No. 01-1375

In the Supreme Court of the United States

UNITED STATES OF AMERICA , PETITIONER

v.

NAVAJO NATION

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

JOINT APPENDIX
(VOLUME I)

THEODORE B. OLSON
Solicitor General
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

Counsel of Record
for Petitioner

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Counsel of Record
for Respondent

PETITION FOR WRIT OF CERTIORARI FILED: MAR. 15, 2002
CERTIORARI GRANTED: JUNE 3, 2002

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UNITED STATES COURT
OF THE FEDERAL CLAIMS

No. 93-763

NAVAJO NATION

v.

UNITED STATES

DOCKET ENTRIES

DATE	DOCKET NUMBER	PROCEEDINGS
		* * * * *
12/14/93	1	COMPLAINT. FILING FEE OF $120 PAID. RECEIPT #35665. due on 2/14/94. (ab)
		* * * * *
3/16/94	6	ANSWER to Complaint by USA Service: 3/16/94 (JPSR due 5/3/94). (mm) [Entry date 03/22/94]
		* * * * *
3/30/95	29	FIRST AMENDED COMPLAINT by THE NAVAJO NATION (Answer due 4/12/95 amending [1-1] complaint Service: 3/29/95 (mp)

DATE	DOCKET NUMBER	PROCEEDINGS
4/5/95	30	ANSWER TO AMENDED Complaint by USA. Service: 4/4/95 (as) [Entry date 04/07/95]
		* * * * *
12/15/97	168	MOTION by THE NAVAJO NATION (Service: 12/15/97) for Summary Judgment on the issue of liability on its first claim for relief, together with three separate volumes of appendix (Sealed portion of appendix UNSEALED pursuant to 7/7/00 order). Response due: 1/15/98 (cdc) [Entry date 12/23/97] [Edit date 09/14/00]
12/15/97	169	PROPOSED FINDINGS of Uncontroverted Fact by THE NAVAJO NATION Service: 12/15/97 (cdc) [Entry date 2/23/97]
		* * * * *

DATE	DOCKET NUMBER	PROCEEDINGS
3/24/98	180	CROSS MOTION by USA (Service: 3/17/98) and RESPONSE to [168-1] motion for Summary Judgment by THE NAVAJO NATION. Separate Volume of Appendix and Confidential excerpts from the deposition of Gregory J. Leisse (Exhibit 55)-UNSEALED pursuant to 7/7/00 order. Filed by leave of the Judge. Response due: 4/17/98 9 (jt) [Entry date 03/25/98] [Edit date 09/14/00]
3/24/98	181	PROPOSED FINDINGS of Uncontroverted Fact by USA. Filed by leave of the Judge. Service: 3/17/98 (jt) [Entry date 03/25/98]
3/24/98	182	STATEMENT OF GENUINE ISSUES by USA. Filed by leave of the Judge. Service: 3/17/98 (jt) [Entry date 3/25/98]
		* * * * *
6/1/98	187	RESPONSE by THE NAVAJO NATION (Service: 5/29/98) To [180-1] cross motion. 1 Separate Volume of Appendix (Volume IV). Reply due: 7/17/98 2 DEPOSITION TRANSCRIPT EXCERPTS UNSEALED pursuant to 7/7/00 order. (jt) [Entry date 06/02/98] [Edit date 09/14/00]

DATE	DOCKET NUMBER	PROCEEDINGS
6/1/98	188	STATEMENT OF GENUINE ISSUES by THE NAVAJO NATION. Service: 5/28/98 (jt) [Entry date 06/02/98]
6/1/98	189	PROPOSED FINDINGS of Uncontroverted Fact by THE NAVAJO NATION. Service: 5/28/98 (jt) [Entry date 06/02/98]
		* * * * *
6/17/98	192	CORRECTED RESPONSE by THE NAVAJO NATION (Service: 6/16/98) to [180-1] cross motion. (ab) [Entry date 06/18/98]
		* * * * *
8/3/98	199	REPLY by USA to response to [180-1] cross motion. Service: 8/3/98 (jt) [Entry date 08/05/98]
		* * * * *
8/4/98	200	STATEMENT OF GENUINE ISSUES in response to Plaintiff's additional proposed findings of uncontroverted fact by USA. Filed by leave of the Judge. Service: 8/3/98 (jt) [Entry date 08/07/98] [Edit date 08/07/98]

DATE	DOCKET NUMBER	PROCEEDINGS
8/4/98	201	CLARIFICATION of Certain Proposed Findings of Fact in Response to Plaintiff's Statement of Genuine Issues by USA. Filed by leave of the Judge. Service: 8/3/98 (jt) [Entry date 08/07/98] [Edit date 08/07/98]
9/17/98	202	Supplemental Authorities by THE NAVAJO NATION. Filed by leave of the Judge. Service: 9/14/98 (jt) [Entry date 09/21/98]
		* * * * *
4/30/99	210	Supplemental authorities by THE NAVAJO NATION re: cross-motions for summary judgment filed [by leave of the judge]. Service: 4/27/99 (ds) [Entry date 05/04/99]
		* * * * *
5/4/99	—	Oral Argument re: [168-1] motion for Summary Judgment by THE NAVAJO NATION (Transcript due 6/3/99), [180-1] cross motion by USA (Transcript due 6/3/99) (ds) [Entry date 05/05/99]
		* * * * *

DATE	DOCKET NUMBER	PROCEEDINGS
6/23/99	218	MEMORANDUM by THE NAVAJO NATION re: the Court's inquiry regarding origin of provision in lease amendments calling for vacation of area director's decision. Filed by leave of the Judge. Service: 6/18/99 (jt) [Entry date 06/25/99]
		* * * * *
9/22/99	241	NOTICE of Supplemental Authority by THE NAVAJO NATION. Filed by leave of the Judge. Service: 9/16/99 (jt) [Entry date 09/28/99]
		* * * * *
11/18/99	—	Oral Argument re: [168-1] motion for Summary Judgment by THE NAVAJO NATION [180-1] cross motion by USA set at 10:00 a.m. on 12/1/99 (ds) [Entry date 11/19/99]
		* * * * *

DATE	DOCKET NUMBER	PROCEEDINGS
12/1/99	—	Oral Argument re: [168-1] motion for Summary Judgment by THE NAVAJO NATION (Transcript due 1/3/00), [180-1] cross motion by USA (Transcript due 1/3/00) (ds) [Entry date 12/02/99]
		* * * * *
2/4/00	295	PUBLISHED DECISION concluding the facts of this case show that the Secretary acted in the best interests of a third party and not in the interests of the beneficiary to whom he owned a fiduciary duty—a classic violation of common law fiduciary obligations. Nonetheless, the Navajo Nation has failed to present statutory authority which can be fairly interpreted as mandating compensation for the government's fiduciary wrongs. Defendant has thus established its right to

DATE	DOCKET NUMBER	PROCEEDINGS
		judgment as a matter of law. Further, the Court finds that the government did not enter into a contract with Navajo Nation either by the express terms of Lease 8580 or by implication. Accordingly, defendant's motions for summary judgment with respect to plaintiff's breach of trust claim and its breach of contract claim are granted [180-1]. The Clerk of Court is directed to enter judgment for defendant and dismiss plaintiff's First Amended Complaint. (signed by Judge Lawrence M. Baskir). Copy to parties. (1d)
2/4/00	296	JUDGMENT entered, pursuant to Rule 58, that judgment is entered in favor of the defendant and the First Amended Complaint is dismissed. (signed by Clerk). Copy to parties. (Id)
2/4/00	—	Case closed (1d)

DATE	DOCKET NUMBER	PROCEEDINGS
2/18/00	297	MOTION by THE NAVAJO NATION (Service: 2/18/00) for Reconsideration/Rehearing Pursuant to Rule 59 re: [296-1] judgment order. (jt) [Entry date 04/11/00]
		* * * * *
3/29/00	303	RESPONSE by USA (Service: 3/29/00) to [297-1] motion for Reconsideration/Rehearing Pursuant to Rule 59 re: [296-1] judgement order. Reply due: 4/18/00. (dw) [Entry date 03/30/00]
		* * * * *
4/10/00	306	UNPUBLISHED DECISION denying [291-1] motion for Reconsideration/Rehearing Pursuant to Rule 59 re: [296-1] judgment order. (signed by Judge Lawrence M. Baskir). Copy to parties. (jt) [Entry date 04/11/00]
		* * * * *

DATE	DOCKET NUMBER	PROCEEDINGS
6/1/00	311	NOTICE OF CROSS-APPEAL by THE NAVAJO NATION. Copy to Judge Lawrence Baskir, Defendant, and to CAFC. FILING FEE $ 105.00; RECEIPT #-049744. (hw)
		* * * * *
6/9/00	—	CAFC Case Number Re: [311-1] appeal by THE NAVAJO NATION. CAFC Number: 00-5086. (hw) [Entry date 06/19/00]
		* * * * *
11/26/01	325	MANDATE (certified copy) from CAFC dated November 23, 2001 reversing the [296-1] judgment order (hw)
		* * * * *
6/3/02	329	NOTICE of Granting Certiorari by USA. Service: 6/3/02. (dw) [Entry date 06/04/02]

UNITED STATES COURT
OF THE FEDERAL CLAIMS

No. 00-5085

NAVAJO NATION

v.

UNITED STATES

Chief Judge Lawrence M. Baskir
Lower Court/Agency
#: 93-CV-763

DOCKET ENTRIES

DATE	PROCEEDINGS
	* * * * *
8/25/00	NAVAJO NATION – BRIEF FOR APPELLANT AND SEPARATE APPELLANT'S ADDENDUM (MS-08/25/00). [001404] (EOD 8/29/00 by JAB) 00-5086
9/14/00	PEABODY HOLDING COMPANY, INC., ET AL. [AMICI] – BRIEF FOR AMICUS CURIAE, PEABODY HOLDING COMPANY, INC., PEABODY COAL COMPANY, AND PEABODY WESTERN COAL COMPANY (MS-08/31/00). [001418] (EOD 9/19/00 by JAB) 00-5086
11/02/00	UNITED STATES [APPELLEE] – BRIEF OF THE UNITED STATES (MS-11/02/00) [01149] (EOD 11/15/00 BY JAB) 08-5086

DATE	PROCEEDINGS
	* * * * *
12/01/00	NAVAJO NATION [APPELLANT] – REPLY BRIEF FOR APPELLANT. THE NAVAJO NATION (MS-12/01/00). [011487] (EOD 12/07/00 BY KP) 08-5086
12/06/00	NAVAJO NATION [APPELLANT] – JOINT APPENDIX (VOL. I, II, III) (MS-12/06/00). [011487] (EOD 12/08/00 BY SPP) 00-5086
	* * * * *
3/5/01	Submitted after ORAL ARGUMENT by Paul E. Frye and Todd S. Aagaard. 00-5086 (NEWMAN, SCHALL and LINN)
	* * * * *
8/10/01	REVERSED AND REMANDED. PRECEDENTIAL OPINION BY: J. NEWMAN. OPINION CONCURRING-IN-PART, AND DISSENTING-IN-PART BY: J. SCHALL. JUDGMENT ENTERED: 8/10/01. COSTS AGAINST APPELLEE. (EOD 8/10/01 BY EBG) 00-5086
	* * * * *
10/09/01	APPELLEE – COMBINED PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC [NPF] (MS-10/09/01) PETITION CIRCULATED: 10/10/01. SUGGESTION CIRCULATED: 10/22/01. RESPONSE REQUESTED FROM: APPELLANT (NAVAJO NATION) RESPONSE DUE: 11/06/01 RESPONSE FILED: 11/02/01 RESPONSE CIRCULATED: 11/05/01 PETITION/SUGGESTION: DENIED ON 11/16/01. (EOD 11/16/01 BY AV) 00-5086

DATE	PROCEEDINGS
11/23/01	MANDATE ISSUED TO THE CFC. (EOD 11/23/01 BY AMT) 00-5086

* * * * *

3/15/02	PETITION FOR WRIT OF CERTIORARI FILED. SUPREME COURT # 01-1375. (EOD 4/01/02 BY JNC) 00-5086

[SEAL OMITTED]

United States Department of the Interior
Bureau of Indian Affairs
Washington, D.C. 20245

In Reply Refer To: Trust Services Minerals

[Nov. 26, 1975]

Memorandum

To: Deputy Under Secretary

From: Acting Director, Office of Trust Responsibilities, BIA

Subject: Coal Leasing Policy on Indian Lands

This is in response to your memorandum of November 25, concerning the subject.

In recent years there has been much discussion about the development of coal resources owned by Indian tribes. With the Nation facing a shortage in energy production, some have feared that efforts would be made by the Federal government to develop Indian coal against the wishes of the Indian owners, and without regard to the environmental impacts on the reservations. Therefore, we feel it prudent to set forth the following as the Coal Leasing Policy on Indian Trust Lands.

This Department is deeply committed to the principle of Indian self-determination, and this principle is especially valid with regard to the development of Indian-owned resources. Indian communities should be assured that any development can and will only take place upon their request and in accordance with conditions established in that request.

Indian coal resources represent a significant part of the Western coal reserves. However, our estimates clearly indicate that the public lands contain adequate reserves to meet national needs. There is absolutely no reason for the tribes to fear that efforts will be made to exploit their resources without their full concurrence.

If the Indian tribes determine that they do not wish to develop coal resources they may have, it is their decision to make, and this decision will have the full support of the Department.

If, on the other hand, the tribes do want to proceed with some form of coal development, this too will have the full support of the Department. Such support will include detailed studies in order to prevent or minimize adverse social, cultural or other environmental impacts. It will also include technical advice and assistance to assure that such development will provide maximum long term economic benefits in terms of job opportunities and a fair monetary return reflecting the true value of their developed coal resources.

It is, therefore, the policy of this Department to approve coal leasing on Indian lands where:

(a) the tribal or individual Indian landowner desires to dispose of the coal;

(b) the terms and conditions of the lease are in the best interest of the Indian landowner; and

(c) appropriate environmental protection and reclamation safeguards are imposed on the lessee.

/s/ KENNETH J. FREDERICKS

F.R. Schwab & Associates, Inc.

management consultants

NEW YORK • DENVER • HOUSTON

645 Madison Avenue
New York, N.Y. 10022
(212) 758-6800

February 24, 1983
[Received Mar. 1, 1983]

Chairman Peterson Zah
The Navajo Nation
Window Rock, Arizona 86515

Dear Chairman Zah:

As you may know, the Navajo Nation asked our firm to examine the coal lease royalty arrangements (both the present ones and offers of a 12 1/2 percent royalty) between the Nation and Peabody and Utah International, and to make recommendations as to appropriate royalty levels on these coal leases.

Our study concluded (in our April 12, 1982 report) that both the existing leases and the proposed offers from Peabody and Utah International were inadequate and that the Nation should be receiving higher royalties from both Peabody and Utah. Our purpose in writing this letter to you is to bring these issues directly to your attention as there are undoubtedly substantial amounts of transitioning to be done between the administration of Chairman MacDonald and yourself. Since we regard the issue of coal lease royalty arrangements as a major one, and since so much substantive work has already been done in it we wanted to assure ourselves that the essence of it reached your attention and those of your principal advisors, hence this letter. In this regard, our view is that:

- Peabody should pay the Nation \$8 to \$18 million per [*sic*] year above its proposed 12 1/2 percent offer.
- Utah should pay the Nation for its leases \$4 to \$9 million per year above the current offer.

(These amounts are substantially in excess of the amount actually being received by the Navajos.) These conclusions have been presented to both the utility and coal companies involved. (A brief summary of our conclusions is attached to this letter for your convenience).

We believe at that time we did this report (April, 1982) and we continue to believe that the Nation should seek to demonstrate that the offers of a 12 1/2 percent royalty are not nearly so reasonable or fair as the companies would have one believe. We suspect that this can be done by demonstrating that:

- The consumer of electricity generated with Navajo coal is paying less royalty to the landowner than is the consumer of electricity generated in the Southwest with coal from other sources (based on 12 1/2 percent royalty).
- Other western landowners which have coal similar in quality to the Navajo coal mined by Peabody are receiving higher royalty payments [*sic*] (based on a 12 1/2 percent royalty) than the Navajos would receive under the offer.

If the above two situations can be verified with hard factual data, then the Navajos would be in an excellent position to conclusively demonstrate to the coal operators, the utility companies, the Department of Interior, and others that the proposed offers are both inappropriate and would inadequately compensate the Nation for the coal reserves which they are providing.

Thus, the current situation is that (1) a sound and logical case has been presented that the Nation should be receiving substantially higher royalty payments than that currently being paid or being offered by Utah International and Peabody, and (2) the Nation needs to factually and conclusively demonstrate that the current offers from Utah International and Peabody are unfair and inconsistent with the royalty payments for other coals mined and burned in the region.

We believe that the Nation's case is a strong one. We would be happy to discuss both our past work and our ideas as to how the Nation might further strengthen its case as outlined above. We also have other ideas which we would like to share with you.

If you wish to discuss these or other matters, please contact Earle Johnson (our Principal in charge of the work) or myself at the above address or telephone number.

Cordinally,

/s/ FRANK SCHWAB JR.
F.R. SCHWAB & ASSOCIATES, INC.

Frank Schwab, Jr.
President

FS:SVR

Attachment

June 15, 1984

Area Real Property Management Officer
Proposed Royalty Adjustment of Navajo Coal Lease No. 14-20-0603-8580 (Kayenta Coal Mining Lease by Peabody Coal Company)

Through: Area Director
Assistant Area Director (Resources)

I have reviewed the economic evaluation reports submitted by our Denver Office and the Bureau of Mines regarding the royalty adjustment that is appropriate in August pursuant to Article VI of the above-referenced lease. The reports are based upon some assumed data, particularly capital and operating costs, incorporated with data provided by our office and from the Navajo Tribe.

I also have reviewed the F.R. Schwab & Associates, Inc., report dated April 12, 1982, to the Navajo Nation and the report of Ahmed Kooros, of the Council of Energy Resource Tribes.

The Bureau of Mines has determined that Peabody could afford to pay a royalty of 20.0 percent to the Navajo Tribe and still realize a 20.85 percent rate of return.

Our Denver Office has prepared an independent financial analysis of Peabody's Coal Project and have submitted a summary of the analysis of four (4) different cases, ranging from 12.5 percent to 30 percent and have recommended the "Kayenta" base royalty be adjusted and raised to 24.44 percent.

The Schwab report does not clearly recommend a specific royalty that would be appropriate. It states that a rate of 12.5 percent would be "inadequate."

The CERT report recommends a royalty rate of between 15 and 20 percent.

There is a federal statute that sets 12.5 percent as the minimum coal royalty, but technically it may not apply to Indian lands.

Based on the analysis by our Denver Office, I believe that the royalty adjustment to 24.44 percent, suggested by our Denver Office, is unreasonably high. That recommendation seems intended primarily to establish a bargaining position for a general renegotiation of the Peabody lease rather than a final, fair, supportable readjustment of royalty as permitted by the more limited authority of Article VI of the lease. However, the report clearly supports a royalty adjustment to well in excess of 12.5 percent.

The Bureau of Mines report is more reasonable and justifiable. I support their recommendation.

Therefore, I recommend to you a royalty adjustment of 20.0 percent as a final adjustment decision by your office.

The company should be notified that it must begin paying 20.0 percent royalty on August 28, 1984.

[Seal Omitted]

United States Department of the Interior
BUREAU OF INDIAN AFFAIRS
Navajo Area Office
P.O. Box M
Window Rock, Arizona 86515-0714

In Reply Refer To:
ARPM/Minerals

[June 18, 1984]

CERTIFIED MAIL–RETURN RECEIPT REQUESTED

Mr. Kenneth R. Moore
Peabody Coal Company
Arizona Division
1300 South Yale Street
Flagstaff, Arizona 86001

Re: Lease No. 14-20-0603-8580 (assigned to Peabody Coal Company) Readjustment of Royalty

Dear Mr. Moore:

This letter will notify you of my decision to adjust the royalty rate on coal mined under the above-referenced lease to 20.0 percent of the gross value of the coal mined as determined by the Federal Formula under 45 CFR 3473.3-2(2) and 3485.2f.

In reaching this decision I have considered reports and recommendations from the Bureau's Navajo Area and Energy and Mineral Resources Offices, the Bureau of Mines and others. Those reports are on file in the Navajo Area, Branch of Real Property Management Office.

The basis for this adjustment is the first sentence of Article VI of the lease, originally entered between The Navajo Tribe and Sentry Royalty Company. I am the representative of the Secretary of the Interior authorized to make this adjustment, as evidenced by 10 BIAM 3.0 (copy enclosed).

This is the final decision by my office on this matter. If you wish to appeal this decision pursuant to the provisions of 25 CFR Part 2, you must file a notice of appeal with my office within 30 days of the date you receive this notification.

Sincerely,

/s/ DONALD DODGE
Area Director

Enclosure

TABLE 11. CONSEQUENCES OF 20% ADJUSTMENT ON MINE PRICE LEASE 14-20-0603-8580

Item	Royalty $/Ton	Mine Price $/Ton	Mine Price[3] $ Cost/Million BTU
1964 Lease	0.33	17.35[1]	0.79
20% Royalty Adjustment	3.47	20.82[2]	0.95

Source: Table 6.

[1] Mine Price, 1983.
[2] Mine Price of 1983 with the 20% adjustment for 1984.
[3] 11,000 BTUs/pound. For a larger portion of electricity needs of the members of consortia, which rely greatly on the Navajo plant, the average cost is less than 0.95/million BTU.

If the royalty rate of Navajo coal were increased to 20% of the mine price (16 cents/million BTU is 1984 prices as against the percent 1.5 cents/million BTU) and the higher royalty costs were totally passed on to the power plants and the utilities' customers, then:

1. The two power plants still would have fuel costs among the cheapest in the Southwest.

2. This would have less than one percent (for Nevada Power, it would be 1.5%) impact on the monthly electricity bill of the customers of the five consortia members and would not change their ranking in monthly costs among southwestern utilities.

According to the available standards, this is not only a reasonable but optimal adjustment.

Table 12. CONSEQUENCES OF 20% ROYALTY ADJUSTMENT ON UTILITIES CUSTOMERS[1]

Item	Present Electric Bill $/Month[2]	Additional Cost $/Month[3]
1. Arizona Public Service		
a. 1964 Lease	61.00	
b. 20% Adjustment	61.23	0.23
2. LADWP		
a. 1964 Lease	49.72	
b. 20% Adjustment	49.99	0.27
3. Salt River Project		
a. 1964 Lease	57.48	
b. 20% Adjustment	57.99	0.51
4. Nevada Power		
a. 1964 Lease	42.40	
b. 20% Adjustment	43.04	0.64
5. Southern Cal Edison		
a. 1964 Lease	54.03	
b. 20% Adjustment	54.11	0.08

[1] It is assumed that all extra cost is shifted to the utility customers.

[2] Table 5.

[3] Tables 10 and 11.

February 25, 1985

Mr. John W. Fritz
Deputy Assistant Secretary -
Indian Affairs (Operations)
U.S. Department of the Interior
18th & C Streets, N.W.
Washington, D.C. 20240

Re: Peabody Appeal - Lease #14-20-0603-8580
Letter from Appellants dated February 22, 1985

Dear Mr. Fritz:

The Navajo Tribe vigorously opposes the proposal embodied in the February 22, 1985 letter of appellants, which would delay a decision by your office for at least an additional six weeks. Although it is understandable that the appellants would like to continue to pay a royalty of 1.88% for as long as possible, the regulations of the Department require action on this appeal to be taken within 30 days of the filing of the Navajo Tribe's brief, or March 2, 1985. 25 C.F.R. §2.19. Duly promulgated regulations have the force and effect of law. See, Jicarilla Apache Tribe v. Andrus, 687 F.2d 1324, 1332 (10th Cir. 1982).

There are two issues in this appeal: (1) whether the Area Director's actions were timely and (2) whether appellants have shown that the adjustment is not reasonable. Both of these questions must be answered against appellants as a matter of law. Appellants state generally that the Navajo Tribe has made inaccurate or irrelevant assertions of fact. Appellants do not, however, identify any fact that is erroneous, nor do they relate the purported erroneous fact to the resolution of either of the two issues. (1) There is simply no showing that there is any need to depart from the regulations.

Respectfully yours,

By: Paul E. Frye
Staff Attorney
NAVAJO NATION DEPARTMENT
OF JUSTICE
P.O. Drawer 2010
Window Rock, Arizona 86515

(1) If an assertion of fact is truly irrelevant, the Navajo Tribe expects that the Department will ignore it.

cc: Frederick J. Marton, Esq.
Thomas J. Reilly, Esq.
Gregory J. Leisse, Esq.
Interior Board of Indian Appeals

PEF: daw

UNITED STATES GOVERNMENT
memorandum

DATE: February 26, 1985

REPLY TO
ATTN OF: Vijai N. Rai, Geologist, Energy & Mineral Resources, Lakewood, CO

SUBJECT: Disputed Navajo Coal Royalty Rate Determination for Lease No. 14-20-0603-8580

TO: Office of the Solicitor - Division of Indian Affairs

Attention: Colleen Kelley

THROUGH: Chief, Division of Energy and Mineral Resources

This is in response to your request dated February 6, 1985, asking our assistance and opinion regarding the coal royalty rate determination by the Area Director for Navajo Tribe lease No. 14-20-0603-8580. On June 18, 1984, the Navajo Area Director issued a decision adjusting the royalty rate to 20% of the gross value of the coal under the subject lease.

The essential features of the lease which was entered into by the respective parties on February 1, 1964, and approved on August 28, 1964, are as follows:

1. Acreage: 24,858 acres
2. Primary Term: ". . . . .10 years from the date of approval and for so long thereafter as the substances produced

are being mined by the lessee in accordance with its terms in paying quantities . . . . ."

3. Royalty Payment:

   a. If the average monthly gross realization for the company is less than \$4.00/ton, royalty will be at a rate of 25¢/ton for all coal sold and utilized off the reservation, and 20¢/ton for coal sold on the reservation.

   b. If the average monthly gross realization is between \$4.00 and \$5.00/ton, royalty will be at a rate of 30¢/ton for all coal sold and utilized off the reservation and 24¢/ton for coal sold on the reservation.

   c. If the average monthly gross realization is \$5.00/ton or more, royalty will be at a rate of 37 1/2¢/ ton for all coal sold and utilized off the reservation and 30¢/ton for coal sold on the reservation.

   The term "average monthly gross realization" means the average price of coal produced under the terms of the lease FOB lessee's mine and is determined by dividing the sum of money received for coal and sold during a month by the sum total of tons sold during such month.

The price sold to an affiliate or subsidiary of the lessee is not acceptable.
(Article IV)

4. Provision Authorizing Royalty Rate Adjustment:

   "During the period that the land so leased is under federal jurisdiction, the royalty provisions of this lease are subject to reasonable adjustment by the Secretary of the Interior or his authorized representative at the end of twenty years from the effective date of this lease, and at the end of each successive ten-year period thereafter." (Article VI) (Underlined for emphasis)

The Navajo Area Director, pursuant to his delegated authority to make a "reasonable adjustment" of the royalty terms of Article VI of the said lease, notified Peabody of the adjustment of the royalty to 20% of the gross value of the coal mined. This determination is currently being disputed by Peabody Coal Company (Peabody).

We have reviewed and evaluated six (6) reports that have discussed the issue of royalty rate for coal under the subject lease. In addition, we have examined various justifications for royalty rate determinations presented in the briefs by the respective parties. The royalty rates that have been proposed in these reports are as follows:

1. The Peterson and Company in a report dated November 28, 1984, and prepared at the request

of Peabody proposed a royalty rate between 5.57% to 7.16%. The report concluded that such a rate will restore the benefits that were originally contemplated when the 1964 lease was signed by both parties.

2. Peabody Coal Company - Arizona Division in a report dated September 15, 1982 concluded that the royalty rate proposed by Peabody on December 28, 1981, is equitable. On that date, Peabody offered to raise the royalty rate to 12.5% on gross sales without deduction for coal under the lease currently under dispute, which contains an adjustment clause, and also offered to raise the royalty on Lease No. 9910 (which has no adjustment clause) from 6.67% to 12.5%. This report also questioned the validity of data used in the Schwab Report which was prepared for the Navajo Tribe and is discussed below.

3. The F.R. Schwab & Associates, Inc. in a report dated April 12, 1982, and prepared for the Navajo Tribe recommended a royalty rate of 12 to 16 cents per million BTU; this value is equivalent to $2.64 to $3.52 per ton for all coal mined under the lease. Assuming the sales price of coal was $15.46/ton at the time the report was written, the royalty rate recommended in the report will range between 17.08% to 22.77%. This report is based on a comparative sales approach (analysis of market data); and (2) the income of earnings approach, also known as discounted cash flow analysis.

4. The Council of Energy Resource Tribes (CERT) in a report prepared for the Navajo Tribe stated

that a royalty rate of between 15% and 20% would be "completely justifiable." The rate recommended is based on a discounted cash flow rate of return (DCFROR) model. In a subsequent report dated January 1985, CERT recommended a 20% royalty rate.

5. The United States Bureau of Mines in a report dated June 6, 1984, and prepared at the request of the Energy and Mineral Resource Division of the Bureau of Indian Affairs, recommended a royalty rate of 20%. This recommendation is also based on a discounted cash flow rate of return (DCFROR) model.

6. The Energy and Mineral Resource Division, Bureau of Indian Affairs in a memorandum dated June 6, 1984, to the Navajo Area Director recommended a royalty rate of 24.44%. This computation utilized data from reports prepared by CERT and the Bureau of Mines as well as data from some other sources.

The royalty rates recommended in various reports range from a low of approximately 17% to a high of 24.44%.

Peabody, in its brief, disagrees with the Area Director's adjustment of the royalty rate to 20 percent of the gross value of the coal mined under lease. Peabody contends that a "reasonable adjustment" to the royalty provisions in the lease requires an adjustment sufficient to preserve to the parties to the lease their reasonable expectations regarding the royalties that would be paid by Peabody to the Navajo Tribe over the term of the lease.

Peabody, therefore, contends that any adjustment to the royalty rate by the Area Director should preserve the benefit of the bargain struck by the parties in 1964, with the Navajo Tribe receiving neither more nor less than the royalties that the Tribe could reasonably have anticipated receiving in 1964 for the 200 million tons of coal sold to Peabody.

Such an interpretation of the "reasonable adjustment" provision of the lease, however, is inconsistent with the underlying reasons for that provision in that lease and does not fully comprehend the economic realities and consequences of a leasing transaction.

The "reasonable adjustment" provision provides the royalty owner (landowner) the opportunity to periodically adjust the royalty rate either up or down, if the market and economic conditions so dictate.

It also assures the royalty owner a reasonable and equitable share of the gross income from mining over the life of the lease. Since the royalty owner continues to hold an economic interest in the mineral in place throughout the life of the lease and looks for his share of the income from the extraction for a return of his capital, it is in his best interest to have such a provision in the lease. It is even more critical, if the royalty owner believes the price of his mineral product, and therefore the value of his share of the gross income from property is likely to increase in the future.

The price that Peabody received for the coal extracted from the leased land increased from $2.81/ton in 1972 to $17.35/ton in 1983. Such an increase is considerably higher than either the increase in the cost of mining or the Consumer Price Index (CPI) during that period. As a consequence, Peabody's share of the income from it operation on the leased land was considerably higher than Peabody's most likely anticipated expectations in 1964. No one at that time envisioned such a dramatic increase in the price of coal and other energy resources during the 1970's.

The Tribe's share of income from extraction of that coal during that period, however, was, on a per ton basis, actually lower than its most likely anticipated expectations (The Tribe received a fixed price/ton as royalty and during that period the value of the dollar dropped substantially in response to unexpected high inflation rate).

The "reasonable adjustment" provision in the lease is specifically for the purpose of making adjustments to prevent such inequities. We believe that it is within the Area Director's purview to adjust the royalty rate at the end of the 20 year term and is clearly provided in the lease. <u>Therefore, the real issue is not whether the royalty rate can be adjusted upward if the market and economic conditions clearly so dictate but by how much</u>.

A 20% royalty is reasonable based on the discounted cash flow rate of return (DCFROR) analysis and the comparative sales approach (market analysis) that were utilized in various reports written on or behalf of the Tribe. However, since the revenue, investment, and cost projections were based on estimate, and not on an actual data from Peabody, there is a possibility of error with respect to projections involving Peabody's DCFROR. The DCFROR method is based on certain fundamental and basic assumptions which involve estimating future operating and investment costs, taxes and other expenses. In addition, the result must be discounted to reflect the fact that the dollar earned in the future will be worth less than the present dollar.

In the absence of actual data from Peabody with respect to sales price, operating and investment costs, taxes, and other expenses on which future projection involving these items are made, the accuracy of the projections is questionable. For example, the operating costs in CERT's projection are considerably higher than the one used in the U.S. Bureau of Mines Report ($10.80/ton vs. $8.55/ton, including $3.33/ton capital cost). This represents a substantial difference in the operating cost when multiplied by the total tons mined (nearly nine million tons/yr.), and consequently would affect the DCFROR projections in these reports. In addition, data with respect to cost and other expenses should have been verified and substantiated with data involving these items in Keystone or other publications.

Similarly, the part of the data base used in comparable sales method by Schwab and Associates to determine an equitable royalty rate for the leased coal is also questionable. This method of valuation requires that the comparable sales data to be relied on be specifically comparable with respect to a number of key factors, such as, location with respect to market and transportation, physical characteristics of the coal (BTU, sulfur, ash, etc.), cost of production (surface vs. underground, overburden ratio, multiple seams, production techniques, etc.), size of reserve, size of production, etc.

Determining a royalty rate for the Navajo coal by comparing the royalty rate for eastern coal, or metallurgical coal, or coal that is being extracted by different production techniques than the one used at the Navajo lease are also questionable and Peabody is justified in pointing these inconsistencies.

However, Peabody has not provided any specific data which refutes the specific DCFROR projections or the estimated value of the coal reserves under lease. For example, the thickness of the coal seams, the thickness of the overburden, the overburden and recovery ratios, the size of the coal reserves and its quality, the size of production, marketability, etc. all indicate that the coal reserve under lease to Peabody is extremely valuable. These factors also indicate that the royalty rate for this coal deposit should be much higher than the 12.5% that the Federal Government receives for surface-mined coal. Furthermore, although based on estimates, all the reports involving royalty rate determinations indicate that the DCFROR for Peabody's operations on the leased land are extremely high. In addition, because Peabody has been assured of a 15% DCFROR by the consortium of utilities that buy that coal, it can pass on any increase in the royalty rate to its customers without affecting its DCFROR. Furthermore, the reports involving the royalty rate determinations also indicate that the consumers, who ultimately purchase the power that is generated from the coal mined from the leased land, will also not be adversely affected.

In summary, based on data currently available, a 20% royalty rate determination appears reasonable and defensible. In the appeal decision, we recommend that the Area Director's 20% royalty rate determination be sustained. However, Peabody should be granted a 60 to 90 day time period in which to provide economic data to substantiate its contention that a 20% royalty rate is unreasonable. If Peabody were to provide the actual data with respect to its cost, investment, and revenues, the Bureau of Indian Affairs should reevaluate its royalty rate determination in light of such data. Such data, however, must include information not only with respect to Peabody's mining operation, but also with respect to the overriding royalties that it pays to its wholly-owned leasing subsidiary – The Sentry Royalty Company. This information is significant because the acquisition of a lease interest in coal is nearly always structured so as to qualify a part of the future income from mining under section 631(c) of the Internal Revenue Code by having a company other than the one that will do the actual mining of the coal, acquire the reserves and sublease them for a retained arms-length overriding royalty, to a related mining company. Under such an arrangement, the parent company receives the benefits of both the percentage and cost depletion as well as the preferential capital gains treatment on royalties paid to its leasing entity.

AN ENGINEERING AND ECONOMIC ANALYSIS OF THE KAYENTA LEASE AREA

By Philip C. Perlewitz and Robert L. Davidoff

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AN ENGINEERING AND ECONOMIC ANALYSIS OF THE KAYENTA LEASE AREA

By Philip C. Perlewitz[1] and Robert L. Davidoff[2]

*** INTRODUCTION

Bureau of Mines (BOM) personnel evaluated the economics of the coal mining operation within the Kayenta Lease Area. This evaluation was based on information provided in the Kayenta Mine Plan submitted to the Office of Surface Mining (OSM) by the Peabody Coal Company, Inc. The intent of this study was to arrive at a reasonably site specific estimate of the capital and operating costs incurred by the Peabody Coal Company at the Kayenta Mine. Also, sensitivity analyses were performed to determine the impact of varying royalty rates and coal selling prices on the profitability of this project. Furthermore, the impact of state taxes was considered in this evaluation.

The capital and operating cost estimates were based on data obtained from the Kayenta Mine Plan. For example, the following mine plan information was used to arrive at a site specific cost estimate:

1) Major equipment list
2) Recent crusher and conveyor installations
3) Reclamation cost estimates

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4) Operating parameters (seam thickness, overburden depth, pit width, etc.)

5) Methods and sequence of mining activities (drilling and blasting, overburden removal, coal removal, etc.)

*** ENGINEERING COST EVALUATION METHODOLOGY

The engineering cost evaluation included estimates of all the relevant capital and operating costs for the Kayenta Mine. These cost estimates were based on both the operating parameters and procedures specified in the Kayenta Mine Plan. Capital expenditures were calculated for continued development, equipment replacement and constructing a crusher and conveyor facility (specifically the J-28 crusher facility as detailed in the Kayenta Mine Plan). The capital reinvestment expenditures for mine plant and equipment included the costs for replacing mobile and stationary equipment, and took into consideration the depreciable life of various equipment classifications. It was also determined that $100,000,000 of remaining capital from investments in mine plant and equipment prior to 1984 would be a close approximation of the remaining book value.

The operating cost estimate for this mine includes both direct and indirect costs. The direct operating cost includes: production and maintenance labor, supervision, supplies, utilities, reclamation and payroll overhead. The indirect operating costs include such items as: administrative costs, facilities maintenance and supplies.

METHODOLOGY USED FOR DETERMINING MINE EQUIPMENT CAPITAL COSTS

The capital cost for the walking draglines was estimated using information provided in a thesis by M. J. Ryan (*1*)[3]. Reach requirements for the draglines were taken from the Kayenta Mine Plan. Capital costs for the other mining equipment used at the Kayenta Mine were estimated using information obtained from Dataquest, Inc.(*2*).

An equipment replacement schedule was developed using information provided in a Bureau of Mines Information Circular (*3*). In developing this schedule, consideration was also given to the equipment usage and operating procedures practiced at this mine. For each major piece of equipment, an estimate of operating life was made. Reinvestments were scheduled according to the equipment life and the remaining mine life (see table 1). Pit electrical equipment requirements were assumed base on a BOM Information Circular (*3*).

METHODOLOGY USED FOR DETERMINING MINE EQUIPMENT OPERATING COSTS

The operating costs for mobil mining equipment and coal loading shovels were determined using information provided by Dataquest, Inc. (*4*). Dragline operating costs were derived from information provided in a thesis by M.J. Ryan (*1*). In general, the individual operating costs for each type and model of equipment were determined on a per hour basis. The components of these costs included: replacement parts, fuel or

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[3] Underlined numbers in parentheses refer to items in the list of references at the end of this report.

electricity, lubricants, tires and ground engaging components. The labor costs for operation and maintenance of the equipment were calculated in a separate manning schedule.

The work schedule for determining personnel requirements was as follows:

- 240 days per year or 220 days per year for support activities
- 3 shifts per day for overburden removal
- 2 shifts per day for coal production and support activities

Total annual operating costs were determined by multiplying the annual operating hours by the operating cost per hour for each type of equipment. Equipment was assumed to be available and used for 75 pct of an 8-hour shift; it should be understood that actual usage may vary depending on such factors as production schedule and the mine logistics.

TABLE 1. - Estimated Kayenta Mine investment and production stream for the remaining economic mine life

Year	Item	Cost/Production
1984-1999	Development costs	$2,000,000 per year
1984-1998	Annual coal production	8,3000,000 tons[1]
1999-1999	Annual coal production . . .	7,553,596 tons[1]
1984-1999	Mine operating cost	$5.89 per ton
1984-1999	Reclamation - black lung ...	$0.85 per ton
1984	Remaining capital from prior years investments	$100,000,000
1984	Mine equipment reinvestment .	25,320,000
1985	...do	26,173,900
1986	...do	27,294,700
1987	...do	23,088,700
1988	...do	21,690,500
1989	...do	22,371,100
1990	...do	20,050,000
1991	...do	11,896,700
1992	...do	10,064,700
1993	...do	10,434,700
1994	...do	10,998,300
1995	...do	11,368,600
1996	...do	11,352,100
1997	...do	10,166,200
1998	...do	17,594,400
1999	...do	6,000,000
1984 ...	Mine plant investment	3,450,000
1984 ...	Working capital	8,921,0000

1 All tonnage figures in the report are short tons.

METHODOLOGY USED FOR DETERMINING PERSONNEL COSTS

The personnel required for this operation was determined using information from the Kayenta Mine Plan as well as a BOM Information Circular (*3*). Personnel were broken down into the following categories: union production, union maintenance, general labor and salaried personnel. Salaried personnel included: production foreman, maintenance foreman, mine management, engineering, clerical and support staff.

The production personnel were determined by staffing the equipment according to the coal production rate and operating procedures that are in place at the Kayenta Mine. The required union maintenance personnel were determined in part from the operating procedures specified by the Peabody Coal Company, Inc. and in part from a BOM Information Circular (*3*). The remaining personnel were estimated from the same information circular. The 1984 Keystone Coal Industry Manual reports that employment at the Kayenta Mine equaled 533 people. This study estimates the staffing requirements at 451 people. If the Keystone figure is used, then additional labor cost of approximately $0.60 per ton could be incurred.

Union personnel costs were determined by using the March 1984 standard hourly wage rates for 8-hour shift mines found in a 1984 Western Surface Agreement between a western coal mining company and the International Union of United Mine Workers of America. Both job specific wage rages and shift differentials were used to arrive at these costs (see table 2).

The Kayenta Mine is assumed to operate three 8-hour shifts per day and 240 days per year. Fringe benefits for all personnel were assumed

at 32 pct of the total personnel costs. The percentage of salaried personnel costs is approximately 7 pct of the total manpower costs.

METHODOLOGY USED FOR DETERMINING RECLAMATION COSTS

Reclamation costs were based on figures included in the Kayenta Mine Plan modified for the J-21 pit development. A cost of $0.60 per ton of coal was used for this estimate. This would roughly translate into a cost of $12,500 per acre of mined land. However, if the reclamation cost estimates for the J-21 pit were to include both mined land and associated disturbed areas, then reclamation would cost $27,087 per acre of mined land or approximately $1.30 per ton of coal. Reclamation cost estimates using information provided in a handbook developed by Straam Engineers, Inc. (*5*) indicates a range from $5,000 to $10,000 per acre. Thus, the cost of $12,500 per acre was considered to be reasonable and was used in the estimate.

*** SENSITIVITY ANALYSIS RESULTS

Sensitivity analyses were conducted to determine the effects of several factors on the project economics of the Kayenta Mine. The factors that were considered are as follows:

1. Royalty rate: Range: 10.0 to 20.0 pct of gross sales
2. Coal Selling Price: Range - $16 to $18 per ton of coal
3. The impact of State taxes (property, severance and income tax)

The project was evaluated in both constant January 1984 dollars and under a general inflation rate of 5% per year for the entire property life. These assumptions were made for the purpose of comparability with the results of a prior evaluation (*6*). Table 3 lists the royalty amounts paid to the tribe while varying the royalty rates and coal selling price. Table 4 demonstrates the effects of increasing the royalty rates and coal selling prices on the project Discounted Cash Flow Rate of Return (DCFROR). Table 5 represents the effects of varying coal selling prices and royalty rates on the project DCFROR when only Federal taxes are considered. Table 6 illustrates the impact of price and royalty rate changes on the project's State and Federal tax burden. Since royalties are an allowable deduction for State and Federal income tax determination, any increase in the royalty payment would reduce taxable income and therefore reduce the tax burden on the property. Finally, tables 7-9 depict the effects of a 5-pct rate of inflation on the amount of royalties paid to the tribe and on the rates of return to the company while varying the coal selling price and royalty rates.

By examining the succeeding tables, the following inferences my be made:

1. A change in the royalty rate from 12.5 pct to 20.0 pct will reflect a cost increase of between $1.20 to $1.35 per ton assuming that the coal selling price is between $16 and $18 per ton (table 3).

2. At a 12. pct royalty rate, a change in the coal selling price from $16 per ton to $17 per ton (6.25 pct increase) will increase the DCFROR from 21.6 pct to 26.1 pct (21 pct change) (see table 4).

3. At a 12.5 pct royalty rate, the inclusion of state taxes in the analysis would decrease the

project DCFROR by 13.6 pct (from 25.0 pct to 21.6 pct at a price of $16 per ton) (tables 4 and 5).

4. As can be seen by comparing table 4 with table 8, the project DCFROR increases under an inflation rate. For example, at a $16 per ton coal selling price and with a royalty rate of 12.5 pct, the DCFROR would increase from 21.6 pct to 25.4 pct (all taxes are applied).

TABLE 3. - Royalties over the life of the property using constant 1984 dollars

Coal Selling Price ($/ton)	Royalty Rate (Pct of gross)	Total Royalties[1] ($1,000)	Royalties Dollars Per Ton
16.00	10.0	211,286	1.60
	12.5	264,107	2.00
	15.0	316,929	2.40
	17.5	369,750	2.80
	20.0	422,572	3.20
17.00	10.0	224,491	1.70
	12.5	280,614	2.12
	15.0	336,737	2.55
	17.5	392,859	2.97
	20.0	448,982	3.40
18.00	10.0	237,696	1.80
	12.5	297,121	2.25
	15.0	356,545	2.70
	17.5	415,969	3.15
	20.0	475,393	3.60

[1] All royalties are rounded to the nearest thousand.

TABLE 4. - DCFROR and Net Present Value (N.P.V.) at varying prices and royalty rates using constant 1984 dollars

	All State and Federal Taxes Included		
Price ($/ton)	**Royalty Rate (Pct)**	**DCFROR (Pct)**	**N.P.V.[1] ($1,000)**
16.00	10.0	23.7	28,727
	12.5	21.6	18.014
	15.0	19.3	6,848
	17.5	17.0	-5,093
	20.0	14.5	-18,243
17.00	10.0	28.4	51,650
	12.5	26.1	40,612
	15.0	23.8	29,417
	17.5	21.6	18,032
	20.0	19.2	6,133
18.00	10.0	33.2	73,654
	12.5	30.8	62,470
	15.0	28.3	51,031
	17.5	25.9	39,323
	20.0	23.4	27,437

[1] Discount rate equals 18 pct.

TABLE 5. - DCFROR and N.P.V. at varying prices and royalty rates using constant 1984 dollars and only Federal income tax included

Price ($/ton)	Royalty Rate (Pct)	DCFROR (Pct)	N.P.V.[1] ($1,000)
16.00	10.0	27.4	46,461
	12.5	25.0	35,082
	15.0	22.7	23,557
	17.5	20.3	11,843
	20.0	17.9	-383
17.00	10.0	32.8	71,230
	12.5	30.2	59,658
	15.0	27.7	47,871
	17.5	25.2	35,800
	20.0	22.7	23,557
18.00	10.0	38.4	95,438
	12.5	35.5	83,370
	15.0	32.8	71,230
	17.5	30.1	58,976
	20.0	27.4	46,461

[1] Discount rate equals 18 pct.

TABLE 6. - Average annual tax burden over property life using constant 1984 dollars varying prices and royalty rates

Price ($/ton)	**Royalty Rate (%)**	**State Tax[1] ($000)**	**$/ton**	**Federal Tax ($000)**	**$/ton**
16.00	10.0	10,132	1.23	6,492	0.79
	12.5	9,860	1.19	5,479	0.66
	15.0	9,600	1.16	4,488	0.54
	17.5	9,351	1.13	3,519	0.43
	20.0	9,118	1.10	2,580	0.31
17.00	10.0	10,961	1.33	8,760	1.06
	12.5	10,652	1.29	7,646	0.93
	15.0	10,354	1.25	6,552	0.79
	17.5	10,065	1.22	5,476	0.66
	20.0	9,790	1.19	4,426	0.54
18.00	10.0	11,843	1.43	11,186	1.36
	12.5	11,492	1.39	9,921	1.20
	15.0	11,147	1.35	8,690	1.05
	17.5	10,822	1.31	7,514	0.91
	20.0	10,508	1.27	6,359	0.77

[1] Includes property, severance and state income taxes.

TABLE 7. - Total royalties paid over the life of the property varying selling prices and royalty rates using a 5 pct rate of inflation for all costs and prices

Coal Selling Price ($/ton)	Royalty Rate (Pct of Gross)	Total Royalties[1] ($1,000)	Royalties Dollars Per Ton
16.00	10.0	311,689	2.36
	12.5	389,611	2.95
	15.0	467,533	3.54
	17.5	545,455	4.13
	20.0	623,374	4.72
17.00	10.0	311,169	2.51
	12.5	413,962	3.13
	15.0	496,754	3.76
	17.5	579,546	4.39
	20.0	662,339	5.02
18.00	10.0	350,650	2.66
	12.5	438,312	3.32
	15.0	525,975	3.98
	17.5	613,637	4.65
	20.0	701,300	5.31

[1] All royalties are rounded to the nearest thousand.

TABLE 8. - DCFROR and N.P.V. are varying prices and royalty rates using a 5 pct rate of inflation for all costs and prices

Coal Selling Price ($/ton)	Royalty Rate (Pct of Gross)	DCFROR (Pct)	N.P.V.[1] ($1,000)
16.00	10.0	27.5	58,573
	12.5	25.4	45,697
	15.0	23.2	32,281
	17.5	20.9	18,174
	20.0	18.5	3,102
17.00	10.0	32.2	86,121
	12.5	29.9	72,809
	15.0	27.7	59,403
	17.5	25.4	45,730
	20.0	23.1	31,450
18.00	10.0	37.1	113,184
	12.5	34.6	99,389
	15.0	32.1	85,385
	17.5	29.7	71,273
	20.0	27.3	57,072

[1] All N.P.V. figures are rounded to the nearest thousand.

TABLE 9. - DCFROR and N.P.V. at varying prices and royalty rates using a 5 pct rate of inflation for all costs and prices and only Federal income tax included

Coal Selling Price ($/ton)	Royalty Rate (Pct of Gross)	DCFROR (Pct)	N.P.V.[1] ($1,000)
16.00	10.0	31.3	80,655
	12.5	28.9	66,944
	15.0	26.6	53,126
	17.5	24.3	38,913
	20.0	21.9	24,158
17.00	10.0	36.8	111,088
	12.5	34.2	96,789
	15.0	31.6	82,366
	17.5	29.1	67,802
	20.0	26.6	53,126
18.00	10.0	42.4	140,949
	12.5	39.5	126,101
	15.0	36.8	111,088
	17.5	34.0	95,948
	20.0	31.3	80,655

[1] All N.P.V. figures are rounded to the nearest thousand.

*** CONCLUSIONS

The purpose of the study had a two-fold nature. First, to develop capital and operating costs that would realistically depict the actual costs involved at the Kayenta Mine. Secondly, to analyze the impact of changing coal prices, varying royalty rates and the inclusion of state taxes on the profitability of this project as measured by the DCFROR method. To develop reasonable capital and operating cost estimates, site specific information was obtained from several sources including the Kayenta Mine Plan submitted to the Office of Surface Mining. Also, operating procedures detailed in this mine plan were considered in the development of the operating cost estimate.

Several inferences concerning the impact of price, royalty rates and taxes have been brought out in this study. Under the price and royalty rate ranges investigated by this study, the DCFROR ranged from 14.5 pct to 33.2 pct when state taxes were applied and constant 1984 dollars were been used. The lowest project return (DCFROR = 14.5 pct) occurred at a price and royalty rate of $16 per ton and 20 pct, respectively. Alternatively, the highest project return (DCFROR = 33.2 pct) occurred at a price of $18 per ton and a 10 pct royalty. Further insite on the relationships between the above-mentioned parameters and the project profitability may be gained through a more detailed examination of these tables.

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ADDENDUM TO AN ENGINEERING AND ECONOMIC ANALYSIS OF THE KAYENTA LEASE AREA

By Philip C. Perlewitz and Robert L. Davidoff

May 6, 1985

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AN ENGINEERING AND ECONOMIC ANALYSIS OF THE KAYENTA LEASE AREA

By Philip C. Perlewitz[1] and Robert L. Davidoff[2]

*** INTRODUCTION

Bureau of Mines (BOM) personnel evaluated the economics of the coal mining operation within the Kayenta Lease Area. The intent of this study was to arrive at a more site specific estimate of the capital and operating costs incurred by the Peabody Coal Company at the Kayenta Mine as compared to those costs presented in a previous study[3]. The previous study, performed at the request of the BIA, presented a number of possible scenarios portraying costs at different orders of magnitude. This report (dated 5/6/85), requested to provide a more detailed analysis of the actual cost basis of the operation, was based on information provided in the Kayenta Mine Plan submitted to the Office of Surface Mining (OSM) by the Peabody Coal Company, Inc. Sensitivity analyses were performed to determine the impact of varying royalty rates and coal selling prices on the profitability of this project. Furthermore, the impact of state taxes was considered in this evaluation.

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[2] Mineral Economist, Minerals Availability Field Office, Bureau of Mines, Denver, CO.

[3] Previous study entitled "Analysis of the Financial Aspects of a Reevaluation of the Royalty Terms of the Kayenta Lease Area Between the Navajo Indian Tribe and Peabody Coal Company, Inc.". Prepared by Minerals Availability Field Office, U.S. Bureau of Mines. June 6, 1984.

The capital and operating cost estimates were based on data obtained from the Kayenta Mine Plan. For example, the following mine plan information was used to arrive at a site specific cost estimate:

1) Major equipment list

2) Recent crusher and conveyor installments

3) Reclamation cost estimates

4) Operating parameters (seam thickness, overburden depth, pit width, etc.)

5) Methods and sequence of mining activities (drilling and blasting, overburden removal, coal removal, etc.)

*** ENGINEERING COST EVALUATION METHODOLOGY

The engineering cost evaluation included estimates of all the relevant capital and operating costs for the Kayenta Mine. These cost estimates were based on both the operating parameters and procedures specified in the Kayenta Mine Plan. Capital expenditures were calculated for continued development, equipment replacement and constructing a crusher and conveyor facility (specifically the J-28 crusher facility as detailed in the Kayenta Mine Plan). The capital reinvestment expenditures for mine plant and equipment included the costs for replacing mobile and stationary equipment, and took into consideration the depreciable life of various equipment classifications. It was also determined that $100,000,000 of remaining capital from investments in mine plant and equipment prior to 1984 would be a close approximation of the remaining book value.

The operating cost estimate for this mine includes both direct and indirect costs. The direct operating cost includes: production and maintenance labor, supervision, supplies, utilities, reclamation and payroll overhead. The indirect operating costs include such items as: administrative costs, facilities maintenance and supplies.

METHODOLOGY USED FOR DETERMINING MINE EQUIPMENT CAPITAL COSTS

The capital cost for the walking draglines was estimated using information provided in a thesis by M. J. Ryan (*1*)[4]. Reach requirements for the draglines were taken from the Kayenta Mine Plan. Capital costs for the other mining equipment used at the Kayenta Mine were estimated using information obtained from Dataquest, Inc. (*2*).

An equipment replacement schedule was developed using information provided in a Bureau of Mines Information Circular (*3*). In developing this schedule, consideration was also given to the equipment usage and operating procedures practiced at this mine. For each major piece of equipment, an estimate of operating life was made. Reinvestments were scheduled according to the equipment life and the remaining mine life (see table 1). The type of depreciation used was ACRS for all plant and equipment. Pit electrical equipment requirements were assumed based on a BOM Information Circular (*3*). For the years 1984, 1985 and 1986, a financing scenario of 30:70 (debt/equity ratio was used at a loan interest rate of 12 pct. All investments after that period were financed at 100 pct equity).

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[4] Underlined numbers in parentheses refer to items in the list of reference at the end of this report.

METHODOLOGY USED FOR DETERMINING MINE EQUIPMENT OPERATING COSTS

The operating costs for mobile mining equipment and coal loading shovels were determined using information provided by Dataquest, Inc. (*4*). Dragline operating costs were derived from information provided in a thesis by M. J. Ryan (*1*). In general, the individual operating costs for each type and model of equipment were determined on a per hour basis. The components of these costs included: replacement

TABLE 1. - Estimated Kayenta Mine investment and production stream for the remaining economic mine life

Year	Item	Cost/Production
1984-1999	Development costs	$2,000,000 per year
1984-1998	Annual coal production	8,3000,000 tons[1]
1999-1999	Annual coal production . . .	7,553,596 tons[1]
1984-1999	Mine operating cost	$5.89 per ton
1984-1999	Reclamation - black lung .. .	$0.85 per ton
1984	Remaining capital from prior years investments	$100,000,000
1984	Mine equipment reinvestment .	25,320,000
1985	. . .do	26,173,900
1986	. . .do	27,294,700
1987	. . .do	23,088,700
1988	. . .do	21,690,500
1989	. . .do	22,371,100
1990	. . .do	20,050,000
1991	. . .do	11,896,700
1992	. . .do	10,064,700
1993	. . .do	10,434,700
1994	. . .do	10,998,300
1995	. . .do	11,368,600
1996	. . .do	11,352,100
1997	. . .do	10,166,200
1998	. . .do	17,594,400
1999	. . .do	6,000,000
1984 . . .	Mine plant investment	3,450,000
1984 . . .	Working capital	8,921,0000

[1] All tonnage figures in the report are short tons.

parts, fuel or electricity, lubricants, tires and ground engaging components. The labor costs for operation and maintenance of the equipment were calculated in a separate manning schedule.

The work schedule for determining personnel requirements was as follows:

- 240 days per year for production and 220 days per year for support activities
- 3 shifts per day for overburden removal
- 2 shifts per day for coal production and support activities

Total annual operating costs were determined by multiplying the annual operating hours by the operating cost per hour for each type of equipment. Equipment was assumed to be available and used for 75 pct of an 8-hour shift; it should be understood that actual usage may vary depending on such factors as production schedule and the mine logistics (see table 2).

METHODOLOGY USED FOR DETERMINING PERSONNEL COSTS

The personnel required for this operation was determined using information from the Kayenta Mine Plan as well as a BOM Information Circular (*3*). Personnel were broken down into the following categories: union production, union maintenance, general labor and salaried personnel. Salaried personnel included: production foremen, maintenance foremen, mine management, engineering, clerical and support staff.

The production personnel were determined by staffing the equipment according to the coal production rate and operating procedures that are in place at the

Kayenta Mine. The required union maintenance personnel were determined in part from the operating procedures specified by the Peabody Coal Company, Inc. and in part from a BOM Information Circular

(*3*). The remaining personnel were estimated from the same Information Circular. The 1984 Keystone Coal Industry Manual reports that employment at the Kayenta Mine equaled 533 people. This study estimates the staffing requirements at 451 people. If the Keystone figure is used, the additional labor cost of approximately $0.60 per ton could be incurred.

Union personnel costs were determined by using the March 1984 standard hourly wage rates for 8-hour shift mines found in a 1984 Western Surface Agreement between a western coal mining company and the International Union of United Mine Workers of America. Both job specific wage rages and shift differentials were used to arrive at these costs (see table 2).

The Kayenta Mine is assumed to operate three 8-hour shifts per day and 240 days per year. Fringe benefits for all personnel were assumed at 32 pct of the total personnel costs. The percentage of salaried personnel costs is approximately 7 pct of the total manpower costs.

METHODOLOGY USED FOR DETERMINING RECLAMATION COSTS

Reclamation costs were based on figures included in the Kayenta Mine Plan modified for the J-21 pit development. A cost of $0.60 per ton of coal was used for this estimate. This would roughly translate into a cost of $12,500 per acre of mined land. However, if the reclamation cost estimates for the J-21 pit were to include both mined land and associate disturbed areas, then reclamation would cost $27,087 per acre of mined land or approximately $1.30 per ton of coal. Reclamation cost estimates using information provided in a handbook developed by Straam Engineers, Inc. (*5*) indicates a range from $5,000 to $10,000 per acre. Thus, the cost of $12,500 per acre was considered to be reasonable and was used in the estimate.

*** SENSITIVITY ANALYSIS RESULTS

Sensitivity analyses were conducted to determine the effects of several factors on the project economics of the Kayenta Mine. The factors that were considered are as follows:

1. Royalty rate: Range: 12.5 and 20.0 pct of gross sales
2. Coal Selling Price: Range - $16 to $18 per ton of coal
3. The impact of State taxes (property, severance and income tax)

The project was evaluated in both constant January 1984 dollars and under a general inflation rate of 5% per year for the entire property life. These assumptions were made for the purpose of comparability with the results of a prior evaluation (*6*). Table 3 lists the royalty amounts paid to the tribe while varying the royalty rates and coal selling price. Table 4 demonstrates the effects of varying the royalty rates and coal selling prices on the project Discounted Cash Flow Rate of Return (DCFROR) and Net Present Value (N.P.V.). Table 5 represents the effects of varying coal selling prices and royalty rates on the project DCFROR when only Federal income taxes are considered. Table 6 illustrates the impact of coal selling price and royalty rate changes on the project's State and Federal tax burden. Since royalties are an allowable deduction for State and Federal income tax determination, any increase in the royalty payment would reduce taxable income and therefore reduce the tax burden on the property. Finally, tables 7-9 depict the effects of a 5-pct rate of inflation on the amount of royalties paid to the tribe and on the rates of return to the company while varying the coal selling price and royalty rates.

Table 10 illustrates an example summary of the pertinent data from each of the different analyses performed.

By examining the succeeding tables, the following inferences may be made:

1. A change in the royalty rate from 12.5 pct to 20.0 pct will reflect a cost increase of between $1.20 to $1.35 per ton assuming that the coal selling price is between $16 and $18 per ton (table 3).
2. At a 12.5 pct royalty rate, a change in the coal selling price from $16 per ton to $17 per ton (6.25 pct increase) will increase the DCFROR from 25.0 pct to 32.0 pct (28 pct change) (see table 4).
3. At a 12.5 pct royalty rate, the exclusion of state taxes in the analysis would increase the project DCFROR by 19.0 pct (from 25.0 pct to 29.7 pct at a price of $16 per ton) (tables 4 and 5).
4. As can be seen by comparing table 4 with table 8, the project DCFROR increases under an inflation rate. For example, at a $16 per ton coal selling price and with a royalty rate of 12.5 pct, the DCFROR would increase from 25.0 pct to 29.6 pct (all taxes are applied).

TABLE 3. - Total royalties paid over the life of the property using constant 1984 dollars, and at various coal selling prices

Coal Selling Price ($/ton)	Royalty Rate (Pct of gross)	Total Royalties[1] ($1,000)	Royalties Dollars Per Ton
16.00	12.5	264,107	2.00
	20.0	422,572	3.20
17.00	12.5	280,614	2.12
	20.0	448,982	3.40
18.00	12.5	297,121	2.25
	20.0	475,393	3.60

[1] All royalties are rounded to the nearest thousand.

TABLE 4. - DCFROR and Net Present Value (N.P.V.) at varying coal selling prices and royalty rates using constant 1984 dollars

Coal Selling Price ($/ton)	All State and Federal Taxes Included Royalty Rate (Pct of gross)	DCFROR (Pct)	N.P.V.[1,2] ($1,000)
16.00	12.5	25.0	29,316
	20.0	15.4	-11,962
17.00	12.5	32.0	55,538
	20.0	21.5	14,899
18.00	12.5	39.0	79,563
	20.0	27.9	40,412

[1] Discount rate equals 18 pct.

[2] Numbers rounded to nearest thousand

TABLE 5. - DCFROR and N.P.V. at varying coal selling prices and royalty rates using constant 1984 dollars and only Federal Income Tax included

Coal Selling Price ($/ton)	**Royalty Rate (Pct)**	**DCFROR (Pct)**	**N.P.V.[1,2] ($1,000)**
16.00	12.5	29.7	47,415
	20.0	19.4	6,011
17.00	12.5	37.5	74,628
	20.0	26.2	34,090
18.00	12.5	44.9	99,596
	20.0	33.4	60,295

[1] Discount rate equals 18 pct.
[2] Numbers rounded to nearest thousand

TABLE 6. - Average annual tax burden over property life using constant 1984 dollars varying coal selling prices and royalty rates

Coal Selling Price ($/ton)	Royalty Rate (Pct of gross)	State Tax[1, 2] ($1,000)	State Tax[1, 2] $/ton	Federal Tax ($1,000)	Federal Tax $/ton
16.00	12.5	9,926	1.20	5,383	0.65
	20.0	9,213	1.12	2,687	0.33
17.00	12.5	10,712	1.30	7,553	0.92
	20.0	9,868	1.20	4,409	0.53
18.00	12.5	11,512	1.39	9,825	1.19
	20.0	10,567	1.28	6,254	0.76

[1] Includes property, severance and state income taxes.

[2] Numbers rounded to nearest thousands.

TABLE 7. - Total royalties paid over the life of the property varying coal selling prices and royalty rates using a 5 pct rate of inflation for all costs and prices

Coal Selling Price[1] ($/ton)	Royalty Rate (Pct of Gross)	Total Royalties[2] ($1,000)	Royalties Dollars Per Ton
16.00	12.5	389,611	2.95
	20.0	623,374	4.72
17.00	12.5	413,962	3.13
	20.0	662,339	5.02
18.00	12.5	438,312	3.32
	20.0	701,300	5.31

1 Given a 5 pct inflation rate, the average coal selling price for the life of the property at $16.00, $17.00 and $18.00 were $23.60, $25.10 and $26.60, respectively.

2 All royalties are rounded to the nearest thousand.

TABLE 8. - DCFROR and N.P.V. at varying coal selling prices and royalty rates using a 5 pct rate of inflation for all costs and prices

Coal Selling Price[1] ($/ton)	Royalty Rate (Pct of Gross)	DCFROR (Pct)	N.P.V.[2,3] ($1,000)
16.00	12.5	29.6	59,386
	20.0	20.1	11,585
17.00	12.5	36.5	90,415
	20.0	26.3	43,373
18.00	12.5	43.2	119,055
	20.0	32.4	72,375

[1] Given a 5 pct inflation rate, the average coal selling price for the life of the property at $16.00, $17.00 and $18.00 were $23.60, $25.10 and $26.60, respectively.

[2] Discount rate equals 18 pct.

[3] All N.P.V. figures are rounded to nearest thousand.

TABLE 9. - DCFROR and N.P.V. at varying coal selling prices and royalty rates using a 5 pct rate of inflation for all costs and prices and only Federal Income Tax included

Coal Selling Price[1] ($/ton)	Royalty Rate (Pct of Gross)	DCFROR (Pct)	N.P.V.[2, 3] ($1,000)
16.00	12.5	34.3	81,577
	20.0	24.1	33,052
17.00	12.5	41.9	113,894
	20.0	30.9	65,895
18.00	12.5	49.2	144,538
	20.0	37.9	96,951

[1] Given a 5 pct inflation rate, the average coal selling price for the life of the property at $16.00, $17.00 and $18.00 were $23.60, $25.10 and $26.60, respectively.

[2] Discount rate equals 18 pct.

[3] All N.P.V. figures are rounded to the nearest thousand.

*** CONCLUSIONS

The purpose of the study had a two-fold nature. First, to develop capital and operating costs that would realistically depict the actual costs involved at the Kayenta Mine. Secondly, to analyze the impact of changing coal prices, varying royalty rates and the inclusion of state taxes on the profitability of this project as measured by the DCFROR method. To develop reasonable capital and operating costs estimates, site specific information was obtained from several sources including the Kayenta Mine Plan submitted to the Office of Surface Mining. Also, operating procedures detailed in this mine plan were considered in the development of the operating cost estimate.

Several inferences concerning the impact of price, royalty rates and taxes have been brought out in this study. Under the price and royalty rate ranges investigated by this study, the DCFROR ranged from 14.5 pct to 39.0 pct when state taxes were applied and constant 1984 dollars were used. The lowest project return (DCFROR = 14.5 pct) occurred at a price and royalty rate of $16 per ton and 20 pct, respectively. Alternatively, the highest project return (DCFROR = 33.2 pct) occurred at a price of $18 per ton and a 10 pct royalty. Further insite on the relationships between the above-mentioned parameters and the project profitability may be gained through a more detailed examination of these tables.

*** REFERENCES

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6. Davidoff, D. L. Analysis of the Financial Aspects of a Reevaluation of The Royalty Terms of the Kayenta Lease Area Between the Navajo Indian Tribe and Peabody Coal Company, Inc. BuMines, June 6, 1984, pp. 1-2.

A REPORT ON THE ISSUE OF ROYALTY RATE
ADJUSTMENT FOR LEASE NO. 14-20-0603-8580
(KAYENTA COAL MINE) NAVAJO RESERVATION

By: Dr. Vijai N., Geologist
Energy and Mineral Resources
Office of Trust Responsibilities
Bureau of Indian Affairs

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I. Introduction and Background

The subject lease was entered into by the Navajo Tribe and the Sentry Royalty Company, a wholly-owned subsidiary of the Peabody Coal Company (Peabody), on February 1, 1964. The lease was approved by an authorized representative of the Secretary of the Interior on August 28, 1964. Sentry Royalty Company subsequently assigned its interests in the subject lease to its parent corporation, the Peabody Coal Company.

The Navajo Area Director, on June 18, 1984, pursuant to his delegated authority to make a "reasonable adjustment" in the royalty terms, adjusted the royalty rate to twenty (20) percent of the gross value of the coal mined under the subject lease. Based on current sales price of 17 dollars per ton, this adjustment would escalate the tribal royalty receipts for coal mined under the subject lease from approximately 30[cents] per ton to 3.40 dollars per ton.

Peabody disputed the adjustment, and filed an appeal with the Deputy Assistant Secretary - Indian Affairs (Operations). After a brief review of the appeal, in a letter dated March 4, 1985, the Deputy Assistant Secretary requested Peabody to submit its actual cost, revenue, and investment figures for this lease, including the overriding royalties, if any, paid to assignor Sentry Royalty Company or its successors.

In a letter dated March 29, 1985, Peabody declined to provide the data requested. Peabody believes that the request is not pertinent or necessary to support its arguments that its profitability is a wholly irrelevant factor in seeking to determine a reasonable royalty rate under the adjustment provision contained in the lease.

The subject lease, encompassing 24, 853 acres of tribal land, is for a term of 10 years and for so long thereafter as the substances produced are being mined by the lessee in accordance with its terms in paying quantities, for the purpose and with exclusive right and license to prospect, mine, and strip such lands for coal and kindred products, including other minerals, except oil and gas.

The key aspect of the lease with respect to the royalty rate adjustment is provided in Section VI of the lease. This section provides in part that <u>"during the period that the land so leased is under federal jurisdiction, the royalty provisions of this lease are subject to reasonable adjustment by the Secretary of the Interior or his authorized representative at the end of twenty years from the effective date of this lease, and at the end of each successive ten-year period thereafter."</u> (Underlined for emphasis)

Prior to the adjustment by the Area Director, the royalty rate for coal mined under the lease ranged between twenty (20) cents per ton to thirty-seven and one-half ($37^1/_2$) cents per ton. The actual amount of royalty that the Tribe received depended on the sales price of the coal mined and whether the coal mined was utilized on or off the reservation. At a 17 dollar per ton sales price (current), the royalty rate to the Tribe would range between 1.76 percent to 2.21 percent of the gross value of the coal mined under the lease—1.76 percent if all the coal mined is used on the reservation, 2.21 percent if all the coal mined is used off the reservation.

II. <u>Summary of Royalty Rate Adjustments Proposed by Respective Parties for Coal Mined under the Subject Lease</u>

Royalty rate recommended in various reports ranges from a low of 5.57 percent to a high of 24.44 percent, and are as follows:

1. The Peterson and Company in a report dated November 28, 1984, and prepared at the request of Peabody proposed a royalty rate between 5.57 percent to 7.16 percent of gross realization of coal sold under the lease. The report concluded that such a rate will restore to both parties the benefits that were originally contemplated in 1964 when the lease was signed.

2. The Peabody Coal Company - Arizona Division in a report dated September 15, 1982 concluded that the royalty rate proposed by Peabody on December 28, 1981, is equitable. On that date, Peabody offered to raise the royalty rate to 12.5 percent on gross sales without deduction for coal under the lease currently under dispute, and also offered to raise the royalty on Lease No. 9910, which has no adjustment clause, from 6.67 percent to 12.5 percent. Lease No. 9910 encompasses land with mineral rights owned jointly by the Navajo and the Hopi Tribes. <u>This offer was subsequently withdrawn</u>. This report also questioned the validity of data used in the Schwab Report

which was prepared for the Navajo Tribe and is discussed below.

3. The F.R. Schwab & Associates, Inc. in a report dated April 12, 1982, and prepared for the Navajo Tribe recommended a royalty rate of 12 to 16 cents per million BTU; this value is equivalent to $2.64 to $3.52 per ton for all coal mined under the lease. Assuming the sales price of coal was $15.46/ton at the time the report was written, the royalty rate recommended in the report would range between 17.08 percent to 22.77 percent. This report is based on a comparative sales approach (analysis of market data), and (2) the income of earnings approach, also known as discounted cash flow analysis.

4. The Council of Energy Resources Tribes (CERT) in a report prepared for the Navajo Tribe stated that a royalty rate of between 15 percent and 20 percent would be "completely justifiable." The rate recommended is based on Peabody's tribal mining operations profitability analysis. In a subsequent report dated January 1985, CERT recommended a 20 percent royalty rate.

5. The United States Bureau of Mines in a report dated June 6, 1984, and prepared at the request of the Energy and Mineral Resources Division of the Bureau of Indian Affairs, made a number of projections based on the Discounted Cash Flow Rate of return (DCFROR) method. Under 5 different scenarios, the DCFROR for coal properties within the lease area ranged from a low of 16.27 percent to a high of 120+

percent. The report concluded that the coal properties within the lease area have a very high profit potential.

In a subsequent report dated May 6, 1985, after additional verification of data with respect to cost, investment, and sales, and at a 20 percent royalty rate, the United States Bureau of Mines projected a DCFROR of 21.5 percent using constant 1984 dollars and 26.3 percent using a 5 percent rate of inflation for all costs and prices. The selling price of coal used in these projections is $17 per ton.

6. The Mining Section of the Energy and Mineral Resources Division, Bureau of Indian Affairs in a memorandum dated June 6, 1984, computed a royalty rate of 24.44 percent. Peabody's DCFROR in this study ranged between a low of 26.4 percent at a 30 percent royalty rate to a high of 49.8 percent at a $12^1/_2$ percent royalty rate for coal mined solely under the subject lease area.

III. Review and Analysis of Reports Relied on by the Area Director in his Decision to Adjust the Royalty Rate to 20 Percent

In adjusting the royalty rate to 20 percent of the gross value of the coal mined under the subject lease, the Area Director considered reports and recommendations from the BIA Navajo Area Office, and the BIA Energy and Mineral Resources Division, the U.S. Bureau of Mines, and others. Nearly all of these reports analyzed Peabody's profitability and/or its DCFROR which is based on a method that involves estimating future operating and investments costs, taxes, and other expenses as well as future revenues. Because the actual financial data from Peabody was unavailable, even the current operating costs and investments were based on estimates.

Depending on the scenario chosen, the DCFROR in the Bureau of Mines Report ranged between a low of 16.27 percent to a high of 120+ percent. DCFROR for coal mined under the subject lease, and prepared by the Energy and Mineral Resources, BIA, ranged between 26.4 percent at a 30 percent royalty rate to 49.6 percent at 12½ percent royalty rate. The DCFROR in these reports has such a wide range and in some instances so high that it is difficult to make any meaningful and objective conclusion with respect to Peabody's DCFROR under the subject lease. In addition, as pointed out in Peabody's latest submission, Peabody's cost of operation in the BIA Energy and Mineral Resources Mining Section's Report is grossly understated when compared with the cost that is used by the consortium of utilities in computing the price of coal. Peabody is paid by the utilities for the coal mined under the lease based on its cost of operation. As reported by the consortium, Peabody's cost of operation for 1984 was $12.33 per ton. The operating cost in the BIA Energy and Mineral Resources Division Report ranged between $4.72 per ton to $6.18 per ton.

Therefore, although all projections involving Peabody's DCFROR and profitability analysis indicate that the coal properties within the lease area have a very high profit potential, the specific DCFROR projections can not be relied upon. It becomes obvious when one examines the specific data with respect to cost, revenue, and investment that have been used to make the DCFROR projections in various reports. For example, the operating cost among various reports relied upon by the Area Director are substantially different. Since operating cost is a key component of any DCFROR projection, it would in turn significantly affect the DCFROR projections in these reports.

Despite the fact that the DCFROR projections and the profitability analysis that were relied on by the Area Director in adjusting the royalty rate are at best approximate, certain conclusions with respect to the coal properties within the lease area are obvious. The most significant being that the coal deposits within the lease area from a geological, engineering, and economic standpoint are extremely valuable. Specifically, the thickness of the coal seams, the thickness of the overburden, the overburden and recovery ratios, the quantity and quality of the reserves, the size of production, its marketability, etc., are extremely favorable and indicate that the coal properties within lease area would have a very high profit potential.

In order to analyze Peabody's profitability and DCFROR based on its actual cost, revenues and investment, the Deputy Assistant Secretary - Indian Affairs requested Peabody to furnish such data. Peabody refused to provide such data because, in its opinion, an analysis of the proposed royalty adjustment based on its return on investment is not a relevant inquiry for determining the reasonableness of the proposed royalty adjustment.

In view of Peabody's refusal to provide such data, this office reconsidered and reevaluated the reasonableness of the royalty adjustments made by the Navajo Area Director based on data currently available.

IV. Reconsideration of the Issue Involving Royalty Rate Adjustment by the Area Director

During the course of this reconsideration, we first reviewed various valuation methodologies to determine the most appropriate method to value the remaining coal reserve for purposes of royalty rate adjustment. There are two basic approaches that can be used to determine the value of the coal properties for establishing a royalty rate. They are: (1) The comparable sales approach, and (2) The income and earnings approach.

The comparable sales approach is based on market value (price) and reflects the sales price of comparable investments on the open market. Under this approach, all current transactions in the market area and the corresponding royalty rates for comparable coal properties are analyzed to determine the going royalty rate. Since this rate is highly sensitive and susceptible to changes in the market with respect to supply and demand, under most circumstances, this is considered the most appropriate method for purposes of valuation. However, in order to establish a royalty rate based on this approach, several requirements must be met. First, the coal reserves being compared must be truly comparable and differences, if any, must be adjusted. Specifically, the comparability with respect to the size of the reserve, the physical and chemical characteristics of the coal, the annual production (anticipated or actual), cost of production, mining techniques (surface vs. underground), the overburden ratio, etc., must be established. Secondly, the number of current, comparable transactions (coal mines) must be large, i.e., the data base should be large and representative.

The comparable sales approach was considered not appropriate in determining the reasonableness of the royalty rate for coal under the subject lease for the following reasons. Coal leasing in the Rocky Mountain Region, where the coal deposits under the subject lease are located, is dominated and influenced by the Federal coal leasing activities. Under the Federal coal leasing program, royalties are fixed and based solely on the method of extraction. The Federal royalty rate for surface-mined coal is 12.5 percent of the gross value of coal and 8 percent for underground-mined coal. Thus, if a Federal tract containing an unusually large and valuable deposit is offered for lease, the value of that deposit will be reflected *not* by an increase in the royalty rate, but by an increase in the amount of bonus to the lessor (Federal government). Therefore, a comparable royalty rate for coal under the subject lease based on current transactions involving Federal coal lands is inappropriate. Other current comparable transactions in the market area of consideration are limited in number and do not meet the comparability requirements. Therefore, a royalty rate determination based on comparable analysis will be highly questionable. Because of these reasons, Schwab and Associates royalty rate determination based on comparable sales approach is also questionable and cannot be solely relied upon.

In the absence of data to determine the value of an investment, (in this case the royalty rate to the Tribe) by the comparable sales approach, the income and earnings approach will be considered an acceptable method in valuing a mineral deposit.

Because of the reasons given below, the royalty rate adjustment under this method is based on the analysis of Peabody's after tax rate of return on investment. The agreement between the Tribe and Peabody is a lease where both parties have made significant capital investments—the Tribe in the form of a nonrenewable mineral asset and Peabody in the form of money, men, and equipment. Both are "at risk" with respect to their investment and continue to look toward income from extraction of the mineral for the return of capital *throughout the life of the lease*. The value of the lessor's (Tribe) minerals asset, and its share of the income from extraction is reflected in the royalty rate. If the mineral deposit (asset) is marginal, the royalty rate would be low. However, if the deposit is valuable and unique, the royalty rate would be high. The determination as to whether a deposit is valuable or marginal, in the absence of comparable sales data, can only be accomplished by analyzing the lessee's (Peabody) after tax rate of return and/or its profitability. The after tax rate of return of a lessee, to a large extent, reflects the characteristics of the mineral deposit in terms of its quantity, quality, mineability, marketability, etc. Therefore, Peabody's after tax rate of return and/or its profitability is significant for purposes of royalty rate adjustment. Under this premise, if the after tax rate of return for Peabody is consistently very high, the Area Director would be entitled to adjust the royalty rate upward (to provide an equitable return on investment) under the adjustment provision provided in the lease.

In the absence of actual financial data from Peabody, we requested the U.S. Bureau of Mines to make a DCFROR projection and determine the Net Present Value (NPV) using cost, investment and revenue figures that could be typical for an operation like the Peabody Kayenta mine (subject lease area). The cost, investment, and revenue projections are based on publications that are typically used in making these projections, including mine plan data submitted by Peabody to the Office of Surface Mining. At a 20 percent royalty rate, and $17 per ton sales price for coal mined under the subject lease, the DCFROR in the Bureau of Mines Report dated May 6, 1985, is 21.5 percent using constant 1984 dollars and 26.3 percent using a 5 percent rate of inflation for all cost and prices. NPV using an 18 percent discount rate is positive under both the circumstances described above. The sales price used in this report is also in line with the figures provided by the Salt River Project participants (utilities that buy the coal mined under the subject lease). When Peabody's projected after tax rate of return from its operation under the subject lease is compared with published information regarding return on equity for other coal mining companies certain conclusions are inescapable. Peabody's projected after tax rate of return *over the life of the mine* from its operation under the subject lease (21.5 percent in constant 1984 dollars and 26.3 percent using a 5 percent inflation rate for cost and prices) will be considered an exceptionally good return on investment. Although information with respect to DCFROR for other major coal companies is not readily available, we believe that Peabody's projected after tax rate of return is substantially higher then the rate of return for other major coal mining operations. The Internal Revenue Service and the Standard and Poor, however, publish data regarding income and rate of return on equity for coal mining companies. The rate of return for coal mining companies generally ranges between 10-14 percent. In addition, we believe that if certain items in the Bureau of Mines projection were treated differently, the resulting DCFROR could have been even higher. For example, Peabody, the mining entity, almost certainly pays an unknown amount of money in the form of overriding royalty to its own wholly-owned subsidiary, the Sentry Royalty Company. This is done to a large extent to qualify a part of the future income from mining as capital gains income under section 631(c) of the Internal Revenue Code. This is accomplished by having a company (in this case Sentry Royalty Company) other than the one that will do the actual mining of the coal, acquire the reserve and then sublease to a related mining company (in this case Peabody) with a retained overriding royalty. The parent company thus receives the benefits of both the percentage and cost depletion and manages to convert a portion of the income, which otherwise would have been ordinary, into capital gains income. As a consequence, the *effective* tax rate on net income from mining under the subject lease is in reality considerably lower than those used in the Bureau of Mines projections. Similarly, if certain items of tax preference such as development expenditures were expensed rather than capitalized, the DCFROR could have again been higher.

The latest projection by the Bureau of Mines, however, clearly indicates that coal deposits under lease to Peabody are exceptionally valuable. Furthermore, even with a royalty rate of 20 percent of the gross value of the coal mined under the subject lease, Peabody's after tax rate of return would continue to be significantly higher than the overall coal industry rate of return.

Furthermore, as pointed out in the Peabody's latest submission, its DCFROR and/or profitability will not be affected by any increases in the royalty rate for coal mined under the subject lease. Peabody, under the fuel supply agreement with the utilities, will be allowed to pass on all royalty rate increase to the utilities. In other words, despite a royalty rate increase, Peabody is assured that it will continue to receive a mutually agreed upon after tax rate of return for its operation under the subject lease. That return for the period 1974-1983 (the latest period for which the data is available), was 15 percent after taxes on a discounted cash flow basis.

The fuel supply agreement between the utilities and Peabody is for an initial term of 35 years following the date of firm operation of unit 3 (April 30, 1976). At the option of the utilities, the initial term can be extended further for a period not exceeding 15 years.

It appears that under the agreement, Peabody is not only entitled to pass on any increases in the royalty rate to the utilities but has assured itself of a consistently high rate of return (after taxes). Although the actual financial data from Peabody is unavailable, based on the known industry practices, it appears highly likely that Peabody also passes on as cost the overriding royalties it pays its wholly owned subsidiary—the Sentry Royalty Company. If that amount were added to the rate of return that Peabody has been assured from its mining operation under the subject lease, we believe that the actual *effective* rate of return on its investment would be even higher.

V. Conclusion

Based on a review and analysis of all the information currently available, a royalty rate adjustment to 20 percent of the gross value of the coal mined from the subject lease appears justifiable and defensible.

VI. Recommendation

We recommend that the Area Director's decision to adjust the royalty rate to 20 percent of the gross value of the coal mined from the subject lease be sustained.

[Seal Omitted]

United States Department of the Interior
Bureau of Indian Affairs
Washington, D.C. 20245

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Re: Appeal of Navajo Area Director's Adjustment of Royalty, Lease No. 14-20-0603-8580

Dear Sirs:

This letter is our decision in the above-referenced appeal. Peabody Coal Company, lessee of Lease No. 14-20-0603-8580, and two groups of purchasers of coal, the Navajo Project Participants and the Mohave Project Participants (hereinafter "appellants"), challenge a June 18, 1984 decision of the Navajo Area Director.

The decision informed Peabody that the Area Director was adjusting the royalty rate to "20.0 percent of the gross value of the coal mined as determined by the Federal Formula under 45 CFR 3473.3-2(2) and 3485.2f."

The Navajo Tribe and Sentry Royalty Company entered into lease No. 14-20-0603-8580 on February 1, 1964. The Assistant Area Director approved it on August 28, 1964. In 1968 the lease was assigned to Peabody. The lease provides for a variable royalty rate tied to the gross realization from the sale of the coal and whether the coal mined from the lease is used on or off the Reservation. Article IV.

Article VI "Termination of Federal Jurisdiction" states:

> During the period that the land so leased is under Federal jurisdiction, the royalty provisions of this lease are subject to reasonable adjustment by the Secretary of the Interior or his authorized representative at the end of twenty years from the effective date of this lease, and at the end of each successive ten-year period thereafter.

It was pursuant to this provision that the Area Director issued his decision.

Two issues have been raised by appellants in this appeal. First, did the Area Director adjust the royalty at the time provided for in Article VI; and second, whether the adjustment was reasonable.

I.

Appellants contend that the Area director acted too late to adjust the royalty. They argue that any adjustment must occur before 20 years following the effective date and that the effective date is February 1, 1964. Thus, the Area Director acted too late when he adjusted the royalty on June 18, 1984. The Tribe maintain that the effective date is August 28, 1964 . . . when the lease was approved. Moreover, it argues that even if the effective date was February 1, 1964, the adjustment was timely when it occurred. For the following reasons we conclude the adjustment was made timely.

First, we find that the effective date of this lease is August 28, 1964 when the Secretary's representative approved the lease. The lease was entered into pursuant to the authority contained in 25 U.S.C. § 396a. It authorizes mineral leases on tribal land with the approval of the Secretary of the Interior for terms not to exceed ten years and as long thereafter as minerals are produced in paying quantities. The regulations to which this lease is subject state that the term shall run "from the date of approval by the Secretary of the Interior, or his authorized representative." 25 C.F.R. § 211.10. These requirements control over any language in the lease especially in light of Article X which requires conformance to the regulations. Consequently, notwithstanding the fact that the lease states it is effective February 1, 1964, the approval date is the effective date. The Bureau of Indian Affairs' ("BIA") understanding of the effective date at the time the lease was approved confirms the conclusion that August 28, 1964 is the effective date. Moreover the lessee did not challenge this conclusion when it was communicated to the lessee. See Exhibits 4-7 attached to the Navajo Tribe's Answer Brief.

Appellants' references to and reliance on the doctrine of relation back are not persuasive in this instance.

Appellants content that the law makes the approval on August 28 relate back to February 1. But, as a case Appellants cite makes clear, the doctrine of relation back is resorted to in order to accomplish equity and justice. Appellants Brief at 9. Thus, its purpose is to "prevent a just and equitable title from being interrupted by claims which have no foundation in equity." *Lykins v. McGrath*, 184 U.S. 169, 171 (1902). This principle is demonstrated in the facts of all the cases Appellants cite for their argument for relation back. In every case, there was a third party asserting rights based on a new deed or new lease which, if the first transaction was not upheld as valid, would interfere with the original parties' rights.

That situation, where equity does demand that the doctrine of relation back apply, is not present in our current appeal. Peabody is not defending its leasehold interest against a third party who claims an interest originating from a document entered into between February 1 and August 28, 1964. Thus, there is no need for the doctrine of relation back to be applied to preserve Peabody's interest, and a finding that the approval date is the effective date will not dislodge Peabody's leasehold interest.

Our second reason for finding the adjustment was timely made is that even if we were to agree with Appellants that the effective date is February 1, we still would find the adjustment was timely. Unless otherwise contradicted, terms in leases . . . should be interpreted in a reasonable manner. There is nothing in this lease to indicate that the adjustment could occur only at a precise point in time. Reasonableness would dictate only that notice of the adjustment should be given at a time close to the end of the first twenty years of the lease.

The only authority cited by Appellants to challenge this conclusion is not persuasive. *Rosebud Coal Sales Co., Inc. v. Andrus*, 667 F.2d 949 (10th Cir. 1982) did not involve Indian lands and was an interpretation of the Mineral Lands Leasing Act which is not applicable here. Furthermore, the company in that case reasonably believed that after almost 2½ years the government was not going to adjust the royalty because normal practice was to give notice of the adjustment either before or immediately after the 20 year anniversary date. Indeed, the regulations required prior notice whenever feasible. No such normal practice exists with Indian leases against which to compare the Area Director's action because adjustment clauses are rare. Moreover, only 4½ months had elapsed between the alleged 20 year anniversary date and the Area Director's notice of adjustment, and in any event Peabody was aware that an adjustment to the royalty was likely. An increase in the royalty rate had been discussed during negotiations between Peabody and the Tribe at least two years prior to the Area Director's decision. Consequently, we find little merit in appellants' argument that the adjustment was untimely even if we consider, *arguendo*, that February 1, 1964 is the effective date.

For the above reasons I conclude that the Area Director's decision was timely made. This decision is based on the interpretation of law and shall become final 60 days from receipt of this letter unless an appeal is filed with the Board of Indian Appeals pursuant to 43 C.F.R. § 4.310.

II.

Once we have concluded that the Area Director's adjustment was timely, we must address the second issue. Appellants content the Area Director's decision as to the royalty rate was arbitrary, capricious, and per se unreasonable. Their key point is that he used the wrong methodology to make his determination. Appellants argue that he and his supporting material considered the issue with the view that this was a renegotiation of the lease, not an adjustment of an existing lease, and as a result relied on the wrong standard in making his determination.

While it is true that some of the materials relied upon by the Area Director used the word "renegotiation" and were used to advise the Tribe on negotiation strategies, their underlying methodologies were two: comparable leases and discounted cash flow analysis. In contrast to these established methods, Appellants support an analysis which would preserve for the parties the benefit of the bargain struck by them in 1964. Appellants' Brief at 13.

We do not agree with Appellants. Article VI of the lease allows for an adjustment to the royalty provisions because the parties did not agree to have the same royalty throughout the lease. If they could have satisfactorily anticipated the future there would be no need for an adjustment clause. Thus, the terms of their lease make it clear that the only expectation they had in 1964 was that after 20 years the royalty could be reasonably adjusted by the Secretary based on current market conditions. The only rational basis for an adjustment clause is that the bargain struck in 1964 was to be changed after 20 years.

At the present time, the royalty rate for this lease is far lower than what we could find reasonable or acceptable. It is Departmental policy that the federal minimum rate of 12½% would be a minimum below which we could not set the rate. But our evidence indicates that this coal deposit is unusually valuable. Thus intuitively, we believe the royalty rate should be more than the minimum. How much more depends on how valuable the deposit is. There are two basic methods we can use to determine the relative value of the coal deposit and thus the lease. One is to compare the royalty rate from recent lease sales of comparable deposits of coal. However, little, if any, comparable data is available because this lease is very unusual. Most coal leasing in the Rocky Mountain Region occurs on federal tracts. The royalty rate for these leases is the pre-set 12½% and does not reflect the value of the mineral deposit to either the lessor or lessee. Other areas of the country where non-federal leasing occurs are not comparable in size, physical or chemical characteristics, anticipated production, removal techniques, overburden ratio, etc. Thus, I conclude we cannot use this method in this situation because comparable data is lacking.

The other method, and the one employed by many of the reports relied upon by the Area Director, is to compare the profitability of this lease to others through the evaluation of the after tax rate of return on investment. The basis for an accurate use of this method is accurate data on costs and expenses. The data used by the authors of the reports relied upon by the Area Director were estimates. For this reason we requested Peabody to submit its actual cost figures so that we could generate an accurate evaluation. Peabody declined. Letter of March 29, 1985. However, one of the purchasers did provide some data. In addition, we independently estimated what the typical cost, investment, and revenue figure would be for an operation like Kayenta Mine.

Our analysis concluded that at a 20% royalty rate, and assuming a $17.00 per ton sales price, Peabody's after tax rate of return over the life of the mine would be 21.5% in constant 1984 dollars, and 26.3% considering 5% inflation for cost and prices. This compares to a range of 10-14% for mining companies generally. Thus, even with a 20% royalty rate, Peabody would be getting a significantly higher rate of return on investment than is normal for the coal industry. Moreover, given the current structure of the tax system, Peabody may likely be getting an even greater return due to its ability to convert some income into capital gains through the use of an overriding royalty payment to its subsidiary, and the former lessee, Sentry Royalty Company.

We are told that Peabody and the coal purchasers have entered into agreements whereby Peabody is guaranteed a minimum rate of return. Appellants therefore argue that evaluating a rate of return with respect to Peabody is meaningless. I disagree. The lease provides that the Secretary may make a reasonable adjustment to the royalty rate. As was shown above, other methods of determining a reasonable rate cannot be applied to this situation. The rate of return method provides us a method whereby we can determine if a certain royalty, in this case 20%, will yield a rate of return to Peabody which is comparable to guaranteed a return or not. Our analysis shows that not only is Peabody's projected return comparable to other companies, it is projected to earn more than normal with the royalty at 20%.

For the above reasons I conclude that 20% is a reasonable royalty rate and affirm the Area Director's decision. My decision is based on the exercise of my discretionary authority and is final for the Department.

Sincerely,

Deputy Assistant Secretary
Indian Affairs

cc: Area Director, Window Rock
Field Solicitor, Window Rock
BIA Code 240

PEABODY HOLDING COMPANY INC.
1120 20TH STREET, N.W., SUITE S-720
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(202) 659-8101

CHRIS FARRAND
VICE PRESIDENT
GOVERNMENT RELATIONS

July 5, 1985
[Received July 12, 1985]

The Honorable Donald P. Hodel
Secretary of the Interior
18th and C Streets, N.W.
Room 6151
Washington, D.C. 20240

Dear Mr. Secretary:

It is our understanding that a Departmental decision may be imminent on the Appeal of Peabody Coal Company on the royalty rate adjustment on a coal lease (lease 14-20-0603-8580) issued by the Navajo Tribe to Peabody at Black Mesa, Arizona.

In June 1984, the Area Director of the Bureau of Indian Affairs unilaterally adjusted the royalty rate on the subject lease from 37.5 cents per ton to 20 percent of the value of the coal. This occurred in spite of the fact that Peabody and the Tribe were actively negotiating a comprehensive lease extension which included a royalty adjustment. Even in the face of the Area Director's decision and the immediate appeal by Peabody and its customers, the Tribe continued negotiating with Peabody toward a voluntary agreement providing for a royalty adjustment to 12.5 percent. As recently as May

1985, the Tribe indicated verbally that the Peabody offer would be acceptable provided some other considerations were agreed to.

Apparently, the Tribe has received word of an imminent and favorable decision on the appeal. Last week, we were informed by the Tribe that further negotiations would be suspended until the Department ruled on the appeal of the Area Director's decision.

It seems ill-advised and untimely to make a determination on the appeal of the royalty adjustment. We are confident that a voluntary agreement can be reached between Peabody and the Tribe. The Department, however, appears to be preempting these negotiations, as manifested by the Area Director's June 1984 decision and the seemingly imminent decision on the appeal. Assuming the Department denies the appeal, Peabody and its customers will be obligated to litigate the unilateral imposition of the inordinately high royalty rate. Hence, instead of a mutually-agreed upon contractual arrangement, there will be a one-sided solution followed by protracted litigation, during which the incremental royalties, representing millions of dollars annually, will presumably be held in escrow rather than flow directly to the Tribe.

As we have indicated in our appeal, the adjustment of the royalty to 20 percent puts the Navajo lease virtually in a class by itself. No other Indian leases or federal leases bear royalty rates as high. Not only would such a rate disadvantage Black Mesa coal and the users of electricity produced by that coal, but the Department would be setting a rigid precedent for future royalty adjustments for both Indian and federal leases.

We respectively urge you to (1) assume direct responsibility for this unusual royalty appeal case, and (2) either postpone a judgement to allow for a voluntary settlement or grant Peabody's appeal of the Area Director's decision. We believe it would be far better for the Department to facilitate an agreement between the Tribe and Peabody than to impose an inequitable arrangement and there by set an adverse precedent.

Sincerely,

/s/ CHRIS FARRAND

CF/mm

cc: Mr. John Fritz
Deputy Assistant Secretary of Indian Affairs

Mr. Timothy Vollmann
U.S. Department of the Interior

Mr. Paul Frye
Navajo Nation Department of Justice

Mr. Robert Briedenbecker
Southern California Edison

Mr. Leroy Michael
Salt River Project

Mr. R.H. Quenon
Peabody Holding Company, Inc.

Mr. W.T. Ewing
Peabody Coal Company

Mr. K.R. Moore
Peabody Coal Company

COMPANY MEMORANDUM

TO: F.L. Barkofske – CONFIDENTIAL

DATE: July 22, 1985

FROM: E.L. Sullivan

RE: Navajo Lease Royalty Rate Adjustment

Ken Moore, President of Arizona Division, contacted me by telephone on July 11, 1985, and requested that I arrange a dinner meeting for Greg Leisse and a Mr. Stan Hulett. The president of Southern California Edison Company (So. Cal.) had recommended Mr. Hulett to Ken Moore. Mr. Hulett was a former upper level Department of Interior employee whom So. Cal. believed may have some influence with the current Secretary of Interior (Don Hodel). The dinner meeting was arranged to consider the prospect of Mr. Hulett discussing the Navajo Lease royalty rate adjustment with Secretary Hodel. Chris Farrand was informed of this matter and suggested that if it appeared that Mr. Hulett possessed the type of influence which would be required that we should make use of his services.

After our meeting with Mr. Hulett, Greg Leisse and I discussed the pros and cons of having Mr. Hulett act on Peabody's behalf. This included, among others, consideration of the following: (1) whether this activity would be considered an "*ex parte*" contact as part of Peabody's appeal of the Navajo Area Director's decision; (2) whether Mr. Hulett possessed the requisite influence; (3) the fact that So. Cal. recommended that Peabody make use of Mr. Hulett's services in the matter of the royalty rate adjustment; (4) the cost of Mr. Hulett's services; and (5) the interplay of a contact by Mr. Hulett on Peabody's behalf with the recently sent letter from Chris Farrand.

After weighing all factors, Greg and I agreed that we should allow Mr. Hulett to proceed on Peabody's behalf. He subsequently met with both Mr. Fritz (Deputy Assistant Secretary, Bureau of Indian Affairs) and Secretary Hodel on at least two (2) occasions. Secretary Hodel was sympathetic to Peabody's concerns and agreed that the parties to the lease should be encouraged to work out an agreeable resolution of the issue without interference from the Bureau of Indian Affairs. He agreed to, and subsequently did, sign a memo—drafted in large part by Greg and myself—addressed to Mr. Fritz instructing him to (1) not make an untimely decision on the appealled case itself, and (2) encourage the parties to negotiate their differences.

I have been informed that that memo was delivered to Mr. Fritz's office on Monday, July 22, 1985.

Compensation for Mr. Hulett's services, according to Ken Moore, will be paid by the Arizona Division and will be passed on to our customer when coal shipments resume. The fee will be paid as a retainer, and spread over the remainder of the year (July-December) and will be in the range of $1,500-$2,000 per month. This arrangement will avoid the budgetary effects of a lump sum payment and will also allow Peabody to avail itself of Mr. Hulett's services again this year if such is deemed desirable. With Ken Moore's approval, Greg Leisse and I have been authorized to negotiate a firm monthly fee for Mr. Hulett within the range set out above.

I am available to provide additional information.

ES/mm[E.L.S.]

DRAFT
July 15, 1985

TO: John W. Fritz

FROM: Don Hodel

RE: Appeal of Navajo Area Director's Adjustment of Royalty, Lease No. 14-20-0603-8580

I have reviewed the attached letter from Mr. C.G. Farrand of Peabody Holding Company, Inc. While I do not necessarily agree with all of its points, there would appear to be significant advantages to be derived from the successful renegotiation of the royalty rate under the above lease by the parties to that agreement. Any royalty adjustment which is imposed on those parties without their concurrence will almost certainly be the subject of protracted and costly appeals. The ultimate outcome could well impair the future of the contractual relationship established by the parties under the current lease.

Therefore, I suggest that you inform the involved parties that a decision on this appeal is not imminent and urge them to continue with efforts to resolve this matter in a mutually agreeable fashion.

As I understand the facts surrounding this appeal, in June 1984 the BIA Area Director adjusted the royalty rate on Lease No. 14-20-0603-8580 from 37.5 cents per ton to 20 percent of the value of coal. This occurred at a time when the coal company and the Navajo Tribe were actively engaged in negotiations involving both a lease extension and a royalty rate adjustment. In fact, I understand that these negotiations had begun as early as late 1979 (several years before it was necessary to consider readjustment) and that the royalty rate which the lessee was offering was in the vicinity of the 12.5 percent which is currently required on surface coal mining leases on federal land. The lessee (Peabody Coal) appealed the Area Director's decision.

From the filing of that appeal until the present time, the Navajo Tribe and Peabody have been meeting in an attempt to negotiate their way out of a somewhat complex legal dilemma.

I find it preferable to allow parties, with conflicting interests in the same matter, to have a sufficient amount of time to sit down and work out their differences. I believe this can be accomplished with respect to the issues currently subject to this appeal, therefore, a decision on the appeal at this time would be ill-timed.

I wish to assure you, however, that this memorandum is not intended as a determination of the merits of the arguments of the parties with respect to the issues which are subject to the appeal. If it becomes inevitable that such a determination must be made by the Department, then we can discuss it at that time.

as sent forward for signature

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

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Phoenix, Arizona 85073

Paul Frye
Navajo Nation Department of Justice
P.O. Box 2010
Window Rock, Arizona 86515

Re: Appeal of Navajo Area Director's Adjustment of Royalty, Lease No. 14-20-0603- 8580

Dear Sirs:

This letter is our decision in the above-referenced appeal. Peabody Coal Company, lessee of Lease No. 14-20-0603-8580, and two groups of purchasers of coal, the Navajo Project Participants and the Mohave Project Participants (hereinafter "appellants"), challenge a June 18, 1984 decision of the Navajo Area Director. The decision informed Peabody that the Area Director was adjusting the royalty rate to "20.0 percent of the gross value of the coal mined as determined by the Federal Formula under 45 CFR 3473.3-2(2) and 3485.2f."

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Article VI "Termination of Federal Jurisdiction" states:

> During the period that the land so leased is under Federal jurisdiction, the royalty provisions of this lease are subject to reasonable adjustment by the Secretary of the Interior or his authorized representative at the end of twenty years from the effective date of this lease, and at the end of each successive ten-year period thereafter.

It was pursuant to this provision that the Area Director issued his decision.

Two issues have been raised by appellants in this appeal. First, did the Area Director adjust the royalty at the time provided for in Article VI; and second, whether the adjustment was reasonable.

I.

Appellants contend that the Area director acted too late to adjust the royalty. They argue that any adjustment must occur before 20 years following the effective date and that the effective date is February 1, 1964. Thus, the Area Director acted too late when he adjusted the royalty on June 18, 1984. The Tribe maintains that the effective date is August 28, 1964 when the lease was approved. Moreover, it argues that even if the effective date was February 1, 1964, the adjustment was timely when it occurred. For the following reasons we conclude the adjustment was made timely.

First, we find that the effective date of this lease is August 28, 1964 when the Secretary's representative approved the lease. The lease was entered into pursuant to the authority contained in 25 U.S.C. § 396a. It authorizes mineral leases on tribal land with the approval of the Secretary of the Interior for terms not to exceed ten years and as long thereafter as minerals are produced in paying quantities. The regulations to which this lease is subject state that the term shall run "from the date of approval by the Secretary of the Interior, or his authorized representative." 25 C.F.R. § 211.10. These requirements control over any language in the lease especially in light of Article X which requires conformance to the regulations. Consequently, notwithstanding the fact that the lease states it is effective February 1, 1964, the approval date is the effective date. The Bureau of Indian Affairs' ("BIA") understanding of the effective date at the time the lease was approved confirms the conclusion that August 28, 1964 is the effective date. Moreover the lessee did not challenge this conclusion when it was communicated to the lessee. See Exhibits 4-7 attached to the Navajo Tribe's Answer Brief.

Appellants' references to and reliance on the doctrine of relation back are not persuasive in this instance. Appellants contend that the law makes the approval on August 28 relate back to February 1. But, as a case Appellants cite makes clear, the doctrine of relation back is resorted to in order to accomplish equity and justice. Appellants Brief at 9. Thus, its purpose is to "prevent a just and equitable title from being interrupted by claims which have no foundation in equity."

Lykins v. McGrath, 184 U.S. 169, 171 (1902). This principle is demonstrated in the facts of all the cases Appellants cite for their argument for relation back. In every case, there was a third party asserting rights based on a new deed or new lease which, if the first transaction was not upheld as valid, would interfere with the original parties' rights.

That situation, where equity does demand that the doctrine of relation back apply, is not present in our current appeal. Peabody is not defending its leasehold interest against a third party who claims an interest originating from a document entered into between February 1 and August 28, 1964. Thus, there is no need for the doctrine of relation back to be applied to preserve Peabody's interest, and a finding that the approval date is the effective date will not dislodge Peabody's leasehold interest.

Our second reason for finding the adjustment was timely made is that even if we were to agree with Appellants that the effective date is February 1, we still would find the adjustment was timely. Unless otherwise contradicted, terms in the lease should be interpreted in a reasonable manner.

There is nothing in this lease to indicate that the adjustment could occur only at a precise point in time. Reasonableness would dictate only that notice of the adjustment should be given at a time close to the end of the first twenty years of the lease.

The only authority cited by Appellants to challenge this conclusion is not persuasive. *Rosebud Coal Sales Co., Inc. v. Andrus*, 667 F.2d 949 (10th Cir. 1982) did not involve Indian lands and was an interpretation of the Mineral Lands Leasing Act which is not applicable here. Furthermore, the company in that case reasonably believed that after almost 2½ years the government was not going to adjust the royalty because normal practice was to give notice of the adjustment either before or immediately after the 20 year anniversary date. Indeed, the regulations required prior notice whenever feasible. No such normal practice exists with Indian leases against which to compare the Area Director's action because adjustment clauses are rare. Moreover, only 4½ months had elapsed between the alleged 20 year anniversary date and the Area Director's notice of adjustment, and in any event Peabody was aware that an adjustment to the royalty was likely. An increase in the royalty rate had been discussed during negotiations between Peabody and the Tribe at least two years prior to the Area Director's decision. Consequently, we find little merit in appellants' argument that the adjustment was untimely even if we consider, *arguendo*, that February 1, 1964 is the effective date.

For the above reasons I conclude that the Area Director's decision was timely made. This decision is based on the interpretation of law and shall become final 60 days from receipt of this letter unless an appeal is filed with the Board of Indian Appeals pursuant to 43 C.F.R. § 4.310.

II.

Once we have concluded that the Area Director's adjustment was timely, we must address the second issue. Appellants content the Area Director's decision as to the royalty rate was arbitrary, capricious, and per se unreasonable. Their key point is that he used the wrong methodology to make his determination. Appellants argue that he and his supporting material considered the issue with the view that this was a renegotiation of the lease, not an adjustment of an existing lease, and as a result relied on the wrong standard in making his determination.

While it is true that some of the materials relied upon by the Area Director used the word "renegotiation" and were used to advise the Tribe on negotiation strategies, their underlying methodologies were two: comparable leases and discounted cash flow analysis. In contrast to these established methods, Appellants support an analysis which would preserve for the parties the benefit of the bargain struck by them in 1964. Appellants' Brief at 18.

We do not agree with Appellants. Article VI of the lease allows for an adjustment to the royalty provisions because the parties did not agree to have the same royalty throughout the lease. If they could have satisfactorily anticipated the future there would be no need for an adjustment clause. Thus, the terms of their lease make it clear that the only expectation they had in 1964 was that after 20 years the royalty could be reasonably adjusted by the Secretary based on current market conditions. The only rational basis for an adjustment clause is that the bargain struck in 1964 was to be changed after 20 years.

At the present time, the royalty rate for this lease is far lower than what we could find reasonable or acceptable. It is Departmental policy that the federal minimum rate of 12½% would be a minimum below which we could not set the rate. But our evidence indicates that this coal deposit is unusually valuable. Thus intuitively, we believe the royalty rate should be more than the minimum. How much more depends on how valuable the deposit is. There are two basic methods we can use to determine the relative value of the coal deposit and thus the lease. One is to compare the royalty rate from recent lease sales of comparable deposits of coal. However, little, if any, comparable data is available because this lease is very unusual. Most coal leasing in the Rocky Mountain Region occurs on federal tracts. The royalty rate for these leases is the pre-set 12½% and does not reflect the value of the mineral deposit to either the lessor or lessee. Other areas of the country where non-federal leasing occurs are not comparable in size, physical or chemical characteristics, anticipated production, removal techniques, overburden ratio, etc. Thus, I conclude we cannot use this method in this situation because comparable data is lacking.

The other method, and the one employed by many of the reports relied upon by the Area Director, is to compare the profitability of this lease to others through the evaluation of the after tax rate of return on investment. The basis for an accurate use of this method is accurate data on costs and expenses. The data used by the authors of the reports relied upon by the Area Director were estimates. For this reason we requested Peabody to submit its actual cost figures so that we could generate an accurate evaluation. Peabody declined. Letter of March 29, 1985. However, one of the purchasers did provide some data. In addition, we independently estimated what the typical cost, investment, and revenue figures would be for an operation like Kayenta Mine.

Our analysis concluded that at a 20% royalty rate, and assuming a $17.00 per ton sales price, Peabody's after tax rate of return over the life of the mine would be 21.5% in constant 1984 dollars, and 26.3% considering

5% inflation for cost and prices. This compares to a range of 10-14% for mining companies generally. Thus, even with a 20% royalty rate, Peabody would be getting a significantly higher rate of return on investment than is normal for the coal industry. Moreover, given the current structure of the tax system, Peabody may likely be getting an even greater return due to its ability to convert some income into capital gains through the use of an overriding royalty payment to its subsidiary, and the former lessee, Sentry Royalty Company.

We are told that Peabody and the coal purchasers have entered into agreements whereby Peabody is guaranteed a minimum rate of return. Appellants therefore argue that evaluating a rate of return with respect to Peabody is meaningless. I disagree. The lease provides that the Secretary may make a reasonable adjustment to the royalty rate. As was shown above, other methods of determining a reasonable rate cannot be applied to this situation. The rate of return method provides us a method whereby we can determine if a certain royalty, in this case 20%, will yield a rate of return to Peabody which is comparable to other mineral operations, disregarding whether Peabody is guaranteed a return or not. Our analysis shows that not only is Peabody's projected return comparable to other companies, it is projected to earn more than normal with the royalty at 20%.

For the above reasons I conclude that 20% is a reasonable royalty rate and affirm the Area Director's decision. My decision is based on the exercise of my discretionary authority and is final for the Department.

On July 5 Peabody requested that the Secretary assume direct responsibility of this appeal and either postpone a decision or issue one in its favor. Peabody contended that delaying the decision would encourage a voluntary settlement of new lease terms. The Navajo Nation responded on July 11 that no negotiations were pending and urged the Department to issue a decision upholding the Area Director. We do not believe any delay in our consideration of the appeal is warranted without the support of both parties. Consequently, I am now issuing this decision affirming the Area Director.

Sincerely,

Deputy Assistant Secretary
Indian Affairs

cc: Area Director, Window Rock
Field Solicitor, Window Rock
BIA Code 240

[Seal Omitted]

United States Department of the Interior
OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

CONFIDENTIAL [July 15 1985]

In reply please refer to:
Main Interior, Room 6456

BIA.WR.0260

MEMORANDUM

To: Deputy Assistant Secretary-Indian Affairs

From: Assistant Solicitor, Land and Minerals Branch
Division of Indian Affairs

Subject: Adjustment of Royalty Rate for Navajo Coal Lease held by Peabody

Peabody Coal Company has appealed a decision of the Navajo Area Director adjusting the royalty rate in Lease No. 14-20-0603-8580. Attached is a copy of a decision drafted for your signature which is currently proceeding through the surname process.

The lease was entered into in 1964. It has a specific provision subjecting the royalty provisions of the lease "to reasonable adjustment by the Secretary of the Interior or his authorized representative at the end of twenty years." In June 1984 the Area Director adjusted the royalty to 20% of the gross value of the mined coal. The original royalty had been set at a variable rate of between 25 and 37½ cents per ton of coal sold. Peabody challenges both the reasonableness of the adjustment and the timing, claiming the Area Director's decision occurred too late.

Peabody and the Navajo Nation had been negotiating over the preceeding three years in an attempt to reach mutually satisfactory terms for a new lease. The negotiations were not successful. Because of the time frame for adjustment outlined in the lease, the Area Director felt he could not postpone the decision indefinitely. Last fall, purchasers of coal from Peabody requested Secretary Clark to stay this appeal so negotiations could continue. At that time you indicated that unless all parties supported a stay consideration of the appeal would continue. The Navajo Nation indicated it was not supportive of a stay and consideration has continued. In addition, requested meetings between Peabody, the Solicitor, and yourself were not scheduled because of the problem of *ex parte* communication.

The decision, as drafted, upholds the reasonableness of an adjustment of the royalty rate to 20%. An analysis of estimated costs and expenses reveals that with a 20% royalty rate Peabody could still be expected to earn a rate of return that was better than average for coal companies. Consequently, it could be considered reasonable.

/s/ THORNTON W. FIELD

[Seal omitted]

THE SECRETARY OF THE INTERIOR

WASHINGTON

July 17, 1985

MEMORANDUM FOR: JOHN FRITZ

FROM: DONALD PAUL HODEL/s/

SUBJECT: APPEAL OF NAVAJO AREA DIRECTOR'S ADJUSTMENT OF ROYALTY LEASE NO. 14-20-0603-8580

I have reviewed the enclosed letter from C.G. Farrand of Peabody Holding Company, Inc. While I do not necessarily agree with all of its points, there would appear to be significant advantages to be derived from the successful renegotiation of the royalty rate under the above lease by the parties to that agreement. Any royalty adjustment which is imposed on those parties without their concurrence will almost certainly be the subject of protracted and costly appeals. The ultimate outcome could well impair the future of the contractual relationship established by the parties under the current lease.

Therefore, I suggest that you inform the involved parties that a decision on this appeal is not imminent and urge them to continue with efforts to resolve this matter in a mutually agreeable fashion.

As I understand the facts surrounding this appeal, in June 1984 the BIA Area Director adjusted the royalty rate on Lease No. 14-20-0603-8580 from 37.5 cents per ton to 20 percent of the value of coal. This occurred at a time when the coal company and the Navajo Tribe were actively engaged in negotiations involving both a lease extension and a royalty rate adjustment. In fact, I understand that these negotiations had begun as early as late-1979 (several years before it was necessary to consider readjustment) and that the royalty rate which the lessee was offering was in the vicinity of the 12.5 percent which is currently required on surface coal mining leases on Federal land. The lessee (Peabody Coal) appealed the Area Director's decision.

From the filing of that appeal until the present time, the Navajo Tribe and Peabody have been meeting in an attempt to negotiate their way out of a somewhat complex legal dilemma.

I find it preferable to allow parties, with conflicting interests in the same matter, to have a sufficient amount of time to sit down and work out their differences. I believe this can be accomplished with respect to the issues currently subject to this appeal; therefore, a decision on the appeal at this time would be ill-timed.

I wish to assure you, however, that this memorandum is not intended as a determination of the merits of the arguments of the parties with respect to the issues which are subject to the appeal. If it becomes inevitable that such a determination must be made by the Department, then we can discuss it at that time.

THE NAVAJO NATION
WINDOW ROCK, NAVAJO NATION [ARIZONA] 86515

[Seal Omitted]

PETERSON ZAH	*EDWARD T. BEGAY*
CHAIRMAN, NAVAJO TRIBAL COUNCIL	VICE CHAIRMAN, NAVAJO TRIBAL COUNCIL

[Seal Omitted]

The Honorable Donald P. Hodel
Secretary of the Interior
18th and C. Streets, N.W.
Room 6151
Washington, D.C. 20240

RE: Navajo Lease
No. 14-20-0603-8580

Dear Mr. Secretary:

On July 5, 1985, Chris Farrand, Vice President, Peabody Holding Company, wrote to you asking you to intervene in their appeal before the Department of Interior and to postpone the Department's decision on the matter of the royalty adjustment to the Navajo Nation.

I am writing to express my objection to Peabody Coal Company's attempt to further delay the adjustment of the royalties due to the Navajo Nation.

The Bureau of Indian Affairs made its decision, pursuant to the lease terms, to adjust the royalty rate over a year ago. We expected then, and expect now, that the Department of the Interior, acting in the best interests of the Navajo Nation as our trustee, will act promptly to insure that the Navajo Nation receives a fair return for its coal resources.

Peabody's request for postponement simply is not justified. While it is true that the Nation had been, for close to two years, trying to renegotiate the terms of our coal lease with Peabody, the negotiations cannot be characterized as "actively" occurring at this time. It has been some nine months since negotiations with Peabody became stalled over such issues as their requests for additional coal, the very difficult water issues and other important area of concern to both parties.

Since the U.S. Supreme Court decided the *Kerr-McGee v. Navajo Nation* case in our favor, I have discussed the payment of past-due back taxes with Ken Moore, the President of Peabody Coal Company. Royalty rates and the lease itself have not been discussed.

Contrary to Mr. Farrand's assertion, I am not confident that a voluntary agreement can be reached between Peabody and the Navajo Nation on the royalty adjustment and other lease terms.

I urge you to see to it that a final decision for the Department of the Interior upholding the Area Director be made as soon as possible.

Thank you for your assistance.

Sincerely,

/s/ PETERSON ZAH
Chairman
Navajo Tribal Council

cc: Chris Farrand
Peabody Holding Co.

Timothy Vollmann, Esq.
Office of the Solicitor

Mr. John Fritz
Deputy Assistant Secretary

Claudeen Bates Arthur, Esq.
Attorney General
Navajo Nation Department of Justice

Paul Frye, Esq.
200 Lomas Blvd. N.W.
Albuquerque, N.M. 87102

Eric D. Eberhard, Esq.
Navajo Nation Washington Office

K.R. Moore
Peabody Coal Company

[Seal omitted]

United States Department of the Interior

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

BIA.WR.0260

MEMORANDUM

No memo but include in briefing 4 p.m. by Tim

TO: Principal Deputy Solicitor

FROM: /s/ TIM VOLLMANN
Associate Solicitor, Indian Affairs

SUBJECT: Appeal of Navajo Area Director's Adjustment of Royalty

By memorandum of July 17, 1985 (attached), the Secretary instructed the Deputy Assistant Secretary - Indian Affairs to refrain from issuing a decision in this appeal and to urge the parties to resolve the matter in a mutually agreeable fashion.

At issue in this administrative appeal is the decision of the Navajo Area Director which, pursuant to a lease between the Navajo Nation and Peabody Coal Company, adjusted the royalty rate. We seek an opportunity to brief the Secretary on this matter.

As a consequence of the Secretary's instruction, the Navajo Nation will likely transfer this appeal to the IBIA pursuant to BIA regulations. 25 C.F.R. §2.19(2)(b). If that happens the Secretary would have to personally assume jurisdiction of the appeal to avoid a decision by the IBIA. This would likely result in a lawsuit by the Navajo Nation. The Secretary's action may be challenged on the issue of ex parte contact if he has been in communication with Peabody and failure to provide the tribe the due process protections afforded by the administrative appeal process. At a minimum, he would be subject to a deposition.

Furthermore, it appears from the face of the Secretary's memo that he was unaware of the Navajo Nation's response to Peabody's letter (attached). In its letter the Nation makes it clear that it does not favor any stay of the appeal and does not believe negotiations are promising.

Lastly, the Secretary is correct in stating that negotiations had been ongoing when the Area Director issued his decision. However, the Area Director was required to act when he did because of a time deadline in the lease. Ironically, in its appeal Peabody argues that the Area Director's decision was made too *late* to be effective.

Because of the sensitive nature of this appeal, your early review is appreciated.

[Seal omitted]

United States Department of the Interior

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

In reply please refer to:
Main Interior, Room 6456

[Aug. 29, 1985]

BIA.WR.0260

Peterson Zah
Chairman, Navajo Tribal Council
Navajo Nation
Window Rock, Arizona 86515

Chris Farrand
Vice President
Peabody Holding Company, Inc.
1120 20th Street, N.W., Suite S-720
Washington, D.C. 20036-3445

Paul E. Frye, Esq.
200 Lomas Blvd., N.W.
Suite 815
Albuquerque, New Mexico 87102

Re: Appeal of Peabody Coal Company of Adjustment of Royalty: Navajo Lease No. 14-20-0603-8580

Gentlemen:

The Secretary has received your letters dated July 19, July 5, and July 11, 1985, and has asked me to respond. Your letters concern an appeal filed by Peabody of the

Navajo Area Director's decision adjusting the royalty rate on a Navajo coal lease with Peabody.

As you are aware, the briefing schedule has been completed and a decision on the appeal is currently being considered by the Deputy Assistant Secretary-Indian Affairs and his staff. They are aware of both Peabody's and the Tribe's concerns regarding settlement but the decision has not yet been finalized. You of course will be informed when that decision is made.

Sincerely,

/s/ TIM VOLLMANN
Associate Solicitor
Division of Indian Affairs

1. *Expect tough negotiations*

2. *Close to a deal with the Chairman*

3. *Attorneys divided; 60/40 against (hard line coming from Interior staff)*

4. *Zah needs near term revenue willing to accept a $12^{1}/_{2}$% rate but needs something more*

5. *Claudine out of picture but Nelson getting instructions from Washington (Eberhard)*

6. *Washington doesn't believe facts on appeal have been adequately refuted by Peabody*

7. *Hold out for Sect. or under Sect. approval of negotiated package*

August 6, 1987

MR. R. H. BRIDENBECKER

SUBJECT: Indian Lease Negotiations

Attached for your review and comment are drafts of proposed slides and a presentation outline for your use in reporting on the Indian lease negotiations to the Board of Directors and the Management Committee.

/s/ R.M. BERTHOLF

RMB: dw

Attachments

cc: H.F. Huettemeyer
C.G. Thompson
M.D. Monninger

COST-BENEFITS
OF LEASE NEGOTIATIONS

	DO NOTHING	AS AMENDED
ROYALTY RATE –		
NNL	20%	12.5%
JUA	6.67%	12.5%
BACK ROYALTIES DUE (1984-1987)	$100 MILLION	$44 MILLION
BACK TAX LIABILITY (1978-1984)	$33 MILLION	WAIVED
COAL VOLUME	400 MILLION TONS	670 MILLION TONS
WATER - VOLUME	ENOUGH TO MINE 400 MILLION TONS OF COAL	ENOUGH TO MINE 670 MILLION TONS OF COAL
—ANNUAL COST	$42,000	$3,400,000

[Seal omitted]

United States Department of the Interior

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

MEMORANDUM

To: Whit Field

From: Edwin Winstead

Subject: Navajo & Hopi Coal Lease Amendments: Issues to be considered Prior to Approval

Hopi Lease No. 14-20-0450-5743

1. Amendment 2. *Additional Coal.* This lease amendment allows Peabody to mine an additional 180 million tons of coal. We should consider the need for a NEPA environmental impact study.

This section also requires Peabody to mine twice as much coal from the Hopi lease as from Navajo lease no. 14-20-0603-8580. Since both tribes have apparently agreed to this format, the Department should be able to ratify it without any unfairness to the Navajo Tribe.

Finally this section may require the federal government to examine and approve the surface mining methods used by Peabody. The Department should consider whether it is willing to assume the duties provided in the leases.

2. Amendment 3. *Royalty Rate.* Section C discussed what will happen if uranium ore is discovered on the property. Since uranium mining has a different set of environmental problems, any future mining of this substance may require an EIS.

3. Amendment 6. *Assignment of Lease*. This entire provision allows assignments of the Lease without approval of the Secretary (25 C.F.R. § 211.26). We should clarify that any transfer must be approved by the Secretary.

4. Amendment 10. *Rights-of-way*. Allows the tribe to grant rights of way without the approval of the Secretary pursuant to 25 C.F.R. § 169. It should be made clear that any rights-of-way must be granted by the Secretary.

Navajo Lease Nos. 14-20-0603-8580 and 14-20-0603-9910

1. Amendment 2. *Additional Coal*. As in the Hopi Lease this additional coal may require an EIS.

2. Amendment 5. *Assignment of Lease*. This section requires the Secretary to waive the provisions of 25 C.F.R. § 211.26 for certain transfers.

3. Amendment 11. *Rights-of-way*. This section should be clarified to require the Secretary's approval for any grant of a right of way pursuant to 25 C.F.R. § 169.

General compliance problems with all three leases.

1. The leases do not comply with 25 C.F.R. § 211.2 which requires advertisement for bids prior to leasing. We will need to explain why this situation merits a waiver.

2. 25 C.F.R. § 211.9 limits leasing acreage to 2,560 acres.

3. 25 C.F.R. § 211.10 provides a 10 year time limit.

Other Matters

If the Secretary approves the leases it may be appropriate to disclaim any knowledge or undertaking on the part of the Secretary as to the adequacy of the consideration received by the tribes.

According to the leases the parties will not be bound to the terms of the leases as submitted after the following dates:

A. Navajo Leases—Nov. 9, 1987

B. Hopi Leases—Nov. 30, 1987

MEMO TO: CGT 12/1/87

DATE PREPARED

Re: Lease Amendment Approval

L. Cope talked to Chris Farrand, Peabody's VP in Wash, DC, this afternoon. Mr. Farrand had just left the Solicitor General's Office and things are moving ahead as the various groups are submitting their approvals to the Secretary of the Interior. Apparently Mr. Farrand has also talked to Scty. Hodel who says he will sign the lease amendments. This could take place as early as Thursday, 12/3/87.

cc: HFH FROM: RMB

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

No. 93-763L
JUDGE BOHDAN A. FUTEY

THE NAVAJO NATION, PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

DEFENDANT'S RESPONSES TO PLAINTIFF'S INTERROGATORIES (*THIRD SET*)

Defendant United States responds to Plaintiff's Interrogatories (Third Set) as follows:

* * * * *

31. Was the "Coal Leasing Policy on Indian Lands," as stated on the attached exhibit 1, in effect within the Department of the Interior as of November 26, 1975?

ANSWER: Defendant stipulates that the "Coal Leasing Policy on Indian Lands," as stated on the attached exhibit 1, was in effect within the Department of the Interior as of November 26, 1975.

32. If your answer to interrogatory no. 31 is "yes,"

    (a) state whether such policy has been modified, rescinded, withdrawn, or otherwise changed or made ineffective since November 26, 1975 and, if so,

(b) state the date or dates of any such modification, withdrawal or rescission, identify the person and means by which it was effected, and identify all documents concerning such modification, withdrawal or rescission.

ANSWER: Defendant knows of no modification to the policy expressed in the memorandum of November 26, 1975 from the Acting Director, Office of Trust Responsibility, of the Bureau of Indian Affairs.

* * * * *

42. Did any study, analysis or report prepared by any person within the Department from January 1, 1984 to January 1, 1988 conclude that the 20% royalty rate for the Lease was not reasonable? If so, identify such study, analysis or report by stating its author, recipient, and date, and by identifying its current custodian.

ANSWER: Defendant knows of no such analysis or report.

* * * * *

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

No. 93-763L
JUDGE BOHDAN A. FUTEY

NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DEFENDANT'S RESPONSES TO PLAINTIFF'S SECOND REQUEST FOR ADMISSIONS

Defendant submits the following responses to Plaintiff's Second Request of Admissions.

* * * * *

95. The policy set by Secretary Andrus in 1977 which established that a 12½% royalty rate should be the absolute minimum in any Indian lease for coal to be mined by surface mining methods was maintained by the Department of the Interior between June 1, 1984 and January 1, 1988.

RESPONSE: Admitted.

* * * * *

108. On August 29, 1985, a decision on the appeal of the Area Director's June 18, 1984 adjustment of the royalty rate on the Lease to 20% was not currently being considered by the Deputy Assistant Secretary and his staff.

RESPONSE: Admitted.

*   *   *   *   *

110. Peabody submitted the amendments to the Secretary's office on November 27, 1987 and the approval process of those lease amendments thereupon became a "rush job" within the Department of the Interior.

RESPONSE: Admitted.

111. The attached Exhibit 92 was partly drafted by and is a product of discussions with representatives of Peabody.

RESPONSE: Admitted.

112. The attached Exhibit 94 was partly drafted by and is a product of discussions with representatives of Peabody.

RESPONSE: Admitted.

*   *   *   *   *

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

No. 93-763L
JUDGE BOHDAN A. FUTEY

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Received Dec. 15, 1997]

PROPOSED FINDINGS OF
UNCONTROVERTED FACT

Paul E. Frye
Attorney for Plaintiff
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* * * * *

21. Peabody is the world's largest private coal producer. Peabody Group Webage (visited Nov. 26, 1997) http://www.peabodygroup.com/pHCIHome.hmtl, III App. 1811.

* * * * *

24. Mohave is operated by the Southern California Edison Company ("Edison"), one of the nation's two or three largest investor-owned utilities. Bridenbecker Dep. at 8, 66, II App. 917, 925.

* * * * *

51. By 1983, Peabody's sales of Navajo coal under the 8580 surpassed $141 million, yet the Navajo Nation had received less than $2.7 million in royalties for that coal. Council of Energy Resource Tribes, "Navajo Nation Peabody Coal Selling Price and Royalty Analysis" at Fig. 6 (Jan. 1985), I App. 364.

52. In 1978, the Acting Regional Audit Manager of the DOI Office of Audit and Investigation, "[b]ased on the apparent inequitableness of the royalty rates," urged the BIA "to exercise its trust responsibility and attempt to have these [Peabody] leases amended. . . ." Memorandum from Acting Regional Audit Manager, DOI, to Area Directors, Phoenix and Navajo Area Offices 3 (June 28, 1978), I App. 202.

* * * * *

54. In 1979, the BIA and the United States Geological Survey inspected Peabody's mines and found that Peabody's lease violations regarding reclamation, rights-of-way and waste "warrant our consideration of a recommendation to cancel the leases." Letter from Donald Dodge, Area Director, Navajo Area Office, to Peabody Coal Company (Sept. 4, 1979), I App. 204.

* * * * *

56. Peabody then obtained the assistance of Peter MacDonald, Chairman of the Navajo Tribal Council, who reported to the BIA that Peabody had agreed to

renegotiate its leases, "with any renegotiated terms to be retroactive to January 1, 1980." Letter from Peter MacDonald, Chairman, Navajo Tribal Council, to Donald Dodge, Area Director, Navajo Area Office, BIA (Dec. 19, 1979), I App. 207. MacDonald requested that the BIA "suspend its administrative activities" relative to the leases for three months "so that this renegotiation can proceed without undue duress." *Id.*

* * * * *

59. After fourteen months passed without any renegotiated agreement, the Window Rock Field Solicitor recommended to the BIA's Assistant Area Director for Resources that the BIA require Peabody to apply for a right-of-way for its access road. Memorandum from Field Solicitor, Window Rock, DOI, to Assistant Area Director (Resources) (April 27, 1981), I App. 212. Tom Lynch, the Assistant Area Director for Resources, demurred because

> [a]pprox. 2 wks ago Mr Moore of Peabody advised that agreements with [Peabody's] customers have been worked out resulting in increased royalty to Tribe of not less than 12½% and water sales from present $5.00 per acre foot to $50.00 per acre foot per year [sic]. Final proposal to Tribe is to be presented Tribe (when?) soon.

Id. at handwritten note (April 30, 1981); Back Dep. at 80-82, II App. 869-70.

* * * * *

64. On March 28, 1984, five months prior to the twentieth anniversary of the approval of the 8580 Lease, the Navajo Nation requested that the Secretary

of the Interior adjust the royalty rate of that Lease pursuant to Article VI thereof. Letter from Peterson Zah, Chairman, Navajo Tribal Council, to Hon. William Clark, Secretary, Department of the Interior (March 28, 1984), I App. 223. The royalty in effect at that time was approximately 37 cents per ton, which translated to a 2% royalty rate on Peabody's gross proceeds. *Id.* at 1.

65. The Acting Assistant Area Director responded to Zah's request and stated that

> [s]ince the lease renegotiation efforts of the Navajo Tribe have been unfruitful to date, we are pursuing our responsibility to ensure compliance with the terms of the lease by implementing an adjusted royalty rate as called for by the said lease.

Letter from Jack Kyselka, Jr., Acting Assistant Area Director, Navajo Area Office, BIA, to Peterson Zah, Chairman, Navajo Tribal Council (April 19, 1984), I App. 228.

* * * * *

67. At the request of the Navajo Nation, Letter from Peterson Zah, Chairman, Navajo Tribal Council, to Donald Dodge, Area Director, Navajo Area Office, BIA (April 2, 1984), I App. 229, the Navajo Area Office notified Peabody of additional lease violations that were causing "a substantial loss in revenues for the Navajo Tribe." Letter from Floyd Espinoza, Acting Area Director, Navajo Area Office, to Peabody Coal Company (April 25, 1984), I App. 233.

68. The BIA Division of Energy and Mineral Resources ("E&M") is the DOI agency responsible for providing technical assistance to the BIA and federally-

recognized Indian tribes in the leasing of energy minerals on Indian lands. 130 DM § 10.5, I App. 88.

* * * * *

70. The BIA also sought to enter into a Memorandum of Understanding ("MOU") with the Bureau of Mines ("BOM") to analyze the economics of the Peabody mine and assist in determining a reasonable royalty rate for the 8580 Lease. In commenting on the draft BIA/BOM MOU, the Field Solicitor urged that the study be a top priority, because the Navajo Nation's "loss in royalty may be $50,000 per day." Memorandum from Field Solicitor, Window Rock, to Area Director 2 (May 11, 1984), I App. 245.

* * * * *

75. BOM performed a study under the MOU which supported a royalty rate adjustment to 20%. Bureau of Mines, "Analysis of the Financial Aspects of a Reevaluation of the Royalty Terms of the Kayenta Lease Area Between the Navajo Indian Tribe and Peabody Coal Company, Inc." 10 (June 6, 1984), I App. 280.

76. The BIA's Area Real Property Management Officer reviewed the analyses of E&M and BOM and determined that "[t]he Bureau of Mines report is more reasonable and justifiable." The officer thus recommended to the Area Director "a royalty adjustment of 20.0 percent as a final adjustment decision by your office." Memorandum from Area Real Property Management Officer to Area Director (June 15, 1984), I App. 286.

77. Navajo Area Director Dodge, under authority delegated by the Secretary of the Interior, adjusted the royalty rate to 20% after a thorough review with and the concurrence of his Washington superiors and the Solicitor's Office. Letter from Donald Dodge, Area Director, Navajo Area Office, to Kenneth R. Moore, Arizona Division, Peabody Coal Company (June 18, 1984), I App. 287; Dodge Dep. at 41-44, II App. 996-99; Fritz Dep. at 83, II App. 1066.

THE APPEAL OF THE AREA DIRECTOR'S ROYALTY ADJUSTMENT DECISION

78. SRP and Edison (on behalf of themselves and the other NGS and Mohave participants) and Peabody all appealed from the Area Director's decision, invoking the appeal procedures of 25 C.F.R. Part 2, I App. 25 (collectively, the "Appeal"). I App. 290, 291, 293 (notices of appeal). Greg Leisse represented Peabody in the Appeal. I App. 290. Tom Reilly represented Edison. I App. 292. Fred Martone represented SRP. I App. 294.

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81. Peabody, SRP and Edison then met to develop a strategy. At that meeting, Moore stated Peabody's "hope for Secretarial recommendation to settle new rate [and to] open negotiations between Navajo & PC/SR/SCE." Notes by Hermann F. Huettemeyer, Manager, Fuel Supply, Edison (July 13, 1984), I App. 298 (concerning meeting SRP Director of Resource Planning Darrell Smith and Peabody's Gerald Grow, Moore and Leisse). Greg Leisse was designated the "key contact." *Id.*; Leisse Dep. at 150-51, III App. 1328-29.

* * * * *

83 At that time, Fritz held the positions of Acting Assistant Secretary of the Interior and Deputy Assistant Secretary-Indian Affairs (Operations), and performed the functions of the former "Commissioner of Indian Affairs." Fritz Dep. at 10, 85, 109, II App. 1048, 1067, 1076.

* * * * *

85. Edison instructed its attorney Reilly to "proceed[] on maximum delay mode in the appeal of the 20% royalty rate." Memorandum from H.F. Huettemeyer to Larry Cope (Sept. 14, 1984), I App. 301; Huettemeyer Dep. at 62, II App. 1175.

* * * * *

88. Vollmann and one of his subordinates in the Solicitor's Office, Colleen Kelley, in conjunction with E&M Chief Joe Johnston, reviewed the procedural options for the Appeal. Ultimately, Fritz opted to make the decision himself, in accordance with 25 C.F.R. Part 2. Note from Colleen [Kelley] to Joe [Johnston] (Sept. 11, 1984), I App. 305 (attaching a copy of a draft memorandum from Associate Solicitor, Indian Affairs, to Deputy Assistant Secretary—Indian Affairs (Operations)(n.d.)); Memorandum from Associate Solicitor, Indian Affairs, to Deputy Assistant Secretary—Indian Affairs (Operations) (Sept. 13, 1984), I App. 309; Kelly Dep. at 29-30, II App. 1274-75; Vollmann Dep. (Sept. 21, 1995) at 85-99, III App. 1593-1607.

89. The Associate Solicitor pointed out that the parties had negotiated unsuccessfully for 10 years, that a decision on the appeal was of "vital importance" to the Navajo Nation, and that a court challenge to any decision was likely. Memorandum from Associate

Solicitor, Indian Affairs, to Deputy Assistant Secretary —Indian Affairs (Operations) 1 (Sept. 13, 1984), I App. 309.

90. None of the possible procedures listed by the Associate Solicitor included a direct appeal to the Secretary of the Interior because under such a procedure " it is difficult to control or have a meaningful administrative appeal process which protects against *ex parte* communication, that sort of thing." Vollmann Dep. (Sept. 21, 1995) at 87, II App. 1595.

* * * * *

101. Peabody, SRP and Edison filed a joint brief in the Appeal and relied on a report prepared by Peterson & Company. Peterson & Co., "Analysis of a Reasonable Adjustment of Navajo Coal Lease Royalty Rates" (Nov. 28, 1984), I App. 318 (reproduced at Peabody Coal Company, *et al*., Appeal Under 25 C.F.R. Part 2, In the Matter of Appeal of the Navajo Area Director's Adjustment of Royalty, Peabody Lease No. 14-20-0603-8580, Ex. I (Nov. 30, 1984)). That report concluded that "a reasonable royalty rate would be in the range of 5.57% to 7.16% of the gross realization of coal sold under the 1964 [8580] lease." *Id.*, Executive Summary at i, I App. 319. This is about one-half of the minimum royalty rate for federal coal mined by surface mining methods under the Federal Coal Lease Act Amendments of 1976. *Compare id. with* 30 U.S.C. § 207(a).

* * * * *

103. The Navajo brief urged that a royalty rate of 20% be affirmed, or– if it were not– that the 8580 Lease should be terminated based on Peabody's failure to

comply with its terms and which Interior regulations. Answer Brief of the Navajo Tribe of Indians, *supra*, at 32-34, I App. 329-31.

104. Peabody, SRP and Edison, through attorneys Fred Martone and Tom Reilly, wrote to Fritz seeking an opportunity to file a supplemental statement of fact and requesting oral argument. Letter from Frederick J. Martone, Esq., Jennings, Strouss & Salmon, and Thomas J. Reilly, Snell & Wilmer, to John W. Fritz, Deputy Assistant Secretary–Indian Affairs (Operations) (Feb. 22, 1985), I App. 454. The companies did not seek an evidentiary hearing. *Id.*

105. The Navajo Nation opposed the companies' request, primarily because of the delay it would cause in deciding the Appeal. Letter from Paul E. Frye, staff attorney, Navajo Nation Department of Justice, to John W. Fritz, Deputy Assistant Secretary–Indian Affairs (Operations) (Feb. 25, 1985), I App. 457; Fritz Dep. at 117-19, II App. 1081-83.

106. In the meantime, Fritz assigned to the Solicitor's Office much of the responsibility for preparation of the decision on the Appeal. Fritz Dep. at 113-14, 123, II App. 1077-78, 1085. Colleen Kelly was a assigned to gather information for that office. *Id.* at 123, II App. 1085. Fritz took special care to assure that his decision on the Appeal would be rational, thoughtful and supported by the facts and law. *Id.* at 114-16, II App. 1078-80.

107. Kelly sought the assistance of Vijai N. Rai, Ph. D., a geologist with E&M. Rai Dep. at 46, III App. 1452.

108. Dr. Rai examined the Appeal briefs and the reports of Peterson and Company, Peabody Coal Company–Arizona Division, F.R. Schwab & Associates,

Council of Energy Resource Tribes, BOM, and E&M. Memorandum from Vijai N. Rai., Geologist, E&M, to Colleen Kelley, Office of the Solicitors–Division of Indian Affairs 2-3 (Feb. 26, 1985), I App. 460-61.

109. Dr. Rai concluded as follows:

> In summary, based on data currently available, a 20% royalty rate determination appears reasonable and defensible. In the appeal decision, we recommend that the Area Director's 20% royalty rate determination be sustained. However, Peabody should be granted a 60 to 90 day time period in which to provide economic data to substantiate its contention that a 20% royalty rate is unreasonable. If Peabody were to provide the actual data with respect to its cost, investment, and revenues, the Bureau of Indian Affairs should reevaluate its royalty determination in light of such data.

Id. at 5-6, I App. 463-64; *see* Rai Dep. at 49, III App. 1453.

110. Fritz granted in part and denied in part the companies' request of February 22, 1985. Letter from John W. Fritz, Deputy Assistant Secretary–Indian Affairs (Operations), to Gregory J. Leisse, Peabody Coal Company (March 4, 1985), I App. 465; Fritz Dep. at 117-19, II App. 1081-83. Fritz felt oral argument would serve no useful purpose, and denied that request. Fritz Dep. At 118-19, II App. 1082-83. However, Fritz allowed the companies to submit a supplemental fact statement. Letter from John W. Fritz (March 4, 1985), I App. 465.

111. In conformity with Dr. Rai's recommendation, Fritz also granted Peabody an extraordinary opportun-

ity to provide data necessary to support assertions made but not supported in its brief, as follows:

> We have been reviewing the briefs and exhibits submitted by the Tribe and by the appellants in this appeal, and it has come to our attention that the cost of operating [the 8580 Lease] was a key factor in certain reports relied upon by the Area Director. The cost figures were admittedly estimates formulated by the reports' authors. In appellants' brief, Exhibit I at page 8, it is stated that these estimates "are unreasonable even with respect to industry data." It would be helpful for our review if Peabody was explicit in its arguments about what are reasonable cost figures.
>
> Consequently, we are requesting Peabody to submit its actual cost, revenue, and investment figures for this lease, including the overriding royalties, if any, paid to assignor Sentry Royalty Company or its successor. Pursuant to 25 C.F.R. § 2.16, we will stay our consideration of this appeal for three weeks to allow you to submit these costs. If Peabody declines to submit them, we shall make our decision in this appeal on the record as it now stands.

Id.; *see* Fritz Dep. at 122-23, 125, II App. 1084-85, 1086; Kelly Dep. at 57, II App. 1279.

112. Upon reading Fritz' letter, Tom Reilly, Edison's outside counsel in the Appeal, advised Larry Cope, Edison's in-house counsel, that:

> I suspect that this is just about the worst possible letter that could have been received by Peabody Coal Company. Perhaps I misjudge the tone of the letter, but I think the train is coming down the track

> and the Department is preparing to support the decision of the Area Director.

Letter from Thomas J. Reilly, Snell & Wilmer, to Larry Cope, Southern California Edison Company (March 11, 1985), I App. 468.

113. Cope forwarded Reilly's letter to R.H. Bridenbecker, the Edison executive ultimately responsible for the royalty rate matter. Memorandum from Larry R. Cope to R.H. Bridenbecker (March 18, 1985), I App. 467.

114. Fritz' letter of March 4, 1985, prompted the companies to intensify their behind-the-scenes efforts. Peabody, SRP, and Edison immediately sought a meeting with Secretary Hodel and deciding official Fritz. *See* Memorandum from Frank K. Richardson, Solicitor, to Secretary of the Interior (March 12, 1985), I App. 470; Kelly Dep. at 59-62, II App. 1280-83; Sullivan Dep. at 14-15, III App. 1559- 60.

115. Secretary Clark had rejected all attempts by the companies to communicate *ex parte* with him. Fritz Dep. at 107, II App. 1075 (Clark had a "very strict rule" against *ex parte* contacts to which he and Solicitor Richardson, both former justices of the California Supreme Court, adhered).

116. However, Clark was replaced by Donald Hodel as Secretary in February 1985. Hodel Dep. at 20-21, II App. 1143-44.

117. Solicitor Richardson reiterated his advice to Secretary Hodel:

> We recommend that you not discuss this administrative appeal or associated issues with Peabody primarily because it would raise the problem of *ex*

> *parte* contact. Deputy Assistant Secretary Fritz has already decided he cannot meet with Peabody because in his case it would clarly constitute *ex parte* contact. In the event you do decide to discuss this with Peabody, recent court decisions indicate it would be appropriate to grant the Navajo Tribe a similar opportunity to discuss this issue with you. *E.g.*, *Dawn Mining Co.* v. *Clark*, No. C-82-974-JLO, U.S.D.C. E.D. Wash., December 19, 1984.

Memorandum from Frank K. Richardson, Solicitor, DOI, to Secretary of the Interior (March 12, 1985), I App. 470-71.

118. Hodel took a different approach than Clark, however, Fritz Dep. at 148-49, II App. 1098- 99:

> Secretary Clark and Judge Richardson stopped *ex parte* meetings, but then after Secretary Hodel arrived back from [the Department of] Energy those requests went to him. . . . I saw a large number of industry people arrive back at the building, people who hadn't been around when Secretary Clark was there in the building. They had been there, but only in formal functions.

Those people included Howard Allen, President of Edison. *Id.* at 149, II App. 1099.

119. Farrand confirmed arrangements for a meeting without Navajo participation to be held on March 19, 1985, between DOI representatives–including Fritz or his representative–and high-ranking executives of Peabody, SRP and Edison. Letter from Chris Farrand, Vice President, Government Relations, Peabody Holding Company, Inc., to Hon. Frank Richardson, Solicitor, DOI (March 15, 1985), I App. 473. Farrand wrote: "We also understand that Secretary Hodel may

be able to stop by the meeting if his other commitments permit." *Id.*

* * * * *

123. About two weeks later, on April 16, 1985, the United States Supreme Court upheld the validity of Navajo tax laws enacted in 1978 that applied to Peabody. *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195 (1985).

124. Because of that decision, Edison's Vice President in charge of fuels observed that "April 16th becomes the Navajo 4th of July." Bridenbecker Dep. at 90-91, II App. 930-31. Edison's attorneys determined that the Navajo taxes could be lawfully collected retroactively to 1978. *Id.* at 92-93, II App. 932-33. Edison was thus "concerned that [the *Kerr-McGee* decision] left us in a position of significant exposure in terms of fuel cost." *Id.* at 91, II App. 931; *see* Bertholf Dep. at 37, II App. 894.

125. Edison was "surprise[d]" by the *Kerr-McGee* decision. Huettemeyer Dep. at 81, II App. 1181. As Huettemeyer elaborated: "Well, this was the Supreme Court. We thought we would win at the Supreme Court, and we lost 8-0, because one judge was absent." *Id.*

126. The Navajo taxes also applied to the slurry pipeline that extends from the Peabody mine to Mohave, and the cost implications of this tax burden also concerned Edison. *Id.* at 82-84, II App. 1182-84. By 1987, Edison calculated that it owed the Navajo Nation $33 million in back taxes. R.M. Bertholf, "Cost-Benefits of Lease Negotiations" (Aug. 6, 1987), I App. 635-36; Huettemeyer Dep. at 127- 28, II App. 1190-91.

PREPARATION OF THE DECISION ON THE ROYALTY ADJUSTMENT APPEAL

127. In light of Peabody's refusal to supply the data he requested, Fritz sought further technical assistance from BOM. Fritz Dep. at 134-36, II App. 1087-89. Fritz "wanted the evaluation of the economic impact to be done by somebody who had the knowledge, skills and ability to make an appropriate evaluation, and I also wanted it to be as objective as possible." *Id.* at 134-35, II App. 1087- 88.

128. BOM assigned a mineral economist and a mining engineer to collaborate on the analysis. Davidoff Dep. at 9, 46-52, II App. 980, 983-89; Perlewitz Dep. at 8-10, 39-43, III App. 1435-37, 1439-43.

129. BOM's Perlewitz and Davidoff produced an initial report and an addendum to that report which fine-tuned the analysis. Philip C. Perlewitz and Robert L. Davidoff, "An Engineering and Economic Analysis of the Kayenta Lease Area" (April 24, 1985), I App. 499; Philip C. Perlewitz and Robert L. Davidoff, "Addendum to an Engineering and Economic Analysis of the Kayenta Lease Area" (May 6, 1985) (hereinafter "BOM Addendum"), I App. 520.

130. That analysis concluded that Peabody's rate of return would range from 20.1% to 32.4% if the 20% royalty rate were upheld. BOM Addendum, *supra*, at 19, I App. 538; Davidoff Dep. at 55, II App. 990.

131. E&M Mining Engineer D.L. Cramer Bornemann reviewed the BOM analysis and found it to be competent and based on sound assumptions and methodology. Bornemann Dep. at 71-72, II App. 911-12.

132. Dr. Rai made sure that the BOM analysis employed correct assumptions and he reviewed its conclusions. Rai Dep. at 62-63, 80, III App. 1454-55, 1456.

133. Dr. Rai made sure that the BOM study, Dr. Rai refined his own earlier report of February 26, 1985, *see supra* ¶¶ 108-09. Dr. Vijai N. Rai, Geologist, E&M, Draft "Report on the Issue of Royalty Rate Adjustment for Lease No. 14-20-0603-8580 (Kayenta Coal Mine), Navajo Reservation" (rec'd May 17, 1985), I App. 543. Kelley reviewed that revised report and suggested modifications. *Id.* at 4 (marginalia), I App. 547.

134. Dr. Rai then produced his final report. Dr. Vijai N. Rai, Geologist, E&M, "A Report on the Issues of Royalty Rate Adjustment for Lease No. 14-20-0603-8580 (Kayenta Coal Mine), Navajo Reservation" (n.d.) (hereinafter "Rai Report"), I App. 554.

135. There, Dr. Rai found that the "coal deposits under lease to Peabody are exceptionally valuable." *Id.* at 8, I App. 562; *see* Rai Dep. at 81, III App. 1457. Dr. Rai's conclusions are unequivocal:

> V. Conclusion
>
> Based on a review and analysis of all the information currently available, a royalty rate adjustment to 20 percent of the gross value of the coal mined from the subject lease appears justifiable and defensible.
>
> VI. Recommendation
>
> We recommended that the Area Director's decision to adjust the royalty rate to 20 percent of the gross value of the coal mined from the subject lease be sustained. Rai Report at 9, I App. 563.

136. No study, analysis or report prepared by any person within the Department between January 1, 1984 to January 1, 1988 concluded that the 20% royalty rate for the 8580 Lease was not reasonable. Def.'s Resp. to Pl.'s Interrog. No. 42, III App. 1708; Aubertin Dep. Vol. I at 154-55, II App. 816-17.

* * * * *

138. Colleen Kelley of the Solicitor's Office drafted Fritz' decision document for the Appeal. Kelley Dep. at 68-70; II App. 1285-87. The document was typed on or about June 18, 1985. *Id.* at 70, II App. 1287.

139. Fritz, Kelley, Assistant Solicitor Whit Field and probably Vollmann went through the draft decision line-by-line. Fritz Dep. at 142-45, 156-57, II App. 1092-95, 1101-02.

140. Fritz sought to have the decision on the Appeal be the "model in effect for how we were going to go about doing things and how we were going to do the economic analysis and that sort of thing." *Id.* at 145, II App. 1095.

141. In the latter half of June or early July 1985, the decision document was finalized, copied and awaiting Fritz' signature. *Id.* at 140-42, II App. 1090-92. However, Fritz was on travel and was unavailable to sign it then. *See id.* at 142, II App. 1092.

142. The decision document, indeed, was readied for mailing to all counsel in the Appeal. Unsigned Letter from Deputy Assistasnt Secretary–Indian Affairs to Gregory J. Leisse, *et al.*, ("Decision Document") at 1, I App. 566 (check mark by counsel Martone's name); Neidernhofer Dep. at 74, III App. 1424; Everette Dep. at 53, II App. 1001 ("Q. Okay. Does the check mark

around Mr. Martone's name indicate anything to you? A. That this copy was sent to him."); Crosby Dep. at 35, II App. 966 ("Q. What does that check mark signify to you? A. That this copy should go to him or the copy that had that mark should go to him."); Wilkinson-Flavin Dep. at 125-26, III App. 1652-53.

143. The Decision Document was thought by some to have been signed by Fritz, but Fritz testified that he did not sign it. *Compare* Ryan Dep. at 102, III App. 1495, *and* Crosby Dep. at 35, II App. 966 *with* Fritz Dep. at 141-42, II App. 1091-92. Fritz testified that the Decision Document was "close to 100 percent" final. Fritz Dep. at 140-47, II App. 1090-97.

144. The Decision Document relied heavily on the technical work of BOM and Dr. Rai. Kelley Dep. at 65, II App. 1284. *Compare* Decision Document at 4-6, I App. 569-71, *with* Rai Report at 7-9, I App. 561-63.

SUPPRESSION OF THE ROYALTY ADJUSTMENT APPEAL DECISION

145. Peabody's President Moore arranged a lunch meeting with Navajo Chairman Zah on July 1, 1985. Moore Expense Report (July 1985), I App. 572. Shortly thereafter, Moore informed Edison's Bridenbecker that "he had dinner with Zah. Zah said wouldn't talk about leases as has gone so far in appeal process. Wanted to talk about tax matters-concerned about retroactivity–Moore told him unfair and we would fight[.]" Notes of Richard M. Bertholf (July 3, 1985), I App. 573 (marginalia); *see* Bertholf Dep. at 37-38, II App. 894-95.

146. At that meeting, Zah expressed his reluctance to negotiate amendments to the 8580 Lease and his hope that the Appeal would be decided in favor of the Navajo position. Moore Dep. (May 29, 1996) at 147, III

App. 1391 ("I remember having dinner with Pete and him telling me that he thought they wouldn't negotiate any further at the time. He thought maybe, just like it says here, not for sure but the appeal may be decided in their favor.")

* * * * *

149. Edison learned, probably from Peabody, that the decision document awaiting Fritz' signature would affirm the 20% royalty rate. Bridenbecker Dep. at 100-01; II App. 937-38. Peabody's practice was to inform SRP and Edison equally of such significant events. Leisse Dep. at 133, III App. 1324.

150. Farrand immediately wrote to Secretary Hodel. Letter from Chris Farrand, Vice President, Government Relations, Peabody Holding Company, Inc., to Hon. Donald P. Hodel, Secretary of the Interior (July 5, 1985), I App. 577. Peabody did not follow its usual protocol with Edison by allowing Edison prior review of the letter because "there wasn't time." Notes of Richard M. Bertholf ¶ 4 (July 3, 1985), I App. 573.

151. Farrand's July 5, 1985 letter was routed to the BIA's Office of Trust Responsibilities by the Executive Secretariat in the ordinary course of business. *See* Letter from Chris Farrand (July 5, 1985), at 1, I App. 577 (marginalia indicating routing to "code 200"); Vollmann Dep. (Sept. 21, 1995) at 154, III App. 1615 (code 200 was for the BIA's Office of Trust Responsibilities).

152. SRP took matters into its own hands. On July 12, 1985, SRP's Director of Resource Planning provided to its Assistant General Manager for Governmental Affairs "some background information to assist you in whatever discussions you may have with Secretary Hodel and/or others." Memorandum from Darrell E.

Smith, Director, Resource Planning, SRP, to D.M. Rappaport, Assistant General Manager, Government Affairs, SRP 1 (July 12, 1985), I App. 579. Copies of that memorandum were provided to Leroy Michael, Jr., SRP's Assistant General Manager, and R.H. Silverman, SRP's General Counsel. *Id.* at 2, I App. 580.

153. The background information provided for Rappaport highlighted the additional coal royalties that would be borne by all NGS participants collectively, and SRP and BOR individually, if the royalty rate were finally adjusted to 20% or to the 12½% the companies hoped to achieve. *Id.* at attached table ("Amended Navajo Coal Supply Agreement, Indian Royalties"), I App. 582. For Arizona water costs (of BOR), this impact amounted to $177.5 million over existing royalty costs, and $85 million more than the 12.5% federal minimum that SRP hoped to achieve if the Secretary forced the Navajos to the bargaining table. Leroy Michael, Jr., "Impact of 20% Indian Coal Royalty on Arizona's Water and Electric Users" (n.d.) (hereinafter "Impact of 20% Royalty"), I App. 585; *see* Michael Dep. at 21-22, III App. 1345-46 (memos in all capital letters are those of Leroy Michael, Jr., SRP's Assistant General Manager). The difference in royalties for all NGS participants was estimated at $347.5 million when 20% royalty rate was compared with the federal minimum rate of 12½%. "Impact of 20% Royalty" at 1, I App. 585; Michael Dep. at 159-60, III App. 1368-69.

154. SRP provided this information to lobby Interior officials. Smith Dep. at 98-100, III App. 1541-43.

155. Michael also focused on the "United States' 24.3% interest in the Navajo Generating Station" in a handwritten memorandum to Rappaport. Handwritten

Draft Memorandum from Leroy Michael, Jr., to D.M. Rappaport 1 (n.d.), I App. 588.

156. Michael repeatedly warned that if the 20% royalty rate were affirmed for the 8580 Lease, "20% royalty will become the standard for the 1882 Reservation Lease [the 9910 Lease], as well." *Id.* at 2, I App. 589; Memorandum from Leroy Michael, Jr., to Mike Rappaport 2 (rec'd July 15, 1985), I App. 592 ("If the coal mined from the 1934 [8580] Lease goes to 20% royalty, the pressure to increase the royalty for coal from 1882 area will be a near impossible factor to deal with."); Michael Dep. at 146-48, III App. 1365-67.

157. Edison agreed with this view. Bridenbecker Dep. at 40-41, 103-04, II App. 920-21, 940-41.

158. Another SRP strategy to subvert the lawful appeal process was to have the Arizona congressional delegation intercede directly with Secretary Hodel. Handwritten Draft Memorandum from Leroy Michael, Jr., to D.M. Rappaport at 3 (n.d.), I App. 590; Memorandum from Leroy Michael, Jr. to Mike Rappaport at 1, 2 (rec'd July 15, 1985), I App. 591-92; Michael Dep. at 134-38, III App. 1360-64.

159. Edison's Bridenbecker was dissatisfied with Peabody's efforts to influence Hodel and, in essence, directed Peabody to retain Stanley W. Hulett, an extremely close friend and business associate of Hodel, to intercede directly with Hodel about the Appeal. Bridenbecker Dep. 97-105, II App. 934-42; Hulett Dep. (May 15, 1996) at 17, 25, 60-61, II App. 1220-21, 1237-38.

160. Hulett scheduled meetings with Hodel and Fritz on July July 16, 1985. Memorandum from R.M. Bertholf to file (July 16, 1985), I App. 593; Hulett Dep. (May 15, 1996) at 31-37, 72, II App. 1223-29, 1243.

161. At Moore's request, Peabody's Washington D.C., counsel, Edward Sullivan, arranged a dinner meeting with Leisse and Hulett in Washington on July 11, 1985. Memorandum from E.L. Sullivan to F.L. Barkofske (July 22, 1985), I App. 595; Leisse Dep. at 30, III App. 1316.

162. Leisse prepared Hulett to discuss the companies' view of the merits of the appeal with both Hodel and Fritz–it was to be a "gut issue" of Hulett's communications with Interior officials. Hulett Dep. (May 15, 1996) at 71, II App. 1242. Hulett admitted that his "mission . . . was to get the Secretary to prevent the royalty from going into effect at the point at which it had then been set . . . ." *Id.* at 11, II App. 1219; *see id.* at 32, 47, 62-63, II App. 1224, 1231, 1239-40.

163. A Peabody memorandum correctly summarizes the events of July 11, 1985 to July 17, 1985. Sullivan Dep. at 28-29, III App. 1561-62. It reads as follows:

COMPANY MEMORANDUM

TO: F.L. Barkofske – CONFIDENTIAL
DATE: July 22, 1985

FROM: E.L. Sullivan

RE: *Navajo Lease Royalty Rate Adjustment*

Ken Moore, President of Arizona Division, contacted me by telephone on July 11, 1985, and requested that I arrange a dinner meeting for Greg Leisse and a Mr. Stan Hulett. The President of Southern California Edison Company (So. Cal.) had recommened Mr. Hulett to Ken Moore. Mr. Hulett was a former upper level Department of the Interior employee whom So. Cal. believed may have some influence with the current Secretary of the Interior (Don Hodel). The dinner meeting was arranged to consider the prospect of Mr. Hulett discussing the Navajo Lease royalty rate adjustment with Secretary Hodel. Chris Farrand was informed of this matter and suggested that if it appeared that Mr. Hulett possessed the type of influence which would be required that we should make use of his services.

After our meeting with Mr. Hulett, Greg Leisse and I discussed the pros and cons of having Mr. Hulett act on Peabody's behalf. This included, among others, consideration of the following: (1) whether this activity would be considered an "*ex parte*" contact as part of Peabody's appeal of the Navajo Area Director's decision; (2) whether Mr. Hulett possessed the requisite influence; (3) the fact that So. Cal. recommended that Peabody make use of Mr. Hulett's services in the matter of the royalty rate adjustment; (4) the cost of Mr. Hulett's services; and (5) the interplay of a contact by Mr. Hulett on Peabody's behalf with the recently sent letter from Chris Farrand.

After weighing all factors, Greg and I agreed that we should allow Mr. Hulett to proceed on Peabody's behalf. He subsequently met with both Mr. Fritz (Deputy Assistant Secretary, Bureau of Indian Affairs) and Secretary Hodel on at least two (2) occasions. Secretary Hodel was sympathetic to Peabody's concerns and agreed that the parties to the lease should be encouraged to work out an agreeable resolution of the issue without interference from the Bureau of Indian Affairs. He agreed to, and subsequently did, sign a memo–

drafted in large part by Greg [Leisse] and myself–addressed to Mr. Fritz instructing him to (1) not make an untimely decision on the appealed case itself, and (2) encourage the parties to negotiate their differences.

I have been informed that the memo was delivered to Mr. Fritz's office on Monday, July 22, 1985.

Compensation for Mr. Hulett's services, according to Ken Moore, will be paid by the Arizona Division and will be passed on to our customer when coal shipments resume. The fee will be paid as a retainer, and spread over the remainder of the year (July-December) and will be in the range of $1,500–$2,000 per month. This arrangement will avoid the budgetary effects of a lump sum payment and will also allow Peabody to avail itself of Mr. Hulett's services again this year if such is deemed desirable. With Ken Moore's approval, Greg Leisse and I have been authorized to negotiate a firm monthly fee for Mr. Hulett within the range set out above.

I am available to provide additional information.

ES/mm /s/ E.L.S.

Memorandum from E.L. Sullivan to F.L. Barkofske (July 22, 1985), I App. 595-96.

* * * * *

165. The Navajo Nation was unaware of these *ex parte* contacts between Peabody and Interior officials. Hulett Dep. (June 24, 1997) at 24, 49-50, II App. 1245, 1248-49 (". . . I had no contacts with the Tribe at that

point that it would have made any sense for me to pick up the phone and say hey, oh, by the way, I'm going to do this to you."); Leisse Dep. at 68-69, III App. 1320-21.

166. However, the Navajo Nation did receive a copy of Farrand's July 5, 1985 letter to Secretary Hodel, and responded to it. Letter from Paul E. Frye, Navajo Nation Department of Justice, to Hon. Donald P. Hodel, Secretary of the Interior (July 11, 1985), I App. 599. In that response, the Navajo Nation objected to Peabody's attempt to circumvent the appeal procedures that it had initiated, stated that there were then no ongoing negotiations, and again urged that a decision on the Appeal be made "with all deliberate speed." *Id.* at 2, I App. 600.

167. As a result Farrand's and Frye's letters, the Solicitor's staff added one paragraph to the Decision Document " as sent forward for signature," as follows:

> On July 5 Peabody requested that the Secretary assume direct responsibility of this appeal and either postpone a decision or issue one in its favor. Peabody contended that delaying the decision would encourage a voluntary settlement of new lease terms. The Navajo Nation responded on July 11 that no negotiations were pending and urged the Department to issue a decision upholding the Area Director. We do not believe any delay in our consideration of the appeal is warranted without the support of both parties. Consequently, I am now issuing this decision affirming the Area Director.

Unsigned Letter from Deputy Assistant Secretary–Indian Affairs to Gregory J. Leisse, Peabody Coal Company, *et al.*1 (marginalia), 6 (n.d.) ("Revised Decision Document"), I App. 602, 607. The note "as sent forward for signature" on the first page of the Revised Decision Document is in the handwriting of Tim Vollmann, then Associate Solicitor for Indian Affairs. Everette Dep. at 59, II App. 1002.

168. The Revised Decision Document "as sent forward for signature" again "conclude[d] that 20% is a reasonable royalty rate and affirm[ed] the Area Director's decision." Revised Decision Document at 6, I App. 607. The Revised Decision Document again was intended to be "final for the Department." *Id.* And, for the second time, the Solicitor's Office rejected a procedure under which the Secretary would assume jurisdiction over the appeal. *Id.*; *see* Vollmann Dep. (Sept. 21, 1995) at 87, III App.1595.

169. The Revised Decision Document was forwarded to Fritz for his signature on or about July 15, 1985–the same day Sullivan and Leisse finished drafting the memorandum for Hodel's signature that would order Fritz to suppress the decision. Memorandum from Thorton W. "Whit" Field, Assistant Solicitor, Land and Minerals Branch, Division of Indian Affairs, to Deputy Assistant Secretary–Indian Affairs (July 15, 1985), I App. 609; Vollmann Dep. (Sept. 21, 1995) at 146-47, III App. 1613-14.

170. Before Fritz could sign the decision, he received orders from Secretary Hodel in the form of a July 17, 1985 memorandum. Memorandum from Donald Paul Hodel to John Fritz (July 17, 1985) (hereinafter "Hodel Memorandum"), I App. 613. The body of the memorandum signed by Hodel is identical to that drafted by Peabody's attorneys, with the exception of one word in the first line (Peabody's "attached "was changed to "enclosed"). *Compare id.*, I App at 615-16,

with Memorandum from E.L. Sullivan (July 22, 1985), at attached Peabody draft, I App. 597-98.

171. Although Fritz was "on the road" a lot from July 5, 1985 to August 5, 1985, Fritz Dep. at 165, II App. 1108, Hulett's July 16, 1985 meeting with Fritz ensured that Fritz would not act between then and when Fritz would hear from Hodel. Hulett Dep. (May 15, 1996) at 33-34, II App. 1225-26; Hulett Dep. (June 24, 1997) at 30, II App. 1247; *see* Everette Dep. at 97-100, II App. 1005-08.

172. Some DOI officials thought that Hulett was working for Interior during that time period because of his pervasive presence there. DeRocco Dep. at 52, II App. 993; Niedernhofer Dep. at 42- 43, III App. 1422-23.

173. Hodel's instructions to withhold the decision came to Fritz in a special blue envelope, which signified that it was an expedited memorandum, "a hand carry from the Secretary's office." Hulett Dep. (June 26, 1997) at 26, II App. 1246; Fritz Dep. at 160-164 II App. 1103-07.

174. Secretary Hodel's extraordinary instructions were the first departure from the orderly deliberative process envisioned by Fritz for the Appeal, and marked Fritz' final involvement with it. Fritz Dep. at 180, II App. 1116. Hodel's July 17,1985 memorandum to Fritz stayed the Appeal. Def.'s Resp. to Pl.'s Req. for Admiss. No. 103, III App. 1717.

175. Secretary Hodel had signed the memorandum Peabody drafted, which was dated and retyped on "personal" Secretarial letterhead by an unknown person in a form not conforming to basic Interior policy and "recorded after the fact" with no prior Departmental review—all in stark contrast to usual procedures.

Niedernhofer Dep. at 78-80, III App. 1426-28. "It just–it doesn't look right." *Id.* at 80, III App. 1428. Wilkinson-Flavin Dep. at 76-82, III App. 1643-49; Fritz Dep. at 177, II App. 1115; Burch Dep. at 137-38, II App. 955-56; Crosby Dep. at 53-55, II App. 968-70; Everette Dep. at 64-65, II App. 1003-04; Saunders Dep. at 61-62, III App. 1525-26; Vollmann Dep. (Sept. 21, 1995) at 155, III App. 1616.

* * * * *

182. Peabody was notified immediately by an unknown Interior official that the decision to affirm the 20% royalty rate had been suppressed. Memorandum from E.L. Sullivan to F.L. Barkofske 1 (July 22, 1985), I App. 595. Peabody immediately notified Edison and SRP of that success. Memorandum from RMB [Bertholf] to HFH [Huettemeyer] (July 26, 1985), I App. 614 (concerning Edison); Bertholf Dep. at 46, II App. 896; *see* Leisse Dep. at 133, III App. 1324.

183. SRP immediately dropped its congressional intercession strategy, Rapaport Dep. at 33-34, III App. 1462-63, although Fritz is "sure" that there were congressional inquiries into the matter, Fritz Dep. at 204-05, II App. 1125-26.

184. In issuing his memorandum to Fritz, Secretary Hodel "assume[d] personal jurisdiction" over the appeal. Fritz Dep. at 155-56, 166-67, II App. 1100-01, 1109-10.

185. Hodel's July 17, 1985 memorandum governed the Department for the next two and one-half years; they were considered "march or die" orders. Ryan Dep. at 75-80, III App. 1486-91; Field Dep. at 138, II App. 1038; Fritz Dep. at 163-64, II App. 1106-07; Memorandum from Frank Ryan, Deputy to the Assistant

Secretary–Indian Affairs (Operations), to Joe Johnston, Chief, Division of Energy and Mineral Resource (May 7, 1987), I App. 633; Memorandum from Joe [Johnston] to Frank [Ryan] (May14, 1987), I App. 634.

* * * * *

187. On July 19, 1985, under the mistaken belief that the formal appeal procedures were still in effect, Chairman Zah responded to Farrand's July 5, 1985 letter to Secretary Hodel. Letter from Peterson Zah, Chairman, Navajo Tribal Council, to Honorable Donald P. Hodel, Secretary of Interior (July 19, 1985), I App. 615. Zah stated that negotiations had stalled nine months previously and again urged that a decision on the Appeal be made "as soon as possible." *Id.* at 2, I App. 616.

188. Solicitor Richardson had left the Department shortly after Secretary Clark, and Marian Horn took over as Acting Solicitor and Principal Deputy Solicitor in June of 1985. Horn Dep. at 6, II App. 1160.

189. Vollmann was assigned to respond to Zah's letter. "Tasking Profile" received July 23, 1985, I App. 617; Vollmann Dep. (Sept. 21, 1995) at 160-63, III App. 1621-24.

190. Vollmann learned of Hodel's instructions to Fritz, which caused him to be "uncomfortable." Vollman Dep. (Sept. 21, 1995) at 164, III App. 1625.

191. Vollmann wrote to his superior Horn and sought an opportunity to brief Secretary Hodel about the conflict between Hodel's instructions and the interests of the Navajo Nation. Memorandum from Tim Vollman, Associate Solicitor–Indian Affairs, Principal Deputy Solicitor (July 26, 1985), I App. 618;

see Vollmann Dep. (June 10, 1997) at 11-12, III App. 1588-89.

192. Vollmann's memorandum to Horn recites that Secretary Hodel "instructed the Deputy Assistant Secretary–Indian Affairs to refrain from issuing a decision in this appeal[.]" Memorandum from Tim Vollmann, Associate Solicitor–Indian Affairs, to Principal Deputy Solicitor (July 26, 1985), I App. 618. In addition, Vollmann noted there that, if the Navajo Nation learned of Hodel's actions, it would likely transfer the Appeal to the Interior Board of Indian Appeals pursuant to 25 C.F.R. § 2.19, which would require the Secretary to assume jurisdiction over it publicly. *Id.* "This would likely result in a lawsuit by the Navajo Nation" or, "[a]t a minimum, [Hodel] would be subject to a deposition." *Id.*

193. Because Vollman did not know then that Peabody's lawyers had drafted Secretary Hodel's memorandum to Fritz, Vollmann Dep. (June 10, 1997) at 12-13, III App. 1589-90, Vollmann included the following comment in his memorandum to Horn:

> The Secretary's action may be challenged on the issue of ex parte contact if he has been in communication with Peabody and failure to provide the tribe the due process protections afforded by the administrative appeal process.

Memorandum from Tim Vollmann, Associate Solicitor–Indian Affairs, to Principal Deputy Solicitor (July 26, 1985) I App. 618.

194. Kelley drafted Vollmann's memorandum to Horn. *Id.* at 2, I App. 619; Kelley Dep. at 82-84, II App. 1288-90.

195. Vollman's memorandum sought Horn's prompt consideration of the concerns stated there because of the "sensitive nature of this appeal," Memorandum from Tim Vollmann, Associate Solicitor–Indian Affairs, to Principal Deputy Solicitor (July 26, 1985), I App. 618, by which Vollmann meant the threat of litigation, Vollmann Dep. (Sept. 21, 1995) at 168, III App. 1626.

196. A briefing and a meeting with Secretary Hodel were scheduled. Memorandum from Tim Vollmann, Associate Solicitor–Indian Affairs, to Principal Deputy Solicitor at post-it marginalia (July 26, 1985), I App. 620, 621 ("No memo but include in briefing 4 pm by Tim" and "Tim, for your meeting w/the Secretary. Whit [Field]."); *see* Horn Dep. at 52-56, II App. 1161-65; Vollmann Dep. (Sept. 21, 1995) at 169-70, III App. 1627-28.

197. The only recollection stated of either the scheduled briefing of Horn or the meeting with Secretary Hodel is that of Vollmann, who testified as follows:

> All I remember regarding any response to my memo to the principal deputy solicitor was a very brief conversation that I had with Marian Horn, and I can't remember the substance of that conversation. It was–it may have been no more than a few sentences, and I can't remember if she said she was going to talk to the Secretary or what. My best recollection is that she said she would talk to the Secretary, but, frankly, I can't really recall.

Vollmann Dep. (June 10, 1997) at 13, III App. 1590. Others recall nothing of these meetings. *E.g.*, Hodel Dep. at 161-62, II App. 1154-55; Horn Dep. at 52-56, II App. 1161-65; Kelley Dep. at 93-94, II App. 1291-92; Field Dep. at 123-24, II App. 1031-32.

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199. About a month after expressing his serious concerns about Secretary Hodel's actions and requesting Horn's early review "[b]ecause of the sensitive nature of this appeal," Vollmann responded to Zah's letter of July 19, 1985 to Hodel. Letter from Tim Vollmann, Associate Solicitor, Division of Indian Affairs, to Peterson Zah, Chairman, Navajo Tribal Council, *et al.* (Aug. 29, 1985), I App. 622.

200. Kelley drafted that letter, also. *Id.* at 2; Kelley Dep. at 96-98, II App. 1293-95.

201. The body of that letter states, in its entirety:

> The Secretary has received your letters dated July 19, July 5, and July 11, 1985, and has asked me to respond. Your letters concern an appeal filed by Peabody of the Navajo Area Director's decision adjusting the royalty rate on a Navajo coal lease with Peabody.
>
> As you are aware, the briefing schedule has been completed and a decision on the appeal is currently being considered by the Deputy Assistant Secretary –Indian Affairs and his staff. They are aware of both Peabody's and the Tribe's concerns regarding settlement but the decision has not yet been finalized. You of course will be informed when that decision is made.

Id. at 1, I App. 622.

202. In drafting that letter, Kelley carefully avoided informing the Navajo Nation about Secretary Hodel's instructions. Kelley Dep. at 123, II App. 1299. DOI tried to answer Zah's letter "without saying anything." *Id.* at 127, II App. 1300.

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204. Kelley, the drafter of that letter, testified that "if I was in the Navajo Nation's feet with that amount of information, yeah, I'd be upset; I'd be outraged." Kelley Dep. at 152-53, II App. 1307-08.

205. Vollmann himself opined that his August 29, 1985 letter to Zah violated the trustee's duty of candor to the Navajo Nation. Vollmann Dep. (Sept. 21, 1995) at 190-91, III App. 1633-34.

* * * * *

207. Peabody, SRP and Edison were fully informed of all the details of the Secretary's actions, however. *E.g.*, Memorandum from E.L. Sullivan to F.L. Barkofske (July 22, 1985), I App. 595; Memorandum from RMB [Bertholf] to HFH [Huettemeyer] (July 26, 1985), I App. 614.

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213. In the words of Frank Ryan, the head of BIA's Office of Trust Responsibilities:

> the message [of Hodel's instructions] was, we're not going to decide anything around here until you guys negotiate an answer that Peabody's going to like and that you [the Navajo Nation] can live with. It seemed to me that that was what the message was. Ryan Dep. at 148, III that App. 1514.

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220. Zah had campaigned in 1982 on a platform that emphasized the need to obtain equitable coal royalties. Zah Dep. at 25-27, III App. 1676-78. However, Zah had been unable to achieve anything greater than $37^{1/2}$¢ per ton for the 8580 Coal. *See supra* ¶¶ 217-218.

221. Zah was narrowly defeated by former Chairman MacDonald in the 1986 election although MacDonald had been investigated and prosecuted for various corrupt practices. Zah Dep. at 25-28, 62, III App. 1676-79, 1683; Back Dep. at 15-16, II App. 864-65.

222. MacDonald told Peabody that he wanted to wrap up negotiations with Peabody "as soon as possible." Kenneth R. Moore, Kenmor Resource Consultants, Inc., Draft "Letter/Report on Amended Leases: The Navajo Nation v. The United States of America" 7 (Sept. 28, 1994), I App. 781.

223. At the request of the Navajo Nation, Wilson Barber, who succeeded Donald Dodge as BIA's Navajo Area Director, inquired of Frank Ryan, the Deputy Assistant Secretary (Trust and Economic Development), as to the status of the Appeal. Barber Dep. at 5, 24-25, II App. 873, 874-75.

* * * * *

226. Contemporaneous notes emphasize that Barber would not be told of the true status of the Appeal unless Whit Field authorized it. Those notes state:

– Ltr. to Wilson [Barber] including status (above) **"*NOT*" WITHOUT WHIT'S APPROVAL**

Memorandum from Frank Ryan to Joe Johnston at marginalia (May 7, 1987), I App. 633 (emphasis in original).

227. Barber was refused a status report on the issue of the Appeal, the only time that this happened in his career concerning a matter within his area of responsibility. Barber Dep. at 25, II App. 875.

*   *   *   *   *

229. Pfister presented the deal to SRP's Board of Directors on September 14, 1987, stating that "the utility had been prepared to pay more." Guy Webster, "SRP home-electricity rates to rise 5.9%," *Arizona Republic*, Sept. 15, 1987 at F5, F7, I App. 641-42. Simultaneously, SRP raised its rates by 5.9%—$43.5 million per year–to pay for new corporate headquarters, a power plant expansion and increased operating cost. *Id.*

*   *   *   *   *

232. Peabody had contractually agreed to deliver 424 million tons of coal from its Black Mesa leases, but had rights to only 400 million tons there; the negotiated amendments allowed Peabody to mine 90 million more tons under the 8580 Lease. Moore Dep. (May 29, 1996) at 54, III App. 1388; Huettemeyer Dep. at 123, II App. 1189; Amendments to Coal Mining Lease No. 14-20-0603-8580 Between the Navajo Tribe and Peabody Coal Company 1-2 (executed Nov. 20, 1987) ("8580 Amendments"), I App. 643.

233. The total of 400 million tons in the Black Mesa leases was insufficient to meet the 35 year life requirements of NGS and Mohave. Moore Dep. at 53-54, III App. 1387-88. The additional coal secured through the amendments to the 8580 Lease alone extended the economic life of both NGS and Mohave by about eight years. *See* Huettemeyer Dep. at 128, II App. 1191; Smith Dep. at 67, III App. 1535.

*   *   *   *   *

237. Peabody and Edison faced "unrestricted Navajo tax increases" in future years. R.M. Bertholf, Dis-

cussion Summary–Indian Lease Negotiations 1 (n.d.) ("Discussion Summary"), I App. 637; *Kerr-McGee Corp. v. Navajo Tribe*, 471 U.S. 195 (1985) (upholding Navajo tax laws); *Commonwealth Edison Co.* v. *Montana*, 453 U.S 609 (1981) (upholding . . . coal severance tax of up to 30% of the contract sales price). The Navajo Nation effectively capped its taxes at 8%. 8580 Amendments at 18, I App. 60; Discussion Summary at 1, I App. 660, Discussion Summary at 1, App. 637.

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248. The Navajo Nation requested BIA review of the 8580 Amendments in a letter to Barber dated September 16, 1987. Letter from Michael P. Upshaw, Attorney General, Navajo Nation, to Wilson Barber, Area Director, BIA (Sept. 16, 1987), I App. 687 ("We hereby request the Bureau of Indian Affairs to initiate its technical review of these documents for the approval of the Secretary of the Interior."); Barber Dep. at 28, II App. 877.

249. The Navajo Area Office, still in the dark about Hodel's instructions, invoked normal procedures and requested E&M to review the lease amendments. Memorandum from Assistant Area Director, Navajo, to Division of Energy & Minerals Resources (Sept. 23, 1987), I App. 688. The Area Office specifically requested E&M to

> review the amendments and provide the Navajo Area Minerals Section with your comments[,] recommendations and/or your concurrence and other requirements or stipulations that would improve the amendment economically and environmentally in the best interest of the Navajo Nation.

Id.

250. The Area Office made that request to determine if the Navajo Nation was receiving the maximum benefit for its nonrenewable resource. Barber Dep. at 29, II App. 878.

251. The Navajo Area Office did not receive a response to that request. Barber Dep. at 30, II App. 879; Field Dep. at 143, II App. 1039.

252. The usual meaningful review requested by the Navajo Area Office was not to happen because the approval process had degenerated into a rubber-stamping exercise: "The way this happened was, we were rubber stamping a bunch of amendments that we weren't supposed to review . . . ." Ryan Dep. at 132, III App. 1505.

253. As Ryan testified, "The bottom line on this whole thing is just a confirmation, a sprinkling of holy water on this agreement that the Navajo and the energy company came up with." *Id.* at 128, III App. 1504.

254. Field "assisted Peabody in shepherding the amended leases through the Department in late 1987 and early 1988 for Secretarial approval." Memorandum from E.L. Sullivan, Peabody, to D.L. Stevenson, Peabody (June 5, 1989), I App. 771; Sullivan Dep. at 127, III App. 1567.

255. Field assigned the legal review of perhaps the largest Indian mineral transaction in history to an inexperienced Edwin Winstead, the newest member of the Solicitor's Office at the time. Winstead Dep. at 14-17, 170 ("I was probably the only one with time because I had just started and everybody else was going nuts, so it made sense to give it to me, I'm sure."), III App. 1655-58, 1671.

256. Winstead had no significant experience in mineral royalty or economic issues, Indian law, trust law, mineral negotiations or mineral leasing. *Id.* at 14-17, 22-23, 175, III App. 1655-58, 1659-60, 1672. This was "one of his first assignments." Field Dep. at 144, II App. 1040.

257. Winstead was vaguely aware that an appeal related to Peabody was pending, but he "really didn't have the time at that point [late 1987] in trying to get the review done in the time frame that everybody wanted it done and to try to find other documents." Winstead Dep. at 37, III App. 1663.

258. Winstead saw his job as "just flagg[ing] the major legal issues." *Id.* at 24, III App. 1661.

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260. Field did not tell Winstead that a decision had been drafted for Fritz' signature that would have affirmed the 20% royalty rate as final for the Department. *Id.* at 75, III App. 1664.

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262. Winstead's first memorandum observed that the lease amendments violated three regulations, including one governing the conduct of negotiations. Memorandum from Edwin Winstead, DOI, to Whit Field, DOI 2 (Nov. 3, 1987), I App. 690 (discussing, *inter alia*, 25 C.F.R. § 211.2).

263. These regulations are intended to benefit and protect Indian tribes. Winstead Dep. at 110, III App. 1665.

264. The record is devoid of any advance written permission to negotiate granted by the Department to the Navajo Nation, contrary to the regulations.

Aubertin Dep. Vol. II at 11, 72-73, II App. 830, 861-62; Ryan Dep. at 145-46, III App. 1511-12; Swimmer Dep. at 119, III App. 1578; Hughes Dep. at 164, II App. 1211.

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267. On November 24, 1987, the Navajo Area Office recommended approval of the lease amendments "based on the information we have." Memorandum from Assistant Area Director, Navajo, to Deputy to the Assistant Secretary–Indian Affairs (Trust and Economic Development) (Nov. 24, 1987), I App. 692.

268. This recommendation was based on the belief that "the BIA office at Lakewood, Colorado [E&M] submitted comments based on an in depth technical review of both lease amendments." *Id.*

269. In fact, no such review had been done. Aubertin Dep., Vol. I at 164-65, II App. 820-21.

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271. Thus, Peabody submitted the lease amendments directly to Secretary Hodel's office, as Field's chronology states. Memorandum from Assistant Solicitor, Branch of Land & Minerals, DOI, to Deputy Solicitors, DOI 2 (Dec. 9, 1987), I App. 694 (Nov. 27, 1987 entry states "Advised by Secretary's Office amendments had been submitted by Peabody"); *see* Farrand Dep. at 80, II App. 1021.

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275. Indeed, the Navajo Nation had raised royalty rates 12½% on other leases that did *not* have any reopener or royalty adjustment feature unlike the 8580 lease. Huettemeyer Dep. at 78, II App. 1180 (Utah International lease royalties raised without adjustment

feature); Zaman Dep. at 12, 71-72, III App. 1694, 1699-700.

*   *   *   *   *

277. No economic analysis of the Peabody lease amendments–indeed, not even a comparison of those amendments to the 20% royalty rate that all Departmental studies had concluded was reasonable and appropriate–was ever done. Aubertin Dep. Vol. I at 102, 164-65, II App. 804, 820-21; *see* Swimmer Dep. at 122-23, III App. 1579-80; Rai Dep. at 111, III App. 1458 (no one disagreed with propriety of 20% royalty rate).

278. The merits of the transaction were simply irrelevant to high-level DOI officials. Ryan Dep. at 127-28, 132, III App. 1503-04, 1505.

279. Late in the afternoon on Thursday, November 26, 1987, Johnston told E&M Assistant Chief Don Aubertin to perform a "technical review" of the lease amendments. Aubertin Dep. Vol. I at 130-33, II App. 807-10.

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281. Aubertin's assignment was "[t]o review . . . the negotiated amendments and provide our views on it as–how we felt about that, as acceptable or non-acceptable or whatever." *Id.* at 139, II App. 811.

282. Aubertin was told to have his "technical review" in Washington by the following Tuesday, December 1, 1987. *Id.* at 132, II App. 809.

283. Aubertin was given an unreasonably short period to do any technical analysis of the lease amendments, given the magnitude of the work that should have been done. *Id.* at 130, 139, II App. 807, 811;

id. Vol. II at 42, II App. 844; Swimmer Dep. at 157-58, III App. 1584-85.

284. Because of the unreasonably short deadline, Aubertin:

(a) did not do an economic analysis of the amended lease terms. Aubertin Dep. at Vol. II at 42-43, II App. 844-45.

(b) did not calculate the present value of lease revenues to the Tribe or employ discounted cash flow methods of analysis. *Id.* at 41-42, III App. 843-44; Swimmer Dep. at 123, III App. 1580.

(c) did not determine whether the *in futuro* payments for the new coal rights reflected fair market value. Aubertin Dep. Vol. II at 21-22, 44, II App. 833-34, 846.

(d) did not analyze the economic impact of a tax waiver provision that applied to 90 million tons of coal. *Id.* at 67-68, II App. 859-60.

(e) did not analyze the market for coal under the 8580 Lease. *Id.* Vol. I at 77-78, II App. 797-98.

(f) made errors in mathematical calculations. *Id.* Vol. II at 60-61, II App. 855-56.

(g) did not have basic reference materials needed for his review. *Id.* at 46, II App. 848.

(h) received no staff support. *Id.* at 44, III App. 846.

See Johnston Dep. at 119-30, II App. 1258-69 (E&M was not requested to analyze various factors; BOM should have been asked to do so but was not).

* * * * *

286. The Secretary's right to adjust the royalty rate periodically, as in the original 8580 Lease, was "extremely valuable" to the Navajo Nation. *Id.*, Vol. II at 23-24, II App. 835-36.

287. Aubertin acknowledged that the coal under the 8580 Lease is in a well-established field with infrastructure in place, that the coal is good coal ("compliance" coal under EPA regulations), that the markets for the coal are both well-established and captive, that there is not a lot of overburden, and that there is a fairly low strip ratio–all of which would support a significant royalty to the Navajo Nation. *Id.*, Vol. I at 97-101, II App. 799-803.

288. Aubertin observed that the Hopi Tribe, which had no ability to adjust the royalty rate under its lease, had obtained better results in their negotiations than the Navajo did–even ignoring the $88 million in back taxes and royalties that the Navajo Nation relinquished and the Hopi Tribe did not. *Id.*, Vol. II at 60, 64-65, II App. 855, 857-58; *accord* Smith Dep. at 137-38, III App. 1547-48.

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294. Aubertin did not know if or to what extent the Navajo Nation waived back taxes in order to get the federal minimum royalty rate even though he recognized the importance of that information for review of the 8580 Amendments. *Id.* at 159, II App. 818 ("Well, it would have been obviously good to know.").

295. Such economic negatives were "never brought to [Aubertin's] attention." *Id.* at 162, II App. 819.

296. No other "technical review" was performed in reviewing the 8580 Amendments. *Id.* at 128, II App. 806.

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298. Aubertin then recommended approval of the 8580 Amendments based on additional erroneous assumptions that the combined royalty and tax receipts by the Navajo Nation would equal 20.5% for the 8580 Lease, which he incorrectly believed was coextensive with the Kayenta Mine. Aubertin Dep. Vol. I at 167-68, II App. 822-23, *id.*, Vol. II at 50, II App. 852.

299. Aubertin's assumption is erroneous; because of the tax waiver for Peabody coal used at NGS, the total of royalties and taxes received by the Navajo Nation on that coal cannot exceed 12 1/2%. Shirley Decl., III App. 1816.

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301. Aubertin would not have recommended approval of the lease amendments if he had known that the Navajo nation would obtain only 12 1/2% for its coal mined at Peabody's Kayenta Mine. Aubertin Dep. Vol. II at 51, II App. 853.

302. Aubertin's opinion is that a 12 1/2% royalty rate for that coal would not be in the best interest of the Navajo Nation. *Id.* at 52, II App. 854.

303. Aubertin dutifully faxed his hurried and mistake-ridden "technical review" to Washington at 6:36 a.m. on Wednesday, December 2, 1987. Memorandum from Assistant Chief, Branch of Energy and Mineral Resources, BIA, to Frank A. Ryan, Deputy Assistant Secretary–Indian Affairs (Trust and

Economic Development) (Dec. 2, 1987), I App. 700; Aubertin Dep. Vol. I at 132, II App. 809.

* * * * *

307. The Solicitor's Office finished its legal review on December 1, 1987. Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary–Indian Affairs (Dec. 1, 1987), I App. 715.

308. The Acting Associate Solicitor's review "was not intended to cover economic issues." Hughes Dep. at 101, II App. 1198.

309. The first paragraph of the Acting Associate Solicitor's memorandum states, in part: "We submit the following analysis without having received BIA's NEPA and economic analyses. We will supplement this document after we have received and analyzed those documents." Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary–Indian Affairs 1 (Dec. 1, 1987), I App. 715.

310. No economic analysis concerning this matter was received by the Solicitor's office for comment. *Id.*

311. Thus, no supplement to that memorandum was prepared. Hughes Dep. at 104, II App. 1199.

312. Field did not inform Hughes that a decision document had been drafted that would have upheld the 20% royalty rate. *Id.* at 117, II App. 1200.

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314. The Acting Associate Solicitor was "not able to determine how or if" a provision signifying a non-standard method of calculating the royalty "may affect the Tribes." Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary–Indian

Affairs 2-3 (Dec. 1, 1987), I App. 716-17. The memorandum continues, "[i]n any case, this is primarily an economic issue which should be examined in the Bureau of Indian Affairs economic analysis." *Id.* at 3.

315. This method of calculating royalties resulted in royalty payments lower than the minimum allowable for federal coal. *See* Bertholf Dep. at 93-94, II App. 902-03.

316. That issue was not addressed in the BIA's "technical review." *See* Memorandum from Assistant Chief, Branch of Energy and Mineral Resources, BIA, to Frank A. Ryan, Deputy Assistant Secretary–Indian Affairs (Trust and Economic Development) (Dec. 2, 1987), I App. 700.

317. The Solicitor's office expected a conversational approach with BIA to assure that such issues were addressed by DOI. Hughes Dep. at 147-50, II App. 1205-08.

318. Acting Associate Solicitor Hughes expected that BIA's economic analysis would quantify a proper bonus for the additional coal dedicated to Peabody in the lease amendments, the consequences of the enormous tribal tax issues, and expected costs associated with the replacement of periodic Secretarial royalty adjustments with an arbitration scheme not involving the United States as trustee. *Id.* at 150, 153, 171-73, II App. 1208, 1209, 1212-14.

319. Aubertin's "technical review" did not address these matters. Memorandum from Assistant Chief, Branch of Energy and Mineral Resources, BIA, to Frank A. Ryan, Deputy Assistant Secretary–Indian Affairs (Trust and Economic Development) (Dec. 2, 1987), I App. 700.

320. The Acting Associate Solicitor's memorandum discusses the provisions related to Navajo taxes, with no attempt to quantify the losses to the Navajo Nation. Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary–Indian Affairs, App. I at 23-24 (Dec. 1, 1987), I App. 747-48.

321. Without knowledge of those provisions, Aubertin's "technical review" included the following:

<u>Tribal Taxation</u>

No Comment.

Memorandum from Assistant Chief, Branch of Energy and Mineral Resources, BIA, to Frank A. Ryan, Deputy Assistant Secretary–Indian Affairs (Trust and Economic Development) (Dec. 2, 1987), attachment at 3, I App. 705; *see* Ryan Dep. at 132, III App. 1505 ("The trust people thought that that should be handled by the Solicitor's people.")

322. The lease amendment approval package went to Ryan for his review and recommendation. Ryan Dep. at 119-20, III App. 1498-99.

323. Ryan reviewed the amendments, and "thought some of them were–were wrong." *Id.* at 120-22, 125, III App. 1499-1501, 1502.

324. A memorandum recommending approval of the lease amendments was drafted for Ryan's signature. Memorandum from Deputy to the Assistant Secretary–Indian Affairs (Trust and Economic Development) to Assistant Secretary–Indian Affairs (Dec. 9, 1987), I App. 759.

325. Ryan refused to sign it.

> A. Oh, yes. This is bringing this back. This is–this is out of my shop. I just remembered something. I remember, I saw this memo. This came to me, and I didn't sign it. I refused to sign it.
>
> Q. That's interesting. And your reasons for refusing to sign that?
>
> A. I knew–well, I thought that I would be participating in a breach of trust, and I thought the only honorable thing to do when you work someplace that you feel like you have to do that is to resign. And that's what I had done.

Ryan Dep. at 141, III App. 1510.

326. Ryan tied the breach of trust directly to the violation of the regulation governing the conduct of negotiations and to Secretary Hodel's intervention. *Id.* at 146-48, III App. 1512-14.

327. Shirley Crosby was an administrative employee in the Bureau of Indian Affairs with no training or expertise in mineral leasing, mine economics or mineral negotiations. Def.'s Resp. to Pl.'s Req. for Admiss. No. 104, III App. 1718; Fritz Dep. at 198-99, II App. 1121-22; Crosby Dep. at 15-16, II App. 963-64 (Determining royalty rates was strictly out of my bail[i]wick."); *id.* at 37, II App. 967 ("I don't know anything about royalties.").

328. Ryan having refused to sign the recommendation, Crosby did. Memorandum from Deputy to the Assistant Secretary–Indian Affairs (Trust and Economic Development) to Assistant Secretary–Indian Affairs (Dec. 9, 1987), I App. 759.

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330. Crosby testified that she would not have signed the recommendation if she had known Ryan's position. Crosby Dep. at 76-77, II App. 975-76.

331. The package forwarded to Assistant Secretary Swimmer and later to Secretary Hodel did not include Aubertin's "technical review" or any other economic analysis. Memorandum from Deputy to the Assistant Secretary–Indian Affairs (Trust and Economic Development) to Assistant Secretary–Indian Affairs (Dec. 9, 1987), I App. 759; Swimmer Dep. at 134-35, III App. 1581-82; Field Dep. at 190, II App. 1046; Hughes Dep. at 139-40, II App. 1202-03; Crosby Dep. at 74-76, II App. 973-75; *see* Fritz Dep. 199-200, II App. 1122-23 ("The least they could have done was bring forth the analysis that had been done previously as part of the process that we had in 1985."); Memorandum from Assistant Secretary–Indian Affairs to Secretary (Dec. 9, 1987), I App. 760; Hughes Dep. at 139-40, II App. 1202-03.

332. Swimmer did not even ask for a comparison of the economic package that was negotiated versus simply plugging in a 20% rate into Article VI of the original 8580 Lease. Swimmer Dep. at 138, III App. 1583.

333. Peabody meanwhile continued to lobby Interior officials *ex parte*. *E.g.*, Memorandum from RMB [Bertholf] to CGT [Thompson] (Dec. 1, 1987) at marginalia, I App. 699 (note dated 12/4 reads: "Wed 12/9 latest anticipated 'Hodel execution' date per Peabody"); *see* Bertholf Dep. at 89, II App. 901; Farrand Dep. at 86, II App. 1027; Memorandum from Assistant Solicitor, Branch of Land & Minerals, DOI, to Deputy Solicitor,

DOI 2 (Dec. 9, 1987), I App. 694 (December 9, 1987 entry in Field's chronology reads "Discussed language in proposed Secretarial Approval with Farrand and are very close to a consensus.").

334. In a memorandum drafted in part by Field, Assistant Secretary Swimmer recommended to Secretary Hodel that he approve the lease amendments. Memorandum from Assistant Secretary–Indian Affairs to Secretary (Dec. 9, 1987), I App. 760.

335. Peabody assisted in the drafting of that memorandum. Def.'s Resp. to Pl.'s Req. for Admiss. No. 112, III App. 1722.

336. Swimmer justified his recommendation by the assertion "that the parties have negotiated at arm's length, in good faith to reach these agreements," the same justification that the Department had offered 22 years earlier for the original unconscionable deal. *Compare* Memorandum from Assistant Secretary–Indian Affairs to Secretary 1 (Dec. 9, 1987), I App. 760, *with* Letter from Richard F. Allan, Associate Solicitor, Indian Affairs, to Reed Moyer, Associate Professor, Michigan State University 1 (Oct. 19, 1965), I App. 166.

337. The Department officials in charge of trust responsibilities recognized throughout that the Navajo Nation could not bargain on an equal footing with Peabody. Fritz Dep. at 219-20, II App. 1127-28; Ryan Dep. at 156-61, III App. 1516-22.

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339. After a scheduled meeting with Peabody executives on December 8, 1987, arranged by the National Coal Association, *see* Memorandum from E.L. Sullivan to H.W. Williams (Dec. 1, 1987), III App. 1822-24, Sec-

retary Hodel formally approved the lease amendments on December 14, 1987. Secretarial Approval (Dec. 14, 1987), I App. 764.

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341. Peabody drafted parts of the Secretarial Approval document. Resp. to Req. for Admiss. No. 111, III App. 1721; Notes entitled "Dictated from Chris Farrand" (Dec. 9, 1987), I App. 766.

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343. Secretary Hodel approved amendments that eliminated the trustee's ability to adjust the royalty rate. 8580 Amendments at 8, I App. 650 (deleting Article VI of the 8580 Lease).

344. The 8580 Lease had contemplated this abrogation of the trustee's authority only "in the event of termination of federal jurisdiction." 8580 Lease at 7, I App. 649.

345. That phrase was remnant of the discredited and congressionally-abandoned "termination" era of federal/Indian relations. Fritz Dep. at 54, II App. 1062.

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347. The United States has never relinquished its ability to adjust royalty rates for federal, as opposed to Indian, coal. Hodel Dep. at 88-89, II App. 1146-47.

348. Pursuant to the lease amendments, on December 18, 1987, the Acting Assistant Secretary–Indian Affairs vacated the Area Director's adjustment of the royalty rate. Letter from W.P. Ragsdale, Acting Assistant Secretary–Indian Affairs, to Gregory J.

Leisse, Peabody Coal Company, *et al.* (Dec. 18, 1987), I App. 767.

349. Three days later, SRP–which had estimated an adverse impact of $347 million for just the Arizona consumers of NGS of the 20% royalty rate compared to the federal minimum–determined that "the impact of the approval of the new lease amendments should be negligible." Memorandum from Darrell E. Smith, Director, Resource Planning, SRP, to A. J. Pfister, General Manager, SRP (Dec. 21, 1987), I App. 770.

350. Summaries prepared by Edison's management for Edison's upper management show, among other things, that the Navajo Nation lost at least $89,000,000 in back taxes and royalties immediately upon Hodel's approval of lease amendments. "Cost-Benefits," I App. 636; "Discussion Summary," I App. 637; *see* Bertholf Dep. at 66-67, II App. 897-98.

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