at arm's-length connotes a sale between parties with adverse economic interests and to determine whether a sale between two companies is at arm's-length, it is necessary to look at stockholders behind the corporate structure."

Arm's Length Contract

Control is determined primarily (but not exclusively) in terms of ownership:

- <10% = no control (MMS may rebut)
- 10% to 50% = presume control
- >50% = control (nonrebuttable)

- 30 CFR § 206.257

Less than 10 % Ownership

- MMS may rebut if it can show actual or legal control exists
- Example: Although the 10 % is a minority holding, the block is larger than any other block.
- A minority may have the ability to formulate, determine, or veto basic business decisions and otherwise direct the use of company's resources and assets. (NMA v. DOI, 1999)

NMA V. Department. of Interior

- When there is 10-50% ownership, there must exist the capability for the minority owner to:

"… commit the financial or real property assets or working resources of an entity."

- MMS must demonstrate this existence

NMA V. Department. of Interior

NMA argued against an Office of Surface Mining Interim Final Rule (IFR) which said:

"Rebuttable Assumption" refers to a person who:

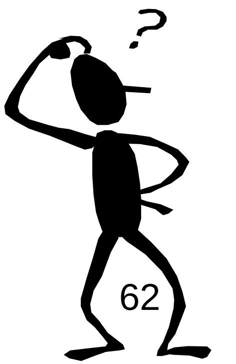
1. **<u>Is an officer or director of both companies</u>**
2. **Operates the coal mining operation**
3. **Controls the assets**
4. **Is a general partner**
5. **<u>Owns 10-50% of the entity</u>**
6. **Owns or controls the coal**

- **Court ruled that # 1 and #5 were invalid for proving control**

Quiz Time

I sell coal to my wholly-owned subsidiary under a contract that contains a "most favored nations" pricing provision that's tied to the market.

Is this an arm's length contract?



Quiz Time

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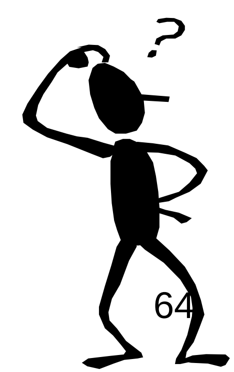
Is this an arm's length contract?

NO, but the prices MAY still be in the range of comparable arm's length sales.

Quiz Time

I sell coal to a joint venture (LLC) in which I have a 40% interest. The other three joint venturers each hold a 20% interest. Since I hold less than a controlling 50%, isn't this arm's length?



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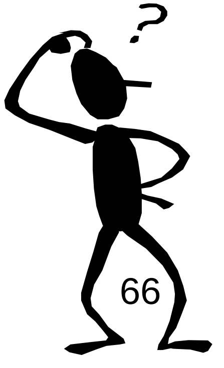
Requires more work- control is the issue and the 40% interest IS the largest block

Quiz Time

My purchaser doesn't own any of my firm's voting stock or any other similar instruments of control. However, my purchaser provided a loan for my working capital requirements and in return I provided a discount of $2/ton plus I repaid the loan principal and all interest. Is this an arm's length contract?



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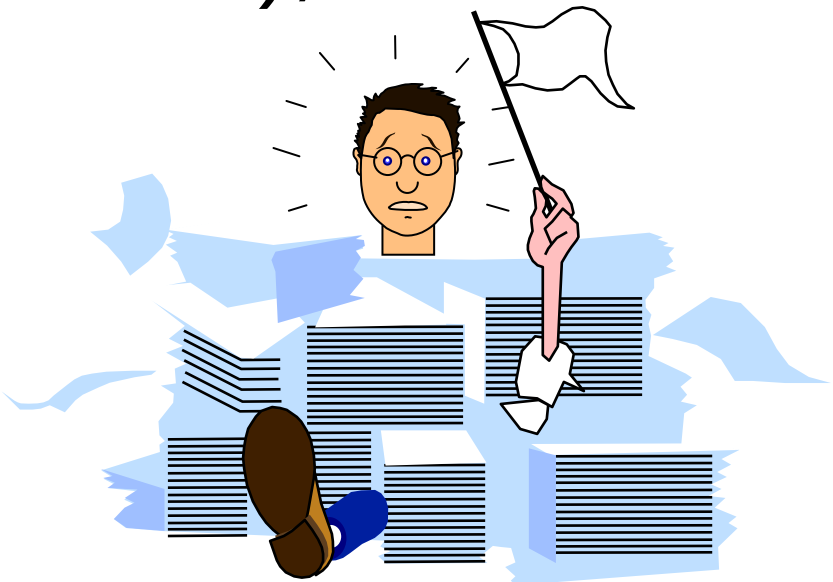
YES, but the $2.00/ton must be added back to determine gross proceeds.

Non-Arm's Length Valuation

- Regulations at 30 § CFR 206.257 allow the lessee to determine his own non-arm's length value (subject to MMS review), or ask for MMS assistance



Non-Arm's Length Valuation

- There are five benchmarks (criteria)
- Benchmarks must be applied sequentially
- Valuation is based on the ***first*** applicable benchmark
- Value is never based on less than gross proceeds
- Value is always based on coal in marketable condition

First Benchmark

- Gross proceeds accruing under the non-arm’s length contract are acceptable if:
  - the prices are within the range of sales prices of <u>comparable</u> arm’s-length contracts
  - parties to the arm’s length contract are not related to the lessee

Second Benchmark

- The price accepted or approved by the public utility commission for inclusion in the rates charged to electric power customers

Third Benchmark

- The price of delivered coal reported to the Department of Energy, Energy Information Administration
- Used by electric power cooperatives and investor-owned utilities with $\geq$50MW capacity
- Transportation and/or washing allowances usually apply

Fourth Benchmark

- Determine the coal value taking into account spot prices or <u>other relevant matters</u> including circumstances unique to the mine

Fourth Benchmark

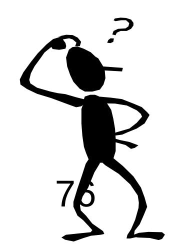
- Some examples of <u>other relevant matters</u> may include:
  - Spot market prices of other unaffiliated producers' with comparable contracts
  - Weighted monthly average of comparable arm's length sales from the mine
  - Cost of mining plus a reasonable ROI
  - Weighted monthly average arm's length prices affiliated utility pays to unaffiliated suppliers for similar coal, even if not comparable contracts.

Fifth Benchmark

- A net-back or any other reasonable method, following consultation with MMS
- Calculate value by subtracting from the ultimate sale any cost incurred or value added to arrive at an f.o.b mine price
- *“The valuation procedure of last resort”*

Quiz Time

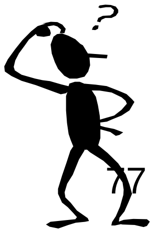
I sold 400,000 tons/yr for $14/ton to my parent firm who consumes it for metallurgical steel making. Arm's length sales from other producers into the met coal market were at prices between $18 - $20/ton. In the same year I sold at arm's-length 400,000 tons of the same coal to a utility for steam generation for $14/ton. What is the value of the coal (mentioned in the first sentence) for royalty purposes?



Quiz Time

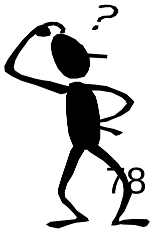
$18/ton. Sales must be into the same market. The met coal market is not the steam coal market. The non-arm's length price must be raised to the range of arm's length prices.

This is benchmark 4, assuming first 3 didn't apply.



Quiz Time

I sell coal to my affiliate using the same price found in comparable arm's length contracts. My affiliate resells that coal into the open marketplace with a 5% mark up. How do I value the coal sold under this arrangement?



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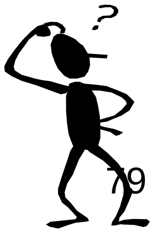
Per the recent Fina decision, you must use the benchmarks to determine royalty value.



Non-Arm's Length Valuation

- *Fina v Gale Norton, Sec. of DOI*, DC Circuit of Appeals # 025241, 6/2003
- If lessee sells to an affiliate which then sells to the open market, MMS cannot automatically assess royalty on the higher value, but must pick first applicable benchmark

Transportation and Washing Allowance Cites and Reporting Requirements

- Federal -- 30 CFR § 206.258-262
- Indian -- 30 CFR § 206.457-461

Transportation Allowances

- Normal point of valuation is f.o.b. mine
- A transportation allowance is allowed when coal is sold f.o.b. destination, and the lessee incurs an out-of-pocket expense
- Allowance cannot reduce royalty to zero

Transportation Allowances

- Allocate transportation allowance according to royalty-bearing lease percentage
- Non-arms length transportation deductions are calculated differently from arms-length

Transportation Allowances

- Arm's-length
- "…reasonable, actual costs incurred by the lessee for transporting the coal under that contract…"
- Subject to review and audit by MMS

Transportation Allowances

- Non-arm's-length calculation
- Unit amount of non-arms-length transportation allowance in $/ton = non-arms length allowance amount (based on operating costs, depreciation, and ROI)/entire tonnage transported.
- Allowance in $ = tons delivered from royalty-bearing lease(s) x allowance rate x royalty rate

Transportation Allowances

- Eligible Expenses: (all downstream from mine)
  - Rail fees
  - Stacker/reclaimer charges
  - Port and dock charges
  - Vessel loading cost
  - Demurrage charges out of your control
  - Vessel survey

Transportation Allowances

- Ineligible Expenses:
  - Mine haulage within the lease or within the vicinity of the mine
  - Haulage from one mine facility to another
  - Haulage prior to the first point where can reasonably be marketed
  - Quality assurance analysis
  - Demurrage within your control
  - Sales commissions and other sales costs

Transportation Allowances

- Sometimes it is not so obvious if transportation is eligible for an allowance.
- For these cases MMS developed four questions to evaluate transportation allowance eligibility. Taken alone, each answer is not the final solution to eligibility. All four of the questions must be answered and taken into account together to arrive at the correct eligibility determination.

Transportation Allowances

- Eligibility Question #1:

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

Transportation Allowances

Rather than use absolute distance measurement from the mine permit boundary or lease boundary to determine if the coal movement is in the vicinity of the mine or lease, MMS established a more relevant standard based on comparison of the distance coal moves away from the mine or lease boundary to the distance moved within the mine or lease boundary

Transportation Allowances

- For example, coal is hauled 4 miles within the mine permit area from the surface pit to crushing and storage facilities.
- The coal is then loaded into trucks and hauled 2 miles away from the mine permit boundary to a train loadout facility.
- Off-mine haulage would have to be at least 4 miles, or the ratio greater than 1:1, before this segment of coal movement may be considered not in the vicinity of the mine.
- Other factors may also be considered

Transportation Allowances

- Eligibility Question #2:

  Is the coal transportation considered a part of the normal mining operation?

Transportation Allowances

- Mine haulage recognized as necessary to normal day-to-day mine operations does not qualify for a transportation allowance.
- This includes moving coal from the point of severance to and between typical mine facilities including, but not limited to, crushers, surge piles, stock piles, storage facilities, screening facilities, and loadout facilities.

Transportation Allowances

- Eligibility Question #3:

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

Transportation Allowances

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

Transportation Allowances

- For example, the lessee has a 6 million ton per year production capacity mine and moves coal on an overland conveyor from the stockpile area to a train loadout facility.
- Rail access is absolutely necessary in order to expand the market area and market all production. In this case, the overland conveyor transportation segment is prior to the point the coal can be reasonably marketed.

Transportation Allowances

- Eligibility question #4:

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

Transportation Allowances

There may be cases where, even though one or more of the first three answers to the transportation allowance eligibility questions indicate that the transportation segment is not eligible for an allowance, extraordinary or exceptional circumstances may render these other criteria invalid and an allowance would be proper.

Transportation Allowances Example

- For example, a lessee loads coal into highway trucks in the pit and transports the coal 17 miles directly to a power plant.
- The coal is unloaded and crushed at the power plant site (the power plant owns the crusher). The power plant is the mine's only customer because there is no access to rail except near the power plant.

Transportation Allowances Example (Cont.)

Applying the 4 transportation eligibility questions:

- -- The answer to question 1 is no, the transportation does not occur in the vicinity of the mine.
- -- The answer to question 2 is yes, the transportation is a normal mining operation because it is between mining facilities, i.e., the excavation and the crushing facility.
- -- The answer to question 3 is yes, the transportation occurs prior to the first point the coal could reasonably be marketed
- -- The answer to question 4 is yes, the 17 mile distance is exceptionally long, and a deduction IS allowed

Transportation Allowances

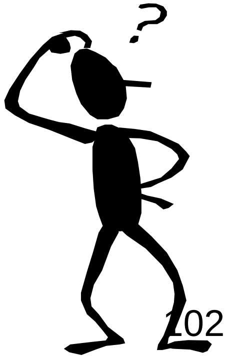
- If allowance eligibility is unclear…

  Lessee should request a determination from MMS – submit a written narrative and include the following data:

    - operation description
    - mine maps
    - lease boundaries
    - mine facility locations
    - transportation route

Quiz Time

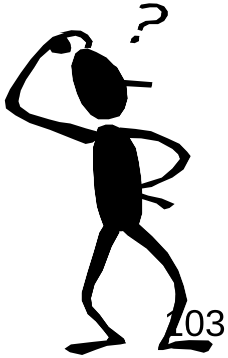
I sell coal on an f.o.b. destination basis to a buyer that's 1,500 miles from the mine and plant location; however, the buyer pays all transportation expenses and I have no out-of-pocket costs. Do I claim a transportation allowance?



Quiz Time

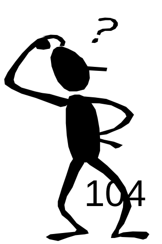
I sell coal on an f.o.b. destination basis to a buyer that's 1,500 miles from the mine and plant location; however, the buyer pays all transportation expenses and I have no out-of-pocket costs. Do I claim a transportation allowance?

NO



Quiz Time

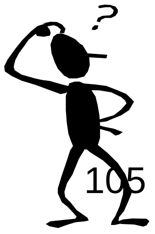
I sell coal to an export buyer on a free alongside ship (f.a.s.) basis. I pay for rail freight, port handling, wharfage fees, vessel loading and trimming expenses, product quality assurance analysis costs, and a fee for currency conversion. Are all these costs included in the transportation allowance?



Quiz Time

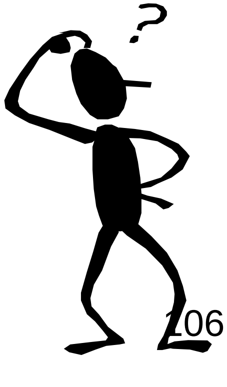
NO.

Only those costs related to transportation - not the transaction - are deductible. Product quality analysis or currency conversion fees are not deductible.



Quiz Time

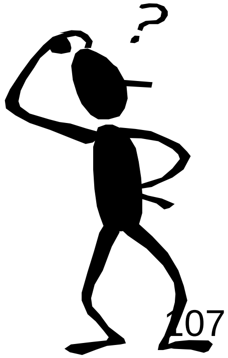
Should a transportation allowance be provided for all tons shipped from a mine if some tonnage is incidentally (unavoidably) lost in transit?



Quiz Time

Should a transportation allowance be provided for all tons shipped from a mine if some tonnage is incidentally (unavoidably) lost in transit?

YES



Transportation Allowances

Example: Warrington Coal ships 1000 tons of coal with associated rail charges of $2000. The total received and sold is 950 tons.

Warrington reports $2000 transportation costs on P&R even though 50 tons were lost.

Transportation Allowance Reporting

- Report on MMS Form 4430 Production and Royalty Report
  – For Indian Properties
    - Lessee must also submit a Form MMS-4293 before he can claim an allowance
    - Until the MMS receives the form, all allowances claimed will be disallowed

Washing Allowances

- A washing allowance is allowed if the lessee incurs out of pocket expenses to wash coal prior to the royalty determination point
- The lessee must proportionately allocate washing costs to royalty-bearing leases
- The claimed allowance cannot reduce the royalty to zero

Washing Allowances

- Arm's-length
- "…reasonable actual costs incurred by the lessee for washing the coal under that contract…"
- MMS prior approval not necessary but subject to review and audit.

Washing Allowances

- Non-arm's-length
- Unit amount of non-arms length washing allowance in $/ton = non-arms length allowance amount (based on operating costs, depreciation, and ROI)/ tonnage exiting wash plant.
- Allowance in $ = tons delivered from royalty-bearing lease(s) x allowance rate x royalty rate

Washing Allowance Reporting

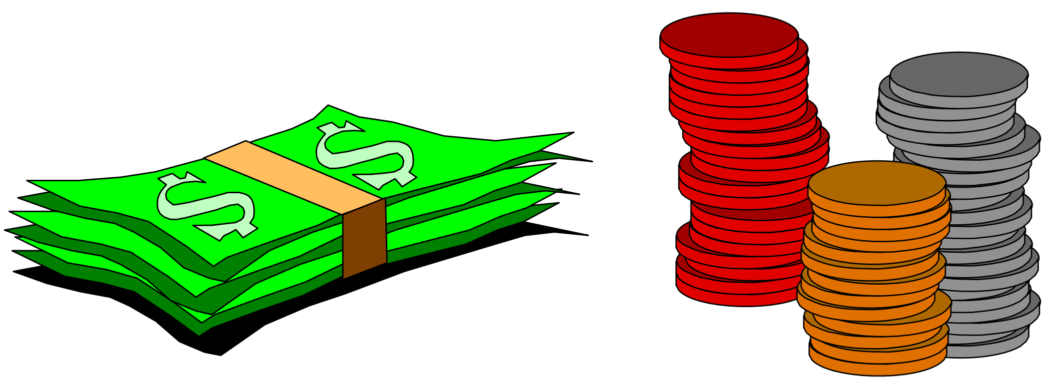
- Report on MMS Form 4430 Production and Royalty Report
- Facility data
- For Indian Properties
    - Lessee must also submit a Form MMS-4292 before he can claim an allowance
    - Until the MMS receives the form, all allowances claimed will be disallowed

Facility Data Report

- Reporting must contain
  - Identification of Facility
  - Mines served
  - Input and Output quantity
  - Input and Output quality
  - MMS will accept internally generated documents from own records.

When Is the Sales Summary, Production and Royalty Report and Royalty Due?

- Federal - EOM following the sales month
- Indian – per lease terms
- Not influenced by purchaser's payment



End of

Coal Valuation…