OFFICE OF NATURAL RESOURCES REVENUE

FEDERAL AND INDIAN COAL VALUATION
PUBLIC WORKSHOP

October 12, 2011

The above-entitled matter came on for hearing on October 12, 2011, at 8:30 AM, at the Offices of Natural Resources Revenue, Denver Federal Center, 6th Avenue and Kipling Street, Building 85, Auditorium A, Denver, Colorado, before Martha Loomis, Certified Shorthand reporter and Colorado Notary Public.

OFFICE OF NATURAL RESOURCES PANEL PRESENT:

RICHARD ADAMSKI
GREG GOULD
JOHN KUNZ
JIM STEWARD
MIKE THROCKMORTON
DEBBIE GIBBS-TSCHUDY

ROYALTY VALUATION STAFF PRESENT:

CHRIS CAREY

INDEX: PAGE:

P R O C E E D I N G S

MR. GOULD: Good morning, and welcome to Denver, those of you that traveled in. We have a few from Wyoming. Thank you for traveling down. We'll get started now. I have some written remarks to start us. And then we'll get started with the questions and answers

Good morning, and welcome. I think we're going to do introductions first.

Good morning. I'm Greg Gould, the Director of the Office of Natural Resources Revenue and the acting Deputy Secretary for Natural Resources for the Department of the Interior.

MS. GIBBS-TSCHUDY: And I'm Debbie Tschudy, the Deputy Director of the Office of Natural Resources Revenue.

MR. STEWARD: Good morning. Jim Steward, Program Director for Financial and Program Management.

MR. ADAMSKI: Good morning. Richard Adamski, Program Manager Asset Valuation.

MR. THROCKMORTON: Morning. Mike Throckmorton, Royalty Valuation

MR. KUNZ: Hello. I'm John Kunz with the Regional Solicitors Office here in Denver. My boss, Matt McGowan, just walked in.

MR. GOULD: Good morning, and welcome to our public workshop to discuss revisions to the Federal and Indian coal valuation regulations.

The purpose of the Federal and Indian coal valuation rules is to ensure that the American public, Indian tribes, and allottees, receive every dollar due on coal resources.

Through these public workshops and the Advance Notice of Proposed Rulemaking, the Office of Natural Resources Revenue is requesting comments and suggestions from affected parties and the interested public before proposing changes to the existing regulations governing the valuation of coal produced from the Federal and Indian leases. In proposing changes to current royalty valuation regulations, ONRR has three goals in mind:

1, provide clear regulations that are easy to understand and are consistent with fulfilling the Secretary's responsibility to ensure a fair value for the public and Indian resources.

No. 2, provide methodologies that are as efficient as possible for lessees to use.

No. 3, provide early certainty that correct payment has been made.

The potential benefits from our discussions today include simplifying and clarifying the regulations, simplifying and clarifying the aspects of the rules, decreasing industry's cost of compliance and government's cost of enforcement, streamlining audits by providing more certainty, and reducing potential litigation.

We feel it is important to obtain your input to determine if further clarifications of our rules is in fact worth pursuing.

The issues we'll be talking about today include examining possible alternatives to the current methods used to value arm's length sales, examining possible alternatives to the current methods used to value non-arm's length sales, coal comparability factors, examining possible alternatives to the current methods used to value sales by coal cooperatives, examining use of index prices to value coal, examining possible alternatives to the requirement to track actual costs for determining transportation allowances, examining possible alternatives to the requirement to track actual cost for determining washing allowances, and merging Federal and Indian rules or changing Indian rules.

We have an official court reporter today on hand. So when you come up -- I'm having trouble speaking today. We have an official court reporter on hand so for speaking, it is important that you identify yourself by stating your name and affiliation.

Finally, based on the feedback received today and the workshops next week, clarifications to Federal and Indian coal rules may be in order. If so, ONRR will take the next step to issue a proposed rule which will be followed by a written comment period.

I'm fighting a bad cold. I've been traveling a lot. Sorry for the issues speaking today.

So with that I am going to actually turn it over to

Jim Steward. I mean, Richard today.

MR. ADAMSKI: Good morning again.

In this part we'll start to get into the questions which we'd like to get feedback on for coal.

Last week we had our public workshops here for Federal oil and gas. And actually, Denver turned out to be our best session out of the three that we had for those.

This session for coal is our first session so it's kinds of a trial run here. You guys are all the Guinea pigs. And next Tuesday we will be in St. Louis, Missouri. And next Thursday for our last public workshop we'll be in Albuquerque to try to cover the largest territory possible, and get the most feedback. Really, that's what we're looking for is your thoughts and feedback. It's pretty much that simple.

ONRR has over 20 years experience valuing coal under the current Federal and Indian coal valuation regulations. The lessons learned from this experience suggest that the current Federal and Indian coal valuation regulations could be improved to provide greater certainty that royalties have been paid correctly, and to reduce the burden to both industry and government.

We are interested in determining ways to simplify, clarify, and provide consistency in product valuation and really that's the main focus of the changes that we'd like to make to the current regulations, so kind of keep that in the back of your mind.

We have examined the written comments submitted for the Advance Notice of Rulemaking, which closed on July 26, and are interested in further input regarding the perceived needs to modify current coal valuation regulations to meet the above-stated objectives. In all we received 11, comments from 11 parties representing a good cross-section of stakeholders.

So now to get into the specific questions. We'll start off with valuation, the sales part of things. Generally, comments agreed, commenters agreed that the current use of arm's length sales prices to value arm's length coal sales is working.

So the question for that would be simply, However, would the use of alternatives such as dollars per energy content, be reasonable? Or does anybody feel that we should have an alternative to generally accepting gross proceeds under arm's length contracts?

MR. HARTZLER: How's this supposed to work?

MR. ADAMSKI: I'll bring over a microphone. Identify yourself.

MR. HARTZLER: Make sure I don't break your rules.

MR. GOULD: We're rewriting the rules right now.

MS. TSCHUDY: Bill, you never break any rules.

MR. HARTZLER: No. I normally speak my mind.

My name is Bill Hartzler. I'm with Alpha Natural Resources. I am also National Mining Association's representative on the Royalty Policy Committee. But today the remarks I will be making will be on behalf of Alpha Natural Resources.

Alpha had submitted comments before going through and endorsing National Mining Association's comments, and so I will take my lead from that.

It is Alpha's position that the current rules work well from the arm's length sales perspective. We have significant concerns if you go to a fixed price indexing, whether it be a market price through one of the publications, or if you would go to a per million BTUs.

We believe that the pricing is not consistent from basin to basin in Wyoming, which is the primary location where there is pricing. We have significant concerns about the other basins as to how you would establish those prices.

Some of our concerns going to an indexing price, the industry is selling coal now for 2012, '13, and '14 in general terms. So if you go to an indexing price today, what price is going to apply to coal that we sell in 2014 that is an arm's length sale today? Or would the published price, which would be traded for 2014 today, be the price that you would use in 2014?

Or are we at the mercy of the market, and have to

negotiate a long-term price to keep our mines active, and then have a significant change to what we thought our royalty and tax obligations were going to be in 2014, particularly if the market goes up or down. I think the states would have the same concern in a down market that the industry has in an up market.

Alpha believes that that uncertainty in today's marketplace, particularly with the competition against other regions, and particularly natural gas, which has not impacted, Powder River Basin coal as much as the other markets, would add uncertainty, and potentially reduce the marketability of our coal further east than it is today.

So that's our concern is that the royalty would get shifted to the lower BTU coals from the higher BTU coals, and also how do you establish, if you sell coal in 2014 today, what is the price, price you're going to be using? Which may make it even more complicated if you agree to use today's price for 2014 that you're going to have all kinds of different prices for every sale during the same period.

Thank you for the opportunity to respond.

MR. ADAMSKI: Thanks. Appreciate that perspective.

Any other comments or thoughts?

Okay. Let's move on to the other side of the house now, which may be a little more complicated than arm's length sales. So we're going to look at non-arm's length sales now.

ONRR is examining possible alternatives to the current prioritized benchmark valuation methodology. While some commenters generally agreed that no changes were necessary, one commenter concluded that the rules need a complete overhaul. A little divergence of thought there.

Regarding methodology, ONRR seeks input on whether the current prioritized benchmark method works well. And if not, what parts do not work well, and how could the system be improved. Also, should the factors for determining the comparability of arm's length contracts to non-arm's-length contracts be amended, clarified, or removed?

So really in this section our focus is on non-arm's-length sales and on prioritized benchmarks, and looking for any issues with using those out there, and any possible improvements that someone might suggest.

MS. PARRISH: Hi. Kim Parrish from Cloud Peak Energy.

I'll make comment on the first benchmark. While we think it's reasonable, we know it is impossible to get other producers' prices to come up with comparable arm's length sales, so we certainly would request that you consider our own arm's length sales; maybe a bucket of pricing to determine what that first benchmark might be.

As to the fourth benchmark, I think Bill addressed a bit about using OTC pricing, some being plusses and minuses to that. We're generally in favor of that, but there would have to be some parameters that you guys kind of identified to make it a

bit clearer to us with different BTU qualities, different bases how exactly a standard like that might work.

MR. ADAMSKI: Thank you.

MR. POTTER: Jeff Potter representing PaciCorp Energy.

We have two captive mines that have gone through an arm's length, an arm's length benchmark. And we worked towards working -- having an alternative methodology. And we felt like that, those benchmarks allowed us to do that.

And by working through those benchmarks and working with the MMS at the particular time we were able to reach an agreement we felt like that really did represent a fair market value for the coal, both for the industry for our electric customers and also for the government itself, federal leases.

We are also concerned a little bit about that, where we've reached alternative valuations, we don't want to see those disappear, with what might go forward with the benchmark going forward.

Now, I kind of wanted to mention also what had previously been iterated here in regards to publications. The comments that we saw from the publications themselves kind of validated that their pricing does represent a spot pricing, and does not really include too many long-term contract pricing in that regard.

Thank you.

MR. HARTZLER: Bill Hartzler again.

I would just like to point out that in the original proposed rules, which I believe was by the Department of Energy before it got moved, that the inclusion of your own arm's length sale was in that original rule in the first benchmark.

For some inexplicable reason, when the final rule was adopted in January 1989, the use of your own arm's length sale was left out of, or was removed from that rule. So it's obvious there was a lot of consideration given initially.

And for whatever reason -- I've heard speculation which I won't go in to as to why that was removed out of the final rule -- but it's obvious that the original agency that proposed the benchmark recognized the value of including the producers' own non-arm's-length sale.

As a secondary note, over the years that the Coal Subcommittee of the Royalty Policy Committee, made up of the states, tribes, and industry, with the then MMS, now the ONRR, met for many many sessions looking at all of these proposals that were in the original Advanced Rulemaking proposal. And the only issue that the Coal Subcommittee could ever come to agreement on was to include the use of the arm's length sale of the producer in the first benchmark.

The Coal Subcommittee never brought that forth to the Royalty Policy Committee because since that was the only issue, speaking frankly, the industry was concerned that if we opened up the rules just for that that there may be adverse issues

occur, particularly in the gross proceeds area while a lot of litigation was going on at that point in time.

So again I would like to point out that the Coal Subcommittee, the first benchmark was the only issue they ever had consensus on between the tribes, states, and industry to revise to include the use of the producers' own non-arm's-length sales.

Thank you.

MR. ADAMSKI: Thank you. We appreciate the specific comments. That helps us kind of focus also.

Anybody else?

Okay. The question deals with the situation that we've started to see and we've known has been out there for a little bit. ONRR also seeks input with whether separate valuation methods need to be developed for sales by coal cooperatives, or no-sale situations, which is consumption by the lessee.

Bill?

MR. HARTZLER: This is not an issue that actually impacts our company. But I would like to make a brief comment from National Mining Association's written comments.

In the Advanced Proposed Rulemaking, ONRR seemed to make this this was a growing problem, which Alpha and National Mining Association do not see that. Because if you look at where the majority of the production has increased on Federal

coal it's been in the Powder River Basin.

And if you compare when, say 1989 to today, as to how much production is going into a captive market compared to the third-party market, the percentage of coal involved in this today is significantly less than what it was in 1989. So Alpha does not quite understand what the issue is. Again, it's not an issue that impacts us.

If you are considering a captive mine to be a cooperative, it may be better for Jeff Potter to respond to a specific issue.

But I would like to point out percentagewise, I think this issue has dropped off compared to where it was. Where the market is going to go in the future, whether it be in-place coal, gasification, or anything, it's probably too soon for ONRR to try to establish some sort of valuation method since nobody knows what that future's going to be until the future gets here.

Thank you.

MR. POTTER: Again, Jeff Potter, PacifiCorp.

I'll just kind of reiterate what I spoke about previously in regards to using the benchmarks for non-arm's-length as they apply to us in the captive methodology.

We worked through it, felt we were able to reach a conclusion and agreement, and would just like to see that be done. We don't really see any particular problems in the future regards to that.

MR. ADAMSKI: Okay, thank you.

This next series of questions deals with I guess a concept that Bill's brought up, his initial comments about arm's length sales and dealing with index pricing.

Again, we are just exploring this possible alternative in the interest of clarity, simplicity, and certainty in the regulations. And we'd definitely like to get people's thoughts, or when using this in any way.

We're not limiting it here to arm's length or non-arm's-length; we're throwing it out as a possible use wherever you may suggest.

Would the use of index pricing simplify and enhance the regulations? Public comments have been mixed ranging from, Do not use, to, May use in some areas, to, Feasible to use.

The ONRR invites more specific comments as to whether index pricing could possibly be used to value Federal or Indian coal production. We want to hear from those that support index pricing as an option, and how that would meet the intent of any changes to the regulations to add simplicity and clarity.

We would also like to hear from those that may not think that that's the best option, and their concerns.

MS. PARRISH: Kim Parrish again.

We believe, while there is some use for index pricing, we do not believe it to be the first alternative. We believe if you do struggle with some of the first couple of benchmarks then

you need to go to a pricing; however, the variability in BTUs, in duration of contracts, in quality, quantity, all the different things that make up the way we sell our coal is a bit challenging.

It's nice that it's out there; that maybe we have a starting point that we can point to and add some parameters if we have big disagreements. But there will be challenges in trying to use one OTC pricing to meet all the different contracts, BTUs, quantities, and qualities throughout the basin.

MR. HARTZLER: Bill Hartzler again.

Again, I support what Kim was saying. There are a multitude of issues that the Coal Subcommittee with the cooperation of the State of Wyoming actually tried to look to see if this would work for Wyoming.

And the State of Wyoming, based on actual numbers, actually did a lot of plotting and so forth. And the Coal Subcommittee came to the conclusion that there was just way too much variability between the three sub basins in the Powder River Basin.

You have the northern part of the basin is only served by one railroad. The mid portion and the southern part of the basin in Wyoming is served by two railroads so there's a competition there on the freight prices.

When customers buy coal they don't buy coal based on an FOB mine price; they pay for it on an FOB delivered price.

So the lower the BTU, the bigger hit in the freight costs the customers have to take.

And then if you don't have any freight competition you also have to fight against the delivered cost of the freight where there is competition in the transportation compared to where there's not.

Also, another concern that I would have I think if you went to an indexing type base is when BLM puts up additional reserves for lease by application they establish what they believe is the market price for the coal at that point in time. And then they open it for competitive bidding. And your price has to at least meet that minimum that we don't know what that is.

And so if you're going to have the coal reserve sold at a competitive bidding price and a market price and then say, Okay, that you're going to pay the royalty on an index price, it seems counterintuitive to me that one of the agencies is saying that you have to purchase the right to mine the coal at a market price, and another agency is saying that they want you to pay the royalty on an index price.

Thank you.

MR. READ: Dave Read with the State of Wyoming.

Just one comment about indexing. Southwest Wyoming there is no indexing pricing. So to put an index, to crank up an index there might be very difficult. We don't have one now.

MR. ADAMSKI: Thank you for all those different perspectives.

Bill?

MR. HARTZLER: Bill Hartzler. I'll make one more comment, one more comment about the indexing.

MR. ADAMSKI: Take as much time as you need.

MR. HARTZLER: One more comment about the indexing.

Another issue I think that you would have to consider is what regions are you going to put into a region to establish a coal indexing.

For example, up in northwestern Colorado there are mines that I believe are in the Green Valley Coal District. But there's also -- I forget the other coal district that is up there.

And this issue was brought out in an Advanced Royalty Appeal where the coal was being marketed more on the other region's coal quality, but the mine that they were looking at was in another region. And they were trying to base the coal prices based on a region.

So how are you going to establish, if you do an indexing, what coals are in what region to use the index price for a region when different coals can be in, quote, unquote, one geological region whereas it's in a different marketing region? Are you going to base that on marketing regions, or physical regions, or geological regions?

So that's another consideration I think that you have to look at, which makes it much more -- less desirable.

And I would also point out that in the original rules that ONRR, back then which was the MMS, had actually dissuaded the use of a per million BTU that they had considered that, thinking that, because of a lot of issues I think we brought up today, would just add to the complexity and probably create additional work for the Agency than going to the arm's length pricing.

Thank you.

MR. ADAMSKI: Okay. Our final question also encompasses index pricing. And I'll kind of throw the issue of revenue neutrality out on the table now, because we know that's an issue in what it means and how it's applied.

And again, we're all brainstorming here. This was an Advance Notice of Proposed Rulemaking and that's the reason for that, to kind of think out of the box. Now's the time to do that, before we have any proposals on the table.

So is there anyone that would support going to an index pricing methodology if it was not revenue neutral for every transaction? Would the economic benefits of simplicity, certainty, and consistency offset any potential increase of royalty revenues paid?

So again, you can look at revenue neutrality maybe not on a transaction, maybe on a transaction basis and not by a

month or quote, but it could be looked at over a period of time that things can be up or down, but you'd have the certainty at the time that you were paid.

Does anybody have any thoughts on how that issue plays into the alternative methodologies?

MR. HARTZLER: Bill Hartzler again.

With regard to revenue neutrality, Alpha believes that the government would look at revenue neutrality from the perspective of the Federal Government being kept whole, which the states may or may not like, and the states would desire to be kept whole, which would require different indexes for each state based on the current collections.

So Alpha views that any issues regarding revenue neutrality, that the industry is going to take the hit one way or the other.

And as an example, in National Mining Association's comments that they had a comparison of the calculation of what the royalty was on the published index price on July 8 from the OTC broker, and the royalty that would have been collected on a million BTUs would have been 9.96, or would be 9.96 cents for million BTUs for 8800 coal whereas on the same day for 8400 coal it would be .08804, or .088 cents.

So if you're looking at that, and if it's going to be revenue neutral for the State of Wyoming, you could assume that the average price would be at the mid point of those two to keep the State of Wyoming revenue neutral.

So those mines that are not in the 8800 are going to take about a one cent to two cent a ton hit in their royalty, whereas the 8800 mines would get a reduction.

And I can guarantee you I can file my reports for a lot less than that two cents a ton is going to cost us in additional royalty.

Thank you.

MR. ADAMSKI: Thank you.

Any other thoughts? So far we've talked about sales of coal non-arm's-length, arm's length. And now I'd like to pass the microphone to Mike Throckmorton to talk about allowances and possible deductions from the royalty value.

MR. THROCKMORTON: As you know, there are two types of allowances granted to cooperations: Transportation and washing. So we would now like to examine possible alternatives to the requirement to track actual costs when determining coal transportation.

Written comments during the Advance Proposed Rulemaking were generally supportive of the status quo. Comments on washing allowances during the Advance Notice of

Proposed Rulemaking were divided.

Two commenters opposed the concept of granting a washing allowance. Others supported the status quo, and continue basing the allowance on actual costs.

In the interest of simplifying the determination and verification of transportation and washing allowances, ONRR requests any alternative method to tracking and using actual transportation costs, including any methods that would adjust for location differences.

Come on, Bill. You can do it.

MR. HARTZLER: Okay. Bill Hartzler.

Alpha and National Mining opposed changes to the washing allowance. We also do not believe that if you went to, quote, unquote, an index -- and we don't know how you would establish the index for a region because transportation allowances particularly are based on distance.

Then you have, based on the price of oil, you have fuel charges if you do it by rail. Some coal may be delivered to market the entire way by rail. Other coal may go by rail and by barge. So there's a significant difference in the transportation costs in each transaction, which should be recovered in the final delivered cost, which gets you back to the market value.

If you went to a standard rate, the producer who is proving that transportation would go through and have all their transportation costs in the original price, getting you back to the true market value.

If you went to an index, there are going to be winners and losers in the transportation. Are you going to do it based

on the mode? All rail is this rate? How do you deal with a fuel surcharge that comes into play after the index has been set? Are you going to adjust the index monthly because of the changes of oil prices and so forth?

We just believe that going to a standard, particularly for transportation, is just going to be a significant issue problem as to how do you apply it and what is it applied to.

With regard to the washing allowance, I have had experience with a washing allowance when Alpha owned the 20 Mile Mine in northwest Colorado. Not all coal is washed, but sometimes it is.

Alpha's position would be if we still had the washing allowance would be that, without the washing allowance, the price that you would get for the run of mine coal from those properties would be significantly less than the price you're going to get for that coal after it's been washed, removed, went through and removed the impurities and so forth.

So Alpha believes that the washing allowance should be continued to be allowed. Because of the washing you wind up selling the coal for a significantly higher price than what you would if you were selling run of mine coal because the run of mine coal you'll be shipping rock and impurities to the customer, which adds to their transportation cost, which reduces the price.

So again, the washing allowance is primarily an non-arm's-length. And we can discuss that later on on some of the proposals, or at least the position that Alpha has as to how the Agency can or potentially reduce their administrative burden and the administrative burden of the producer in reporting that.

I don't know as to where you want that to come. But I think that comes under other ways to improve the method.

Thank you.

MR. THROCKMORTON: Bill, just a second. Are you suggesting that if the allowance isn't granted for washing that companies won't wash? Is that what you're saying?

MR. HARTZLER: I'm not saying that.

MR. THROCKMORTON: They'd rather just send it out --

MR. HARTZLER: I'm not saying that. What I'm saying is that the washing goes through and increases the price that the producer is going to get for the coal because of less impurities being shipped, less weight of noncombustible material being shipped, lower sulfur and so forth, which goes through and increases the price.

And that if you had a true royalty based on what the coal was worth when it came out of the ground, but ONRR uses the gross proceeds method as to what we get for it after we put it into marketable condition, if you had a true, quote unquote, royalty or if like in the gas and oil, where the royalty holder might retain an interest in it, that if the government retained an interest in the coal when it came out of the ground, if the

government wanted to get additional funds for that coal, that they would go through the washing themselves to go through and increase the marketplace, and not sell it.

I'm just saying that you have to recognize the additional value that you're going to get because that coal could be sold in the marketplace without washing today, okay?

MR. POTTER: I'd just like to -- Jeff Potter again.

I'd like to reiterate what Bill mentioned with regards to transportation and washing. We do believe that the washing allowance should continue in regards to placing certain types of coal in market condition.

And I'd also like to mention in regards to that that there are, to come up with a standardized cost for washing would be difficult in regards to those type of operations vary depending on what type of coal you're dealing with.

And I would also point out that the industry, each company knows what those costs are. They track them very closely. They have made economic decisions based on what they expect those costs would be so they would be able to verify that rather than just going to a standard deduction.

Thank you.

MR. THROCKMORTON: Any other comments on allowances? Okay, thank you.

Now let's switch bases and consider Indian coal valuation. One commenter strongly suggested that Indian and

Federal coal valuations not be combined. Another recommended against changing regulations because lessees, states, and tribes would be burdened to learn the new regulations at additional cost to all.

The ONRR requests specific details on why Federal and Indian valuation regulations should or should not be combined.

MR. GOULD: Bill? Thank you.

MR. HARTZLER: You're welcome.

Well, I know who the dissenter commenter was. It was the Navajo nations, which has been typical of the tribes over the years.

Alpha Natural Resources believes that the Federal and the Indian coal valuation rule should be the same. But we also recognize the political realities of the tribe sovereignty.

Thank you.

MR. THROCKMORTON: Any other comments regarding Indian coal valuation? Okay.

We're getting close to the end. Now we'd just like to ask general questions about other possible alternatives for valuation.

ONRR is interested in receiving comments on any other valuation methodologies that would provide clarity, efficiency, and early certainty that correct payment has been made.

MR. GOULD: Bill?

MR. HARTZLER: Bill Hartzler.

Alpha Natural Resources believes that the current method that the MMS has is a very workable method. And that we don't see the need for any major changes in the way that the valuation is done; however, we do believe that there are some administrative methods that ONRR could consider that would, in my opinion, would make their ability to confirm what is going on a lot easier, cut down the administrative workload.

In the Advance Notice of Rulemaking you talked about the number of lines that you have to process each month which, if you look at it, a lot of that work is because of the way you want us to report stuff and so forth.

And the coal industry also already provides the Agency much more information regarding our contracts, sales by customer on a monthly basis, stuff that can be used to verify what is being reported is correct.

And I think since the mid or since the late '90s I believe that the disputes regarding royalty valuation have been very minimum as we worked through the issue of take or pay, the gross proceeds concept, and everything.

I think the industry is very comfortable with using arm's length sales and the benchmarks. I know our company has been able to use the current benchmark for the few non-arm's-length sales we've had.

We've always managed to get down to the last benchmark that gives the Agency a lot of latitude where they have

considered through that our own arm's length sales to help arrive at the value.

The one concern that Alpha has with regard to how our reporting goes to ONRR compared to all the other federal tax agencies and state tax agencies that we report to is that ONRR -- and we believe it is primarily for the assessment of late payment interest, which in the coal industry there's some, but just because of the way the mechanisms works in our coal contracts or invoicing, it leads to a lot of prior period adjustments just because of how the contracts work.

Because like a sulfur allowance adjustment, the contract may require you to have to use all the tons shipped in the month and this calculation.

Well, that calculation and the invoicing cannot be done until the following month. Under the ONRR rules we have to go back and report that adjustment to the previous month, which adds to a line item.

All other government agencies view our tax reporting on an annual or quarterly basis. And we make estimated tax payments. And there's a threshold that we have to make to make those payments. If we meet that threshold then there's no, no late payment filing payments made.

A big issue that ONRR advanced in, I believe in the Advanced Rulemaking was the number of adjustments for transportation allowances and washing allowances, which is

primarily because, particularly the washing allowances, is an annual calculation under the rules where you have to apply the triple B bond rate against your net investment and everything.

So you really can't make that calculation until after the calendar year is done, but ONRR requires you to make an estimate amount, which you show as a line item. And then when you do your annual true-up you go in and you're reporting 12 months of adjustments from what your estimate was, which is primarily for the interest calculation, as I understand it.

So if ONRR would take a look at how important is it to have every detail adjustment backed by the actual month that it is or is required, and if you would set thresholds for reporting where net reporting could be done for your prior period adjustments and not in that, that would save the Agency significant amount of time; it would save the companies significant amount of time.

I recognize that there's probably one state or maybe two states, the way that they distribute their revenues back sort of uses, or the amount by lease again because we have to report all this by lease from a statutory reasoning.

The only reason we need to report it by lease is for our due diligence purposes for developing that. And because most of the mines now roll all their leases into one big, big lease per se for the BLM, from a company's point of view it doesn't make any difference to us what lease we have to do.

But we have to go through and do all of these allocations every month. And then if we have a price adjustment we have to make that price adjustment allocated against all the leases produced in that month.

That, from a perspective to audit, the auditing is done in general on an annual basis on a whole year's worth of production. And that's the only way that you can really audit, because the customers don't take the coal in a uniform basis; you have force majeure claims that change the amount of coal you have to take.

So you really can't audit by month, which we have to report. But then the audit staff has to go through and break the audit down by lease, by month, and everything else. So the current reporting system as a lot of compliance costs for both sides to measure this.

I think that Alpha's position would be that from our perspective the tonnage is important to the BLM for their reasoning. But the fact that the gross proceeds, we don't care what lease it's against. And in most instances I don't think ONRR cares what lease it's against because it's all one big block and it's all going to go to the same place.

There may be a few instances in maybe Utah and Colorado I think are the states that have some issues with how the royalty gets distributed. But in general the bulk of what you have could probably be done on a more consolidated basis

with -- with, if you used an estimated basis and not require prior period reporting in the detail we have to do now, would help I think everyone.

And if you have a threshold that you have to meet before the late interest penalty kicks in like the IRS does for our black lung excise tax payments, our federal income tax payments, if you have that threshold, most of the companies could go through and do it.

Or if you wanted to set up a safe harbor method saying that if you paid X amount based on what you paid last year and then you true up, I think it would make life a lot simpler and easier for everyone.

I have no additional comments there. I'd be glad to take any questions that you may have about doing a change to an estimated basis, which I believe you could do that under your rules because there's no statutory authority as to how you have to collect the royalty. It's more of a policy decision.

Are you going to cut the workload, knowing the aspects of this industry, and knowing -- I don't believe you have a lot of late payment interest charges against the coal industry for all of our line item adjustments per se. It's probably not as much as the costs that you're spending now trying to make that determination.

MS. PARRISH: Kim Parrish.

From Cloud Peaks' perspective I think the current

rules for arm's length sales actually provide us with good certainty in some difficult economic and regulatory times in the coal industry.

The ability to go out and negotiate our contracts for whatever duration, quantity, quality from whatever mine we choose to sell from, under the rules currently we don't have to hedge our risks against what our royalties on those sales would be by trying to guess what a future OTC pricing would be or some standard like that.

Also with regards to the transportation allowance, again it's not in our benefit to not be efficient in our transportation. And we do track it quite well.

And applying a standard or an average that doesn't necessarily reflect our operations but may reflect some other operation that may not be as efficient as ours I think is detrimental to us, and is also detrimental to other producers.

Yes, there are winners and losers. We don't know who they will be. I guess for us, reiterating our non-arm's-length sales benchmarks, are good and we do follow them, as Bill said, we usually do end up at the lowest rung where we end up talking to ONRR about using our own arm's length sales as comparable sales that maybe a look at the first benchmark reconsidering, as Bill said, was in there at the beginning somehow got left out.

But a reconsideration, given that the Department looks at our arm's length sales all the time, looks at those contracts, determines them to be reasonable, and that comparing those to our non-arm's-length sales would give you a good basis to determine how we're coming out on that ground as well.

MS. TSCHUDY: Can I ask a followup question? I guess I've heard from three or four of the commenters that the second third benchmarks really aren't useful.

What would be your thoughts on our eliminating the second and third, which I think is prices reported to FERC, prices reported to the PUC?

I heard you say you support comparability in the first benchmark, as long as you can include your own. And I have a follow-on question on that.

But I would like your thoughts on do we need benchmarks 2 and 3.

MS. PARRISH: That's not relevant to us.

MR. HARTZLER: Benchmarks 2 and 3 are not relevant to Alpha. But from a perspective of what the Agency is trying to do, if you have a captive mine that has no arm's length sale, then you're sort of into what are you going to use for, quote unquote, a basis to arrive at a price for that.

And I believe that a lot of the captive mines that would fall under the non-arm's-length would have an ownership in the power plant. So if nothing else, using those benchmarks for the power plant helps you establish what the market value is as to what the Public Utility Commissions and the FERC is receiving

as to what the companies are saying, because that's one thing you can pass on to the consumer through their ratemaking.

So I can't say per se or for certain. I don't know what Jeff's thought is to that. But it's nothing more than just another place to sort of look to help you get to what is fair market value.

MS. TSCHUDY: In theory you could do that within the context of the existing fourth benchmark?

MR. HARTZLER: Yes, you probably could.

MS. TSCHUDY: The alternative method.

MR. HARTZLER: Yes.

MR. POTTER: Reiterate that also. Jeff Potter, PacifiCorp.

I would also mention that as far as FERC reporting, some of those costs that we report aren't purely coal costs; they include some other transportation and some other costs in there so they're not real pure in that regard in that reporting.

We can only recover as an electric utility our costs that are included in the rate base, so we're kind of -- there's some collars in that regard.

So I think in this month we've gone through a preliminary that could possibly be altered.

MS. TSCHUDY: As a follow-on question about the first benchmark, if we were to modify it such that you could include your own arm's length sales, what are your thoughts on what we

can do to add some certainty?

Oftentimes comparability is in the eyes of the beholder, so would you suggest that we have minimum volumes that occur under those arm's length sales? Or could we add some certainty around what's comparable in terms of duration, quality, et cetera so that we're, you know, not fighting an audit that, Yes, this arm's length contract is comparable and, No, this one is not?

Thoughts on that?

MS. PARRISH: I think you could. It's not going to be perfect.

But you certainly would throw out some minimum and maximum outlying contracts that may not fit. You could, you could take a basket of comparable contracts and not, try not to narrowly define that, because then we might all run into trouble not having that.

But I think you could set some parameters as far as duration, quantity, and certainly quality; you could put things in that same basket.

MR. HARTZLER: Bill Hartzler.

I think you kind of have to leave it broad, broad like it is right now, comparability in term length and so forth.

For example, this year we did a -- donated coal to KFX, which I think they took -- I forget how many barrels, but it was less than one ton, which we had to go through and arrive

at a value on.

So our company in that instance, we just looked at what the OTC price was that day to value this one ton of coal which, which I think you have to use a little common sense when you're doing it because you aren't going to be able to get it so specific to cover every possible instance that's going to happen. Just like here where they wanted some barrels of coal to test and we gave them X barrels, which was less than one ton, and we had to come up with a value for it.

And hopefully in audit that they won't question less than one ton as to how we valued it, because 12 and a half percent of that difference is going to be no change to the value probably initially reported.

Thank you.

MR. GOULD: Sorry for that start, a rough start, but thank goodness I have great staff here to back me up and get us through the meeting.

Also this is for me a true learning experience. I'm a geologist by schooling but unfortunately never got to practice it. And I actually love this field, as John Hovanec knows. John and I have talked about three years now on the differences of coal valuation compared to oil and gas. So I am learning a lot, so that's possibly why some of my panic occurred here in the beginning here.

So there again, what I do want to say though is

concern about certainty going forward. And what our goal honestly is is to make sure that we do have clear and simple regulations that we all understand.

That's something that the whole administration is looking at right now on all the rules across government. Again, we're not looking to cause concern or fear in terms of going forward. What we're trying to do is are there areas in our regulations that we can clarify and simplify.

I know, looking at the benchmark, I've been told through the years there are some changes that could probably be made to the benchmarks. So again, I do appreciate the comments that we've heard so far.

Also we're looking at our definitions throughout the whole rules: Oil, gas, Indian oil and gas, and Federal and Indian coal. So if there's areas in the definition that you think can be clarified we'd love additional comments on that.

We're going to make an attempt at that when we issue our proposed rule, if we do decide to go ahead and do a proposed rule on this.

But again, as we go forward I would like to continue this discussion over the next couple of weeks if there's information just in terms of clarifying the regulations.

I know there's been in existence since 1989, and I think even longer in some places where --

MS. TSCHUDY: For coal.

MR. GOULD: For coal '89. So I know there's probably been decisions and legal decisions and things like that that have occurred through the years.

So if we can get those into the regulations as well so we're not citing court cases, and instead we're citing our current and existing rules, so again if there's anything as we go forward that you see for simplification and clarification, that truly is our goal.

We don't want to add more uncertainty, and especially in this market. So I agree with what Kim was saying there that that's the last thing we want to do right now.

So as we move forward in this discussion, if there's any other areas that you feel, or any other ideas that you have, please bring those forward to the staff while the comment period is open and we'll continue to work with that.

Any final thoughts from anybody? Bill?

MR. HARTZLER: A slightly off topic question. Do you know the status of the 2005 Energy Act Rules?

MR. GOULD: 2005?

MS. TSCHUDY: We're publishing them concurrently with the Bureau of Land Management. And our rules are ready to go. We're waiting for the BLM rules to be ready to go alongside because they're parallel.

MR. GOULD: Question? All right. Thank you again for your patience with me this morning. And thank you for

coming and providing your comments.

(Whereupon the within proceedings adjourned at 9:41 AM.)

C E R T I F I C A T I O N

I, Martha Loomis, Certified Shorthand Reporter, appointed to take the within proceedings hereby certify that the proceedings was taken by me, then reduced to typewritten form by means of computer-aided transcription; that the foregoing is a true transcript of the proceedings had subject to my ability to hear and understand, and that I have no interest in the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand.

____

Martha Loomis

Certified Shorthand Reporter

Proofread by D. Drake