No. 07-1410

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 III)

GREGORY G. GARRE
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Counsel of Record
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PETITION FOR A WRIT OF CERTIORARI FILED: MAY 13, 2008
CERTIORARI GRANTED: OCTOBER 1, 2008

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Report on

THE NAVAJO

Long-Range Program of Navajo Rehabilitation

March 1948

United States
Department of Interior
Washington 25, D. C.

J. A. Krug	William Zimmerman, Jr.	J. M. Stewart
Secretary of the Interior	Acting Commissioner Bureau of Indian Affairs	General Superintendent Navajo Agency

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* * * * *

In summary, the expert testimony of these two witnesses leads to one conclusion: that the Federal Government, faced with several alternatives, has consistently opted for the one of least benefit to the Navajo people and their land and the one most likely to perpetuate a welfare existence on the reservation. The choice, as Dr. Aberle summed it up, is the "difference between running a relief economy and running a development economy."[100] And for 100 years, the Federal Government, as the hearing went on to discuss, has hampered and even blocked Navajo development.

* * * * *

The questions of land reclamation, water rights, adequate royalties or profit sharing, the amount of employment and the degree of managerial training for Navajos—all are issues on which the tribe is in serious and urgent need of both technical and legal advice from trustworthy sources. On none of these issues, as the testimony repeatedly asserted, has the Federal Government, as trustee of the tribal lands, provided that necessary expertise.[117] On all accounts, either by negligence

[100] Testimony of Dr. David Aberle, p. 89.

[117] Herbert Becker, special assistant to the Associate Solicitor, Division of Indian Affairs, DOI, comments: "A generalization such as this

or deliberate bias, the Government's weight has been on the wrong side of the bargaining table.

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is impossible to comment on given the vagueness of the allegation. I can say, though, that our Division recognizes its high responsibility and adheres to the most exacting standards in enforcing the trust responsibility, which includes instituting legal actions on behalf of tribes to protect their resources. Because of this responsibility, we have established a Field Office in Window Rock, Arizona, made up of two lawyers who are in continual contact with the Navajo Tribe. It should also be recognized that in many instances, which are beyond our control, administrative decisions are made within the Department which result in the Indian position being discarded in favor of the interests of another group/client in the Department which the Administration feels has a paramount interest." Letter from Mr. Becker to John A Buggs, Staff Director, USCCR. (The Field Office was established in 1974.)

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF THE INTERIOR

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

[June 30, 1977]

Mr. Peter MacDonald
Chairman, Navajo Tribal Council
Window Rock, Arizona 86515

Dear Chairman MacDonald:

After carefully reviewing the proposed Navajo-El Paso —Consolidation coal lease, I have decided to take no action until the royalty rate is renegotiated. I have concluded that, as trustee, I cannot approve a lease which would return to the beneficiaries of the trust less than I would be required by law to charge for the trustee's in this case the Nation's identical resources. A royalty of 12½ percent is now mandated for Federal coal leases under the Federal Coal leasing Amendment Act of 1975. I realize that at the time you were first negotiating this lease that law had not yet passed. However, it is *now* the law, and in my opinion 12½ percent should be the absolute minimum in any Indian lease as well. A complete financial analysis made by the United States Bureau of Mines indicates a 12½ percent royalty rate would yield a substantially higher return to the Tribe while providing an adequate return to the companies.

Under the terms of the original 1968 lease, the Secretary of the Interior has the authority to review and adjust the royalty terms at the end of 1978. Were I to ap-

prove the proposed renegotiated lease, I would be forfeiting the opportunity to renegotiate for an additional 5 years.

The labor agreement between the Tribe and the companies is a great improvement. It was not a part of our financial analysis of the lease because we believe that a strong labor agreement should be a non-negotiable accompaniment to any lease, and should be external to the negotiation of financial terms.

Although we realize the importance of the $5.6 million advance royalty bonus payment, that must be considered in relation to the total needs of the Navajo Nation, and in light of the substantial benefit to be gained by negotiating a higher royalty. The advance payment, although it may be delayed somewhat, can still be part of the lease.

In closing, I know that both you and I wish to secure the best possible terms on any negotiation, and I am placing the technical expertise of the Department of Interior at the disposal of the Navajo Nation.

Sincerely,

/s/ Cecil D. Andrus

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH Chairman, Navajo Tribal Council	*EDWARD T. BEGAY* Vice Chairman, Navajo Tribal Council

[SEAL OMITTED]

[Mar. 28, 1984]

Honorable William Clark
Secretary, Department of the Interior
18th & C Street, N.W.
Washington, D.C. 20240

Subject: Adjustment of royalty provision of coal mining Lease No. 14-20-0603-8580 held by Peabody Coal Company and other existing Navajo Tribal Coal leases

Dear Mr. Secretary:

This is to inform you that Peabody Coal Company holds the above mentioned coal mining lease on Navajo land. A copy of the lease is enclosed herewith for your reference. The original lease agreement was entered into between the Navajo Nation and Sentry Royalty Company on February 1, 1964 and approved by the Department of Interior on August 28, 1964. Sentry Royalty Company later assigned the lease to Peabody Coal Company.

Pursuant to Article VI of the lease the royalty rate is subject to reasonable adjustment by the Secretary at

the end of twenty years from its effective date which is August 28, 1984. The current average royalty rate is approximately 37 cents per ton which translates into about 2.0% of the gross proceeds. As you are aware the current minimum royalty rate for coal mined on other Federal lands is 12.5%. We believe that considering the quality of the coal on the PCC Lease, prevailing economic conditions an adjustment substantially in excess of 12.5% would be warranted. Simply equity, however, indicates that the minimum royalty payable to the Navajo Nation from the above lease should not be less than 12.5% of the gross realization.

I also take this opportunity to draw your attention to the fact that there are other Navajo coal mining leases which pay outrageously low royalties but include no provision for periodic adjustment of the royalty rates as provided in all non-Indian Federal coal leases. I request you to adjust the royalty provision of the coal mining lease with Peabody Coal Company and seek your assistance and support in securing the voluntary adjustment of the royalty provisions of other coal mining leases which are presently unfair and inequitable to the Navajo Nation. The Navajo Nation will be glad to answer any question and provide all necessary information which you or your staff may require.

Yours sincerely,

THE NAVAJO NATION

/s/ PETER ZAH
PETERSON ZAH, Chairman
Navajo Tribal Council

:rm

Enclosure

cc: David Baldwin Energy & Mineral Res., Lakewood, CO

Kenneth Smith, Asst. Secretary of Interior, DOI, DC

UNITED STATES GOVERNMENT
MEMORANDUM

Date: April 25, 1984

Reply to
Attn of: Mining Engineer, Division of Energy & Mineral Resources, Golden CO

Subject: Adjustment of Royalty Provisions; Navajo Coal Leases

To: Chief, Division of Energy & Mineral Resources, Washington, D. C.

Reference is made to the letter of the Chairman of the Navajo Tribal Council, dated March 26, 1984, copy of which is enclosed, requesting the Secretary of the Interior to adjust the royalty provisions of coal mining lease No. 14-20-0603-8580. Chairman Peterson Zah is also seeking the assistance and support in securing the voluntary adjustment of the royalty provisions of other Navajo coal mining leases.

* * * * *

All five (5) coal leases were approved approximately 20 years ago or more. The royalty provisions, probably fair at the time of approval, do not reflect current economic conditions and market situations. The Navajo and Hopi coal royalties are much lower than the royalty rates of 12½% for surface and 8% for underground mining, now mandated for federal coal leases. They are unfair to the tribes and need to be adjusted.

Navajo coal lease No. N00-C-14-20-2190 was renegotiated and amended. The adjusted royalty rate is 55¢/ton or 12½% of the value of the coal, whichever is greater.

The royalty rates for Navajo coal leases 14-20-0603-2505 and 14-20-0603-9910 cannot be changed without the consent of the parties to the lease. The same provision is included in Hopi coal lease 14-20-0450-5743.

The royalty provisions of Navajo coal lease 14-20-0603-8580 are subject to reasonable adjustment by the Secretary of the Interior at the end of the first 20 years. This would be August 28, 1984.

/s/ D.L. CRAMER BORNEMANN
D.L. CRAMER BORNEMANN

Attachments

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CONFIDENTIAL

May 30, 1984

INTER-OFFICE MEMORANDUM

To: Lare Aschenbrenner,
Deputy Attorney General

From: /s/ PAUL FRYE
Paul Frye, Attorney

Subject: Readjustment provision in Peabody lease

I. QUESTIONS PRESENTED

You asked me this week to determine, with respect to the Peabody lease, two things:

(1) Would action by an authorized representative of the Department of the Interior in retroactively raising the royalty rate back to an asserted "effective date" of February 1, 1984 be effective?

(2) What types of due process safeguards are required, in general, of the Department of the Interior in making a "reasonable adjustment" of the royalty under Article VI of the Peabody lease.

II. CONCLUSIONS

With respect to the first question, such an action would not be upheld either within the Department of the Interior or in the courts. Indeed, if we even intimated to Peabody that the effective date of the lease was prior to August of 1964, we may be making a most damaging admission against interest. As it is, by waiting until this time to require Secretarial notification of royalty adjust-

ments, we may well have forfeited any possibility of receiving an adjusted royalty until 1994 under this lease.

With respect to the second question, it appears that the Secretary or his authorized delegate must only notify Peabody, prior to the expiration of the twenty year period, of a royalty which he or she considers reasonable, granting appeal rights within Interior to Peabody to challenge the decision as unreasonable.

III. DISCUSSION

A. RETROACTIVE ADJUSTMENT

1. The Law Prior to 1982

Prior to 1982, the Department of the Interior consistently held that:

1. BLM may readjust a coal lease issued pursuant to 30 U.S.C. § 207[1] within a reasonable period after expiration of its 20-year primary term;
2. BLM's failure to readjust within the primary term did not constitute a waiver of readjustment rights and such failure does not estop BLM from subsequently readjusting the royalty;
3. Such subsequent readjustments do violate the due process rights of the lessee.

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[1] The critical language is as follows:

> Such rentals and royalties and other terms and conditions of the lease will be subject to readjustment at the end of its primary term of twenty years and at the end of each ten-year period thereafter if the lease is extended.

California Portland Cement Co., et al., 40 I.B.L.A. 339 (1979).[2] *See, Garland Coal & Mining Co.*, 49 IBLA 400 (1980) (BLM notified lessee on February 5, 1980 that the royalty of a 1958 lease would be adjusted to 12½% as of May 1, 1980).[3]

2. The Law after 1982

On January 8, 1982, the Tenth Circuit decided *Rosebud Coal Sales Co., Inc. v. Andrus*, 667 F.2d 949, and *California Portland Cement Company*, 667 F.2d 953. In *Rosebud*, the Department gave notice of its proposed readjustment 2 1/2 years after the expiration of the primary term. The court concluded

> that the Department's attempt by retroactive regulations and by a belated notice to readjust the coal lease in issue was outside of the statutory authority of the Department and contrary to the terms of the lease. The opportunity to adjust the lease pursuant to the Mineral Leasing Act was presented but the Department chose to forego it.

Id., at 953. This was held despite the fact that the Department was extremely busy and that the Department,

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[2] The IBLA reporter is missing this decision. This synopsis is taken from the Index-Digest, at 147.

[3] A review of the IBLA decisions revealed that the Congress, in 1920, had required leases to have royalty readjustment terms. This is relevant to the previous speculation, regarding the Utah lease, that the insertion of such terms was not common practice in 1953. The Department appears to have consistently followed the 1920 Act. *See, e.g., The Montana Power Co.*, 72 I.D. 518 (1965), *Emmett K. Olson*, A-24801 (1947). The effect of the 1976 FCLA Amendments on pre-1976 leases is discussed at 88 I.D. 1003 (1981) (Solicitor's Opinion) and *Lone Star Steel Co.*, 71 IBLA 92 (1983).

in "scattered instances," sent notices after the lease anniversary. *Id.*, at 952. The *California* case implicitly recognized that the date of approval of an assignment of a lease was the relevant date for calculation of the anniversary date.

After *Rosebud* and *California*, the IBLA overruled its decision in *California Portland Cement Co., et al.*, *supra*, and held that if no notice is given prior to the end of the 20-year period, there is no authority to belatedly readjust the terms of the lease. *Kaiser Steel Corp., et al.*, 63 IBLA 363 (1982). This has been strictly followed. *Sunoco Energy Development Co.*, 65 IBLA 323 (1982) (notice issued 2 1/2 years after primary term expired), *Franklin Real Estate Co.*, 71 IBLA 13 (1983) (notice issued 23 months after primary term expired), *Northern Minerals Co., et al.*, 71 IBLA 129 (1983) (6 years).

The IBLA has construed the Tenth Circuit decisions to allow readjustments of lease terms after the expiration of the primary term, but only if notification to the lessee was issued prior to the expiration. *Costal States Energy Co.*, 70 IBLA 386 (1983), *Gulf Oil Corp, et al.*, 73 IBLA 328 (1983), *FMC Corp.*, 74 IBLA 389 (1983). *Cf., Franklin Real Estate*, *supra*, 71 IBLA at 14, *Northern Minerals Co., et al.*, *supra*, 71 IBLA at 130 n.1. The notice need not include the lease terms proposed. *Gulf Oil Corp, et al.*, *supra.*

3. Indian Case Authority

The case of *Robert B. Wooding, et al.*, 4 IBIA 255 (1975), allowed a business site lease readjustment from $1,500 per year rental to $9,668 per year rental. It cited the Memorandum Opinion in *Wooding* v. *Morton*, (W.D. Wash. 8/13/73), unpublished, which remanded the mat-

ter, to the effect that a right to reevaluate the rent does not support action that amounts to complete renegotiation at five-year intervals, as such action would render the 25-year term of the lease illusory. *Wooding* involved a lease provision that subjected the rental "to review and adjustment by the Secretary *at not less than five year intervals . . . .* " *Id.*[4]

The case of *Peabody Coal Co., et al.*, 72 IBLA 337 (1983), concerns only the calculation of "gross realization." It does, however, mention that Peabody has three leases, 14-20-0450-5743, 14-20-0603-9910, and 14-20-0603-8581, reciting that the first two of these were "initiated" in June, 1966, and that Peabody became the "lessee of record in February, 1968 following an assignment from Sentry Royalty Company, it subsidiary." Two of the leases embrace 40,000 acres. *See also, Peabody Coal Co.*, 53 IBLA 261 (1981), also concerning Peabody's computation of royalties for Navajo coal.

The third[5] case involving Indian interests is *Danks* v. *Fields*, 696 F.2d 572 (8th Cir. 1982). It analyzed the following language in a grazing permit:

> Grazing fees shall be reevaluated in accordance with 25 C.F.R. by August 1, prior to the beginning of the fourth year and such rate shall prevail for the balance of the permit period.

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[4] This is a requirement of 25 C.F.R. § 162.8 (formerly of Part 131) for all leases except those where the consideration for the leases is based "primarily on percentages of income produced by the land . . . . " Authority for this regulation includes 25 U.S.C. § 635, the Navajo-Hopi Rehabilitation Act.

[5] IBIA decisions are not indexed in the UNM law library. I did not go through the IBIA reports.

Id., at 574. The court held that this provision required the announcement of the fee increase by August 1, that the August 1, date was neither a non-binding goal nor was it merely a date for the reevaluation to be complete (the announcement to follow), and that an October 3 announcement of an increased fee was void. The court emphasized the need of the lessees to plan in the fall months.

4. The Peabody Lease

The applicable provision of the Peabody lease is as follows:

> 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.

The "at the end of twenty years" language is identical to that construed narrowly by the Tenth Circuit. In light of the Tenth Circuit's views (as well as the lease language setting an "effective date" of February 1, 1964), any attempt (if challenged by Peabody) to (a) set the effective date as February 1, 1964 plus (b) apply an adjusted royalty rate retroactively would cause (a) the retroactive rate to be struck down and (b) the reviewing body to hold that the Navajo Tribe had no right to adjusted royalties until 1994, *unless* the BIA notified Peabody of its intention to increase the royalty prior to February 1, 1984.[6]

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[6] It is possible that, if the effective date really is February 1, 1984, a new effective date is established by an assignment to Peabody. *See, California Portland Cement Co.*, 667 F.2d 953 (10th Cir. 1982). This is a very slender reed to grasp. *See, Lone Star Steel Co.*, 71 IBLA 92 (1983).

5. When is the "Effective Date"?

Apparently, Tom O'Hare pointed out to us that the effective date recited in the lease is February 1, 1964. We had apparently been assuming that the effective date was the date of approval by the Secretary, August of 1964. I was only given a copy of the royalty adjustment part of the lease, so I do not know these facts for sure, nor do I know the exact language used.

We may wish to avoid a determination that the effective date is February 1, 1964. See discussion *supra*. To hold for us on this point, a court would have to:

(1) ignore the express language of the lease and intention of the parties

(2) not apply the "relation-back" analysis to this lease.

It is true that no lease is effective absent Secretarial approval. *See*, 25 C.F.R. § 211.1, 25 U.S.C. § 396a [7]. However, the relation-back doctrine has been applied to conveyances of Indian property. *See, United States v. Getzelman*, 89 F.2d 531 (10th Cir. 1937).

Moreover, by signing the lease, the Secretary at least ostensibly agreed with the terms therein; otherwise, he would have refused to approve it.

6. If the BIA Gave Notice Prior to February 1, 1984, Can the Royalty Rate Be Set Retroactively?

This is worth a shot. The lease in *Wooding*, *supra*, was entered into on June 15, 1964 and subject to adjust-

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[7] *Cf., Vanadium Corp v. Fidelity & Deposit Co.*, 159 F.2d 105 (2d Cir. 1947).

ment at intervals of "not less than 5 years." The IBIA decision notes that in 1970, following unsuccessful negotiations, the BIA required the lessee "to pay the fair rental value for the lease premises as determined from an appraisal retroactive to June 15, 1969."

Following APA review Judge Copple remanded "to determine a reasonable adjustment in rental for Lease No. 4388 for the period beginning June 15, 1969." Such was done, setting a $9,668 annual rental, adjusted from $1,500. The IBIA mentioned, at the least, the fact that the original rental was below value.

The distinction is obviously in the terms of the *Wooding* lease with the Peabody lease; *i.e.*, at "not less than 5 years" versus "at the end of twenty years from the effective date." I think that a reviewing body, however, could ignore this distinction if proper notice was sent to Peabody of the intention to adjust. This would be consistent with the IBLA decisions holding that the actual terms and conditions need not be set out in the notice, but could be set after the anniversary date if notice of intent to adjust was sent previously. However, the IBLA decisions do not reflect the *application* of the new "terms and conditions" retroactively. Most of the decisions are silent on this point, and the regulations provide otherwise. *See*, 43 C.F.R. § 3451.2(c). My view is that we have slim chance of prevailing on retroactive application of the adjusted royalty, even though our equities are enhanced by a limited readjustment to the federal minimum.

B. GENERAL DUE PROCESS REQUIREMENTS

There are no regulations known to me in 25 C.F.R. which specify the procedures under which the royalty

adjustment should be made. The regulations in 43 C.F.R. § 3451. 1, *et seq.*, are set out as Appendix A. I suggest that these be adopted for procedural due process purposes.[8] The reviewing body will generously construe its procedural regulations for Peabody. *See*, *United States Steel Corp.*, 50 IBLA 252 (1980).

With respect to substantive due process, the *Wooding* case suggests that the adjustment cannot be so high as to constitute a forfeiture of the benefits of a lease. The findings must conform to APA standards; *i.e.*, not arbitrary or capricious, etc. In this regard, there must be some factual basis for the determination. Speculation is not sufficient. See *Danks v. Fields*, *supra*, 696 F.2d at 575-76.

The readjustment will be at least as high as the federal minimum, despite a possible showing by Peabody that the minimum 12½% of royalty would be commercially unfeasible. *National King Coal, Inc.* 70 IBLA 124 (1983), *Blackhawk Coal Co.*, 68 IBLA 96 (1982). If taxes are a hindrance, Peabody should to seek relief from the taxing authority, not from the mineral owner or trustee. *The Montana Power Company*, 72 I.D. 518, 519 (1965).

Under 30 U.S.C. § 207, all terms and conditions of the leases may be readjusted. This expansive authority to readjust is not found in the Peabody lease. However, the IBLA has held that § 207 allows, for leases entered into under the MLA, the insertion of all terms mandated by statutes and regulations promulgated after the exe-

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[8] Hardrock lease readjustments are also provided for. *See*, 43 C.F.R. § 3522, *et seq.* It appears that this section used to also apply to coal readjustments. *See*, *California Portland Cement Co.*, 33 IBLA 223 (1977).

cution of the leases. *E.g.*, *Lone Star Steel Co.*, 68 IBLA 96, 100 (1982). The most interesting decision to me is *Blackhawk Coal Co.*, *supra*, requiring the submission of a new mining and exploration plan for approval for unmined lands, even though a mine plan had previously been approved. To obtain the benefit of this expansive authority, we should devise a theory for the application of § 207 *or its principles*, in light of the trust duty.

IV. RECOMMENDATIONS

1. Cease negotiations until the following is done:
   a. Determine if notice of proposed adjustment has been sent;
   b. Determine if assignments of the lease have been approved, and, if so, the dates of such approvals;
   c. Analyze the present lease, with a view to a suit for cancellation. See my memo regarding Utah International.[9] This will require immediate documentary production by BIA.
2. Get a copy of the (W.D.) Washington District Court opinion in *Wooding*.
3. Determine who has the authority to adjust the lease terms.
4. Analyze more thoroughly questions not answered here:

[9] The Peabody lease will require its own separate analysis, part of which is the possibility of breaches of the lease for failure to pay the proper royalty. *See*, *Peabody Coal Co.*, cases, at 53 IBLA 261 and 72 IBLA 337.

a. When is the effective date of the Peabody lease?

b. Does the relation-back doctrine apply to the Peabody lease?

c. Can we apply § 207 or its principles to the Peabody lease?

5. Begin preparation for a suit in Claims Court for breach of trust for BIA's failure to timely notify of adjustment, if inquiry on 1a is a negative.

6. Review IBIA decisions not examined for this memo.

The utmost deliberate speed is required, in my opinion. Even if notice was sent out by the BIA prior to the anniversary date, under 43 C.F.R. § 3451.1(c) (2) the sending of the actual terms and conditions must be done within two years after the anniversary date, or adjustment is waived.

PF/gm

xc: Claudeen

Eric

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH	*EDWARD T. BEGAY*
Chairman, Navajo Tribal Council	Vice Chairman, Navajo Tribal Council

[SEAL OMITTED]

[Aug. 9, 1984]

MEMORANDUM

To : Claudeen B. Arthur, Attorney General Department of Justice

From : Akhtar Zaman, Director Minerals Department

Subject: PEABODY COAL COMPANY, ADJUSTMENT OF ROYALTY, 20% ROYALTY RATE VS 12½% ROYALTY RATE

Peabody Coal/Company's lease No. 14-20-0603-8580 (Navajo Lease) provides for adjustment of the royalty rate by the Secretary of the Interior at the end of 20 years from the effective dote, which was February 1, 1984. Accordingly, the Area Director of the Bureau of Indian Affairs (BIA) vide his letter dated June 16, 1984 adjusted the royalty rate to 20% of gross realization. Presently, Peabody Coal Company is appealing the decision of the Area Director. In the meantime Chairman Peterson Zah has been negotiating a tentative agreement with the companies whereby the royalty rate would be increased to 12½% for surface coal and 8% for underground coal. The Minerals Deportment 's opinion

is that the royalty rate negotiated by the Chairman is reasonable for the following reasons:

1. The legal opinion of some Justice Department Attorneys is that the Secretary should have notified the company about the royalty adjustment prior to February 1, 1984. Their view is that case histories of similar cases illustrates that the U.S. Court has denied a royalty adjustment when the Secretary failed to adjust the royalty at the right time. The companies have agreed to increase the royalty rate for the Navajo lease effective August 28, 1984. However, if we are in court and the companies challenge the royalty increase on the grounds that the Secretary has forfeited his option to adjust the royalty because of his inability to act by February 1, 1984 (illustrated by case history) then we might continue to receive 30 cents and 37.3 cents per ton royalty from the Navajo lease for the next ten (10) years if the court rules against the Area Director's decision.

2. The BIA's decision was based on reports prepared by Dr. Ahmed Kooros of the Council of Energy Resources Tribes F.R. Schwabs and Associates and a computer analysis of Peabody's Discounted Cash Flow Rate of Return (DCFROR) done by the BIA and the U.S. Bureau of Mines (USBM). Our analyses of Peabody's operation also supports USBM's report. However, it must be realized that the analyses had to be based on certain assumptions such as future production, sales prices, operating costs, capital costs etc. Taking advantage of the Freedom of Information Act, the companies have requested that the BIA

provide them with all reports and analyses on which the decision to increase the royalty to 20% was made and all correspondence between the BIA and the Navajo Nation on increasing the royalty rate. The BIA might have to provide the companies with all the information under the Act. Once Peabody has all the reports and analysis they will have the ammunition to refute BIA's recommendation. Internal costs can be easily manipulated, especially if they cannot be verified. Also Tribal correspondence with the BIA will surely make Peabody aware of our concern with the effective date as stated in item 1. If the BIA or the Tribe were able to get Peabody's realistic operating and capital costs we would have been able to compute the company's DCFROR based on varying royalty rates and without any major assumptions. Our recommendation to the Secretary could have been very specific on the royalty increase. But the company will not release this information. Furthermore, the USBM's and our analyses did not account for the Tribal taxes. If Tribal taxes were considered then it would have reduced the DCFROR considerably.

3. The Navajo Lease provides for adjustment in the royalty rate while other provisions remain unchanged. But the Chairman has negotiated a royalty adjustment for both the Navajo and the JUA leases and amended several other clauses in the leases concerning taxes, water rates, scholarship fund, etc.

4. Insisting on the 20% royalty rate will result in prolonged litigation and the final decision cannot be guaranteed in our favor.

5. Peabody Coal Company and the utilities are actively lobbying with the Department of the Interior against the Area Director's decision. If they succeed then the Secretary will revert the royalty rate to 12½% without changing the other provisions of the lease and without adjusting the royalty rate for the Joint Use Lease.

If you have any questions please do not hesitate to contact me.

/s/ AKHTAR ZAMAN
Akhtar Zaman

RSD: rm

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF THE INTERIOR

BUREAU OF INDIAN AFFAIRS
WASHINGTON, D.C. 20245

[Aug. 17, 1984]

REPLY REFER TO:

Gregory J. Leisse, Esq.
Peabody Coal Company
Arizona Division
1300 South Yale
Flagstaff, Arizona 86001

Re: Request for extension of time in the Appeal from the Navajo Area Director's Decision Adjusting Royalties under Peabody Lease No. 14-20-0603-8580

Dear Mr. Leisse:

I have received your request, on behalf of the Peabody Coal Company, for an extension of time within which to file your appeal of the Navajo Area Director's decision dated June 18, 1984. You sought the extra time so that your appeal may reflect any information you receive through a Freedom of Information Act request.

For good cause shown, I extend the time within which you may file your appeal to forty-five days after you receive the Area Director's response to your Freedom of Information Act request.

Furthermore, in the course of my examination of some of the documetns in this appeal, I have noted that the Area Director intended his decision to be effective Au-

gust 28, 1984. This was communicated to the Tribe (see the attached letter), but was inadvertently missing from the decision sent to Peabody on June 18, 1984. Please note that if the Area Director's decision is ultimately upheld, Peabody would be responsible for royalty payments at the new rate from August 28, 1984. Therefore, I am ordering Peabody to begin submitting to Minerals Management Service, if it does not already do so, the data necessary to compute the additional royalty which would be due if the Area Director's decision is affirmed.

Sincerely,

/s/ John W. Fritz
Deputy Assistant Secretary—
Indian Affairs (Operations)

Attachment

cc: Peterson Zah
Robert B. Hoffman, Esq. (w/attachment)
Frederick J. Martone, Esq. (w/attachment)

September 14, 1984

MR. LARRY COPE

SUBJECT: Royalty - Letter to Secretary DOI

Please set up the conference call per Larry Michael's suggestion to finalize the letter to the Secretary of the DOI. I explained that this matter will be taken care of Monday or Tuesday next week.

Thanks.

/s/ H. F. HUETTEMEYER
H. F. HUETTEMEYER

HFH:dw

P.S. Larry:

Please call Tom Reilly to assure that he is proceeding on maximum delay mode in the appeal of the 20% royalty rate.

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF INTERIOR

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

Energy & Minerals
BCCO 8166

[Nov. 8, 1984]

Howard P. Allen, President
Southern California Edison Co.
P.O. Box 800
2244 Walnut Grove Avenue
Rosemead, California 91770

Dear Mr. Allen:

The Secretary has asked me to respond to your letter of October 5, 1984 concerning Navajo coal leases held by Peabody Coal Company.

You expressed concern that the appeal by Peabody of the Navajo Area Director's decision regarding Lease No. 14-20-0603-8580 is disrupting negotiations presently being undertaken by the Navajo Nation, Peabody and yourselves and is frustrating the Navajo Nations's ability to objectively consider negotiation proposals. Consequently, you requested that the Secretary consider vacating the Area Director's decision because you believe that it might help the negotiations.

While it may be appropriate to stay consideration of an appeal if all the parties believe that such an action would

enhance opportunities for a negotiated settlement, the parties to this appeal have not indicated.

We, of course, believe that a negotiated settlement to this royalty dispute is preferable and are quite willing to accommodate the wishes of the parties to the appeal. Therefore, if the Navajo Nation and Peabody believe a stay would help, and so indicate to the Deputy Assistant Secretary—Indian Affairs (Operations), he will consider the request.

Sincerely,

/s/ John W. Fritz
Assistant Secretary—Indian Affairs

IDENTICAL LETTER SENT TO: Mr. A.J. Pfister, General Manager, Salt River Project, BCCO 8166

cc: Secy File, Secy RF (2), ASIA, ES-PR, Sol-IA-CKelly

BIA Surname, Chrony, 200, 201, 101A, 100RF, 866, Holdup

SOL-IA: Ckelly:jme:11/6/84:X5134:otr3/8.3

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH
Chairman, Navajo
Tribal Council

EDWARD T. BEGAY
Vice Chairman,
Navajo Tribal Council

[SEAL OMITTED]

November 27, 1984

CONFIDENTIAL COMMUNICATION

Honorable William P. Clark, Secretary
Department of the Interior
18th & C Street N.W.
Washington, D.C. 20240

Re: Appeal of Peabody Coal Co., et al. from the June 16, 1984, Decision of the Navajo Area Director Adjusting the Coal Royalties Under Lease 14-20-0603-8580

Dear Mr. Secretary:

The joint letter of October 5, 1984, to you from the President of Southern Calilfornia Edison and the General Manager of the Salt River Project requires that the Navajo Nation also send you a letter in your capacity as trustee for the Navajo Nation expressing our objections

We have not authorized the writers of the letter to represent to you what would be acceptable or unacceptable to the Navajo Nation in the Peabody coal lease renegotiations. We also disagree with them that the Area Director's decision would frustrate the coal lease

renegotiations. As a matter of fact, we intend to pursue further negotiations with the companies on the leases.

You are requested not to deviate from the present schedule on the appeal of the Area Director's decision. A delay or change in this schedule will require the Navajo Nation's serious consideration of an immediate lawsuit.

We regard this communication as confidential, between a trustee and trust beneficiary, and ask that this letter or its contents not be released without our assent.

Sincerely,

THE NAVAJO NATION

/s/ PETERSON ZAH
PETERSON ZAH, Chairman
NAVAJO TRIBAL COUNCIL

ANALYSIS OF A REASONABLE ADJUSTMENT OF NAVAJO COAL LEASE ROYALTY RATES

PREPARED BY
PETERSON & CO.
November 28, 1984

EXECUTIVE SUMMARY

Peterson & Co. was asked to perform an independent review of the 1964 lease between Peabody Coal Company (Peabody) and the Navajo Indian Tribe (Navajo Tribe). The overall objective of this review was to determine a "reasonable adjustment" of the current royalty rate, as referred to in the Navajo lease, Article VI.

The scope of our engagement included reviewing 1964 and 1966 leases between Peabody and the Navajo Tribe to gain an understanding of their provisions, reviewing information obtained under the Freedom of Information Act which was relied upon by Mr. Donald Dodge in setting a 20% royalty rate, performing analyses to determine a reasonable adjustment of the current royalty rate and comparing our conclusion to other possible royalty rates. Documents relied upon by Mr. Dodge which were reviewed by Peterson & Co. included a report prepared by F.R. Schwab & Associates, Inc. (Schwab Report), a report prepared by the Minerals Availability Field Office of the U.S. Bureau of Mines (Bureau of Mines Report), a report prepared by Ahmed Kooros of The Council of Energy Resource Tribes (Kooros Report), a report prepared by D.L. Cramer Bornemann of the Bureau of Indian Affairs, Division of En-

ergy and Mineral Resources (Bureau of Indian Affairs Report), and various general correspondence.

Based on our analyses 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 lease.

* * * * *

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF THE INTERIOR

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

[Dec. 20, 1984]

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

Re: Appeal of Peabody Coal Co. from June 16, 1984 Area Director Decision adjusting royalties under Lease 14-20-0603-8580

Dear Chairman Zah:

The Secretary has asked that I respond to your letter dated November 27, 1984. We appreciate your views on the request by Southern California Edison to stay the appeal procedure.

Our response to Southern California Edison (copy enclosed) indicated our preference for negotiated settlements. However, we also stated we would not consider staying the appeal unless all parties believed it would enhance opportunities for a negotiated settlement. In light of your letter, we do not believe a stay is appropriate.

Sincerely,

/s/ John W. Fritz
Acting Assistant Secretary—
Indian Affairs

Attachment

cc: Howard P. Allen
Gregory J. Leisee, Esq.
Robert B. Hoffman, Esq.
Louis Denetsosie, Esq.
Frederick J. Martone, Esq.

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF THE INTERIOR

BUREAU OF INDIAN AFFAIRS
WASHINGTON, D.C. 20245

[Mar. 04, 1985]

Gregory J. Leissee
Peabody Coal Company
1300 South Yale
Flagstaff, Arizona 86001

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

Dear Mr. Leissee:

We have been reviewing the briefs and exhibits submitted by the Tribe and by the appellant in this appeal, and it has come to our attention that the cost of operating Lease No. 14-20-0603-8580 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 costs, 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.

* * * * *

Sincerely,

/s/ John W. Fritz
Deputy Assistant Secretary—
Indian Affairs (Operations)

cc: Frederick J. Martone
Thomas J. Reilly
Paul Frye
Interior Board of Indian Appeals

Law Offices
SNELL & WILMER

3100 Valley Bank Center
Phoenix, Arizona 85073
(602) 257-7211

March 11, 1985

Mr. Larry Cope
Southern California Edison Company
P. O. Box 800
Rosemead, California 91770

Dear Larry:

I enclose a copy of a letter from the Department of the Interior to Greg Leisse. 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.

Very truly yours,

/s/ TOM
Thomas J. Reilly

TJR:eb
Enclosure
[cc: RH Bridenbecker]
3/13/85

[SEAL OMITTED]

UNITED STATES DEPARTMENT OF THE INTERIOR

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

BIA.IA.0302

[Mar. 12, 1985]

MEMORANDUM

To: Secretary

From: Solicitor

Subject: Request for Meeting by Peabody Coal Company

We understand that a representative of Peabody Coal Company has requested a meeting with you. The meeting would also include representatives of the Salt River Project and Southern California Edison Co. and would concern coal leases held by Peabody on Navajo and Hopi lands.

We wanted you to be aware of an administrative appeal filed by Peabody and currently pending before the Deputy Assistant Secretary—Indian Affairs. One of the leases with the Navajo Tribe provides that after 20 years the Secretary may make a reasonable adjustment to the royalty rate. Last June, the BIA Area Director notified Peabody that he was adjusting the royalty from the variable rate tied to the gross realization from the sale of the coal as stated in the lease, to 20% of the gross value as determined by the Federal Formula. Peabody has appealed this decision.

The Salt River Project and Southern California Edison are interested because they purchase coal from Peabody under contracts wherein any increase in the royalty rate is passed through to them. Last October both companies asked Secretary Clark to vacate the Area Director's decision for a period so that negotiations could continue. The Assistant Secretary—Indian Affairs responded that a stay would be considered if all parties to the appeal requested one. Subsequently, the Chairman of the Navajo Tribe indicated that he did not support the stay but did intend to pursue further negotiations.

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 clearly 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.

/s/ FRANK K. RICHARDSON
FRANK K. RICHARDSON

PEABODY COAL COMPANY
ARIZONA DIVISION

1300 South Yale Flagstaff, Arizona 86001
Telephone (602) 774-6253

GREGORY J. LEISSE
DIRECTOR OF LEGAL
AND GOVERNMENTAL AFFAIRS

March 29, 1985

Mr. John W. Fritz
Deputy Assistant Secretary-
Indian Affairs (Operations)
Bureau of Indian Affairs
U. S. Department of the Interior
Washington, D. C. 20245

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

Dear Mr. Fritz:

We are responding to your letter of March 4, 1985, in which you requested that Peabody submit its actual cost, revenue and investment figures for the subject lease so that Peabody would make explicit "its arguments about what are reasonable cost figures".

We do not believe that request is pertinent or necessary to support Peabody's arguments. In view of the contractual terms under which all coal from the subject lease is marketed, an analysis of the impact of the proposed royalty adjustment on Peabody's return on investment is not a relevant inquiry for determining the reasonableness of the proposed royalty adjustment. This

point was emphasized in the joint brief submitted by Peabody and the other appellants:

> "The reports purportedly relied upon by the Area Director focus upon the effect of various royalty rates upon the profitability of the operations of Peabody. This approach completely ignores the fact that Peabody passes through all of its royalties to its utility customers pursuant to the fuel supply contracts with those utility customers. In fact, the establishment of any royalty rate at any leval would have no impact upon the profitability of the operations of Peabody."

* * * * *

Given the terms under which the subject coal is marketed, it continues to be Peabody's position that profit and rate of return to Peabody are not relevant to the determination of a reasonable royalty. We therefore do not intend to submit the requested data.

The request for this data to support what is apparently perceived to be Peabody's argument indicates that the positions Peabody has taken in the appeal have been misconstrued. We are therefore extremely disappointed that the opportunity for oral argument was denied. Oral argument would provide a means of ensuring that the respective positions of the parties are clearly understood before a decision on the appeal is reached. We would respectfully urge reconsideration of the denial of our request for oral argument.

* * * * *

Very truly yours,

/s/ GREGORY J. LEISSE
GREGORY J. LEISSE

Enclosures

cc: Christopher G. Farrand
Peabody Holding Company

The Honorable Frank Richardson, Solicitor
U.S. Department of the Interior

Navajo Nation Department of Justice

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH
Chairman, Navajo
Tribal Council

EDWARD T. BEGAY
Vice Chairman,
Navajo Tribal Council

[SEAL OMITTED]

April 4, 1985

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

Re: Appeal of Peabody Coal Company of Royalty Adjustment

Dear Mr. Fritz:

This letter is submitted in response to the three letters dated March 29, 1985 which the Navajo Tribe received on April 2, 1985. These letters were served on behalf of Peabody Coal Company, the Navajo Project Participants, and the Mojave Project Participants. As is shown below, none of the March 29, 1985 submissions casts any doubt on the propriety of the Area Director's adjustment of the royalty rate on lease 14-20-0603-8580.

* * * * *

There is simply no adequate justification for the additional delay sought by Peabody.

IV. CONCLUSION

Appellants continue to advance their "preserve the inequities" methodology which has been consistently rejected, and properly so. Appellants talk of Peabody's "risks" in doing business, neglecting to mention that Peabody has firm contracts for the coal used by the participants and that it has secured for itself a guaranteed 15% discounted case flow rate of return. The 20% royalty rate is eminently proper, in light of the uncommonly valuable coal deposits—both in quality and quantity.

Peabody has refused to supply the data requested by the Department. It has thus consented to a Departmental decision based on the existing record. The *ex parte* approximations of the participants should be disregarded.

Respectfully submitted,

NAVAJO NATION
DEPARTMENT OF JUSTICE

/s/ P FRYE
PAUL E. FRYE
Post Office Drawer 2010
Window Rock, Arizona 86515
Telephone: (602) 871-6933

Attachments

xc: Counsel of Record

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH
Chairman, Navajo
Tribal Council

EDWARD T. BEGAY
Vice Chairman,
Navajo Tribal Council

[SEAL OMITTED]

May 21, 1985

CONFIDENTIAL

MEMORANDUM

TO: Claudeen Bates Arthur, Attorney General
Navajo Nation Department of Justice

FROM: /s/ ILLEGIBLE for
Paul E. Frye, Staff Attorney
Navajo Nation Department of Justice

SUBJECT: Lease 9910 Negotiations

Last week, I called Colleen Kelley, Esq., Office of the Solicitor in Washington. She informed me that (1) the legal review of the Peabody appeal for royalty readjustment on lease #8580 has been completed and (2) the technical review for the Factual issues was to be completed by May 15, 1985.

Kelley's tone (and the relative strength of the briefs) suggested that we will prevail on the legal issues, i.e., that the adjustment was timely and that the Tribe's methodology for evaluating the proper royalty rate is correct.

I then received a call from Ahmed Kooros, of CERT, who provided the technical report for our brief. He has talked with the BIA technical staff in Lakewood, Colorado. They stated that their conclusion and recommendation was for the 20% royalty rate decided upon by the Area Director.

My reading of the discussion with Kelley was that we should expect a decision by June 15 or hereabouts. The decision should affirm the 20% royalty rate of the Area Director. If it does, we will easily be able to show the comparable worth of the coal on lease #9910, according to Kooros. This would set the stage for either (1) very hard bargaining on lease #9910 (since the current total—Navajo plus Hopi—royalty rate is 33% of 20% and is so low as to form an additional basis for lease cancellation or (2) a lease cancellation petition served without further discussions with Peabody.

Should Fritz' decision affirm the Area Director's decision on #9910, and should the Tribe deem it appropriate to make an overture of settlement for new terms on #9910 at that time, the overture should:

(a) key the royalty rate to that of #8580, allowing room for bargaining flexibility to as low as 17%;

(b) require a bonus of about $35,000,000 for:

  (i) right of way grants;

  (ii) privilege of renegotiating, rather than fighting a lease cancellation action;

  (iii) most importantly, the grant of rights to greater than 200 million tons on lease

hold, something which Peabody failed to secure as provided by lease terms of #8580;[1]

(c) require that the royalties be paid effective August 28, 1984;

(d) require back taxes for the Mohave production. (These may be as high as $50 million.)

I would also suggest that water prices be determined *initially* by an arbitration panel, which would receive evidence of value from all parties. Further, the tax waivers in original #9910 are not a valid baseline for discussions, given the *infirmities* of the lease itself. Further discussions should include taxes, and a valid end point—given the possible *validity* of the waivers—might be tax caps.

These are the most significant recommendations I have for future actions by the Tribe. I would also point out that two other matters may be ripe for discussions: (1) the damages owned to the Tribe for violations of the equalization clause, and (2) the damages owed to the Tribe for Peabody's unlawful royalty calculations. I believe that we should be very critical in our dealings with Peabody on these issues, because of (1) the possibility of exemplary damages in a lawsuit; (2) the possibility that we could use Peabody's lease violations in a lease cancellation petition; and (3) Peabody's unreliability. Regarding the third issue, the Tribe must consider ways of increasing access to Peabody's actual production, cost, and revenue figures.

---

[1] The 17% and $35,000,000 figures are those recommended by Kooros. Regarding Peabody's failure to secure the reserves, Exhibit 33 to Navajo Answer Brief in Peabody appeal.

The rationale for "XIV" of the draft letter to Peabody is unclear to me, and I have no conclusions regarding it.

Finally, if an adjustment provision is to be agreed upon, and if a royalty of 17-20% is agreed upon, the adjustment feature should assure that the royalty shall not decrease. Otherwise, I would recommend that no adjustment clause be considered.

Thus, I recommend that no letter be sent to Peabody until Fritz' decision, and that the client be kept fully informed of the reasons for this strategy so that no precipitous action is taken by Zah, Redhouse, or Tso.

I am returning all files herewith, with the understanding that, if you want me to draft a letter to Peabody for your signature (or anyone else's), you will so inform me.

Please advise if I can be of further assistance.

xc: John MacKinnon, DOJ
Liz Bernstein, DOJ
Ahmed Kooros, Ph.D., CERT
Mike Nelson, Chairman's Office

IMPACT OF 20% INDIAN COAL ROYALTIES ON ARIZONA'S WATER AND ELECTRIC USERS.

* * * * *

Impact of 20% Coal Royalty on Water and Electric Costs

	NGS COSTS	AZ COSTS POWER	AZ COSTS WATER
R. 12.5%			
Ann	$15,300,000.00	$6,600,000.00	$3,700,000.00
Total	$382,500,000.00	$165,000,000.00	$92,500,000.00
Per AFYR			$2.46
R 20%			
Ann	$29,200,000.00	$12,600,000.00	$7,100,000.00
Total	$730,000,000.00	$315,000,000.00	$177,500,000.00
Per AFYR			$4.73

Incremental additional costs.
20% royalty compared to 12.5%

Annual	$13,900,000.00	$6,000,000.00	$3,400,000.00
Total	$347,500,000.00	$150,000,000.00	$85,000,000.00
Per AFYR			$2.27
Total impact for Arizona			$235,000,000.00

Notes

A. All values in 1985 dollars; no escalation.

B. 12.5% is used as shorthand for standard royalty; actual is 14.3%.

C. Total values are based on remaining 25 year fuel supply.

CHART 1

[Undated]

Memorandum

To: *D.M. Rappaport*

From: *Leroy Michael Jr.*

Subject: *Impact of 20% Indian Coal Royalties on Electrical Costs of the Central Arizona Project*

Pursuant to actions authored by the Colorado River Basin Project Act, the electrical requirements of the Central Arizona Project are provided from the United States 24.3% interest in the Navajo Generating Station, located on the 1934 Navajo Indian Reservation, near Page, Arizona.

The Navajo Generating Station coal fuel supply is supplied by Peabody Coal Company from leases with the Navajo Tribe (1934 Reservation Lease) and the Navajo and Hopi Tribes (1882 Reservation Leases). The leases made in 1964 and 1966 provide for $.30 a ton royalty (1934 Reservation Lease) and 6.67% of the Mine Price (1882 Reservation Lease)

Since 1981, Peabody, with the consent of all Navajo Station Coal buyers, has had outstanding an offer to increase the coal royalty of the Tribes to the current standard Federal rate of 12.5% of the Mine Price. The federal standard was set shortly after the mid 1970's energy crises. Most energy economist believe it to be excessive by today's standards. Neither the Navajo, nor Hopi have been willing to accept the Peabody offer.

The royalty in the 1934 Reservation Lease is subject to adjustment. The Gallup BIA Area Director has proposed increasing the royalty to 20% of the Mine Price.

Peabody is contesting the BIA action. It is before Secretary Hodel for decision. Were the Secretary's decision to approve the 20% royalty for the 1934 Reservation Lease, 20% Royalty will become the standard for the 1882 Reservation Lease, as well.

The impact of the BIA Proposed Adjusted Royalty (20%) on the OMER costs of CAP is substantial. It adds $170 to $230 million in incremental costs of electricity for CAP water users over and above the $400 to $500 millions that CAP water users will be paying the Indian Tribes under a 12.5% standard royalty.

There is no justification for burdening the CAP water user with an unprecedented mineral extraction fee. It would be appropriate for the Delegation to bring this to the Secretary's attention.

LM Jr.

cc: A.J. Pfista, Dick Silverman, Darrell Smith

PAUL E. FRYE
Attorney at Law

200 Lomas Blvd., N.W.
Suite 815 Telephone
Albuquerque, N.M. 87102 (505) 247-9592

11 July 1985

Honorable Donald P. Hodel
Secretary of the Interior
18th & C Streets, N.W.
Washington, D.C. 20240

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

Dear Secretary Hodel:

This letter responds on behalf of the Navajo Tribe of Indians to the July 5, 1985 letter of Mr. Chris Farrand, Vice-President, Peabody Holding Company. Peabody seeks, in the July 5 letter, extraordinary actions on your part to either delay or preempt the orderly appeal process now being pursued by Peabody. Thus far, Peabody has succeeded in delaying the payment of fair royalties to the Navajo Tribe for almost a year, [1] and the Navajo Tribe opposes strenuously Peabody's eleventh-hour plea for further delay.

With all respect to Mr. Farrand, the supposed justifications stated in Peabody's July 5 letter are simply without any factual basis. First, Peabody's speculation that "the Tribe has received word of an imminent and favorable decision on the appeal" is groundless. Based on the

[1] The Area Director adjusted the royalty on June 18, 1984, effective August 28, 1984.

briefs and the factual presentation to Deputy Assistant Secretary Fritz, however, the Tribe does view its chances of success in the appeal as good. How Peabody reached its "understanding that a decision may be imminent" is not known to me or disclosed in the July 5 letter.

Second, the quite significantly, the July 5 letter states with no factual support that the 20% royalty rate recommended by the Bureau of Mines[2] and adopted by the Navajo Area Office is "inequitable." Peabody was also unable to provide factual support for such allegations of inequity in its submissions to Mr. Fritz, and the Tribe's detailed analysis of the fairness of the adjusted lease terms is unrebutted. (For example, the Tribe demonstrated that the consumers would pay less than a 1.0% increase in electric rates under the adjusted royalty, while still enjoying fuel costs among the cheapest in the Southwest. Indeed, it appears that Peabody could recoup the added costs fully by achieving presently unattained economies of scale in its operations. *See*, separately bound Exhibit 33 to the Answer Brief of the Navajo Tribe of Indians, at 44 and 46-47.)

Third, contrary to representations in the July 5 letter, the Department is "preempting" *no* negotiations, the Navajo Tribe having concluded long ago that Peabody's penurious views (Peabody has taken the position in the appeal that a "reasonable adjustment" would raise the royalty to less than one-half of the federal minimum) are not conducive to a reasonable and acceptable outcome.

---

[2] BIA's Energy and Minerals experts had initially recommended a 24.44% royalty as a reasonable adjustment pursuant to Article VI of the lease, given the unusual value of the coal deposits leased by the Navajo Tribe to Peabody.

The Navajo Tribe is certainly not willing to accept a royalty adjustment to 12.5%, the unattributed indication of "the Tribe" in Peabody's July 5 letter notwithstanding.

Fourth, Peabody states that the royalty adjustment effected by the Navajo Area Office is a "unilateral imposition" of a royalty rate. Contrary to the implication of this statement, the appeals procedures—which Peabody first initiated and now seeks to circumvent—provide appropriate safeguards for Peabody's interest, as the Department has consistently held. *E.g.*, *Philip A. Cramer*, 74 IBLA 1 (1983), *Robert J. King*, 72 IBLA 75 (1983). Indeed, what is most illuminating about Peabody's apparent belief that it cannot prevail in its appeal on the facts of this case is that, when Peabody was requested by Mr. Fritz to submit cost and revenue date, it replied: "We . . . do not intend to submit the requested data." Letter of March 29, 1985, at 2.

Finally, with respect to Peabody's paternalistic suggestion that the Tribe should be content to accept a 12.5% royalty now rather than collect a proper 20% royalty after possible litigation, please be assured that the Navajo Tribe is prepared to support the Area Director's decision in whatever forums are appropriate.

In closing, the Navajo Tribe urges, as we have urged Mr. Fritz, that a final decision for the Department upholding the Area Director be made with all deliberate speed. By copy of this letter to Mr. Fritz, I request that this letter and the July 5 letter of Peabody be made a

part of the administrative record in the appeal of Peabody.

Respectfully yours,

/s/ P FRYE
PAUL FRYE
Attorney for the Navajo
Tribe of Indians

[Received July 15, 1985
D.M. RAPPAPORT
Ass't. Gen. Mgr
Gov't. Affairs]

MEMORANDUM

To: Mike Rappaport

From: Leroy Michael Jr.

Subject: Federal Coal Royalties: Public Lands and Indian Lands.

At my meeting with Jack the week of July 8, we discussed the possibility of congressional attention to the federal royalty levels on coal mined from public and Indian lands. Jack asked that I provide you with and overview of the situation and certain information that might be used to address this subject.

SRP faces two discrete fact situations relating to the level of federal coal royalty. One concerns the general royalty level of 12.5% applicable to coal on public lands. The second relates to coal located on the Black Mesa of Arizona used by the Navajo and Mohave projects. The second situation affects all of the cap water users as well as the utilities involved in those stations.

1. The 12.5% royalty on public lands.

For some time users of coal from public lands generally have been asking that the 12.5% royalty level; and. The method of calculating the royalty, both have review and revision. Because of the gross up method of calculation, the true royalty rate is closer to 14.5%.

With the exception of some, but not all, of the coal supplied to Coronado, SRP received virtually all of its coal fuel from public land or Indian land leases entered into long before the 12.5% royalty level was instituted. As time goes by, reopeners in the royalty rates under the leases are triggered. When that occurs, the public or Indian land managers seek royalties of 12.5% computed by the federal method, or higher.

Lease royalty adjustments are now pending for: trapper mine (Craig station); Colo-Wyo mine (Craig station); McKinly mine (Coronado station); Seneca mine (Hayden station); and, Black Mesa and Kayenta mines (Navajo and Mohave stations). Navajo and Mohave situation is covered in item 2 below.

When the 12.5% royalty was adopted by the federal government as a standard, coal was at its highest marginal and market value because of the overall pricing of fossil fuels following the Arab oil embargo. The then fact situation, and the perceptions of energy value futures were the rational for the 12.5% royalty level. Both have drastically changed. It is time for the consumers of electricity to have an opportunity to present their case for a royalty reduction.

2. Royalty on the Indian coal leases for the Black Mesa and Kayenta mines.

The situation here transcends the general issue of federal coal royalties in two respects. One is that the federal land managers appear ready to apply a 20% royalty to all coal mined from the 1934 reservation area lease. Secondly, increases in royalty levels applicable to the Navajo generating station will be the responsibility of

cap water users. 25% of the Navajo generating stations costs and expenses are cap water users obligations.

Attached are two pieces: the first is a letter from Peabody holding company to Don Hodel dated July 5, 1985: the second is a SRP memo dated July 12, 1985 describing the impact of the proposed land managers actions. The pieces are background to the issue at hand.

It is my judgement [*sic*] that the state of Arizona has a sufficient interest in the proposed royalty action for the Black Mesa and Kayenta mine leases to consider intercession. Pragmatically, there will not be two levels of approved royalty for coal mined from the Black Mesa. If the coal mined from the 1934 lease goes to 20% royalty, the pressure to increase the royalty for coal from the 1882 area will be a near impossible factor to deal with.

By copy hereof, I am asking strategic planning, in coordination with the fuels department, to calculate the gross dollar affect on cap O&M expense of increasing the royalty on all coal used by the navajo generating station from current levels to 12.5%; and from 12.5% to 20%. In addition an annual calculation, for representative years, should be done to show the increase O&M costs per acre foot of delivered water under average conditions.

In summary, it is my understanding that SRP believes it is time to consider taking the case to the Congress. We stand ready to provide supporting materials in the form and substance that will be appropriate. We need your guidance and assistance in this effort with specific suggestions on what material should be prepared and how it should be presented in format.

We are available to further pursue this matter at your convenience. The letter of Peabody Holding Company suggests time is of the essence on the 1934 lease.

Leroy Michael Jr.

cc. Dick Silverman, Darrell Smith, John Patton, Mike Hitt, and Biff Hoffman.

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July 16, 1985

MEMORANDUM FOR FILE

SUBJECT: Navajo Payments

On July 15, 1985, the following information was provided by Mr. Greg Leisse of Peabody Coal Company.

* * * * *

2. Mr. Leisee met with Mr. Stan Hulett in Washington, D.C. on July 11 and 12. Mr. Hulet is scheduled to discuss the 20% royalty appeal with the Secretary of Interior and the Assistant Secretary on July 16.

* * * * *

/s/ RM BERTHOLF
R.M. BERTHOLF

cc: R.H. Bridenbecker
S.H. Moody
H.F. Huettemeyer
L.R. Cope

MEMO TO *HFH* [*July 26, 1985*]
Date Prepared

Re: Draft Letter to Navajo Tax Commission

* * * * *

Peabody heard Monday that Hodel had signed memo ordering negotiations and sent to Fritz, but haven't heard any more. Subsequently received a copy of a letter Zah had sent to Hodel. To send us a copy. —May change picture.

cc LRC From *RMB*

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

[CONFIDENTIAL]

PETERSON ZAH	*EDWARD T. BEGAY*
Chairman, Navajo	Vice Chairman, Navajo
Tribal Council	Tribal Council

[SEAL OMITTED]

[Sept. 3, 1985]

Memorandum

To: Peterson Zah, Chairman
Navajo Tribal Council

From: Michael C. Nelson, Staff Assistant
Office of the Chairman

Subject: Summary of Negotiations - Meeting with Peabody, Salt River Project and So Cal Edison, August 30, 1985

I. So Cal's initial offer was an 8% royalty until August, 1988, with a 12½ royalty thereafter. In addition, they would pay an upfront bonus equal to the amount owed since August, 1984 under a 12½% royalty, plus the estimated 4½% royalty payment through August, 1988, plus taxes due for the first six months of 1985, a total of $14,971,984.

Salt River Project would pay 12½% royalty form the effective date of the amended lease, with a lumpsum payment of the 12½% royalty due from August, 1984, a sum of $8,478,097.

The total upfront payment would be $23.4 million. The Navajo Nation would forgive all back taxes due. So Cal would not challenge the tribal taxes anymore.

II. Navajo Nation proposed two options.

A. 16.5% royalty on 8580 Lease. Forgive backtaxes. $150 acre/ft for water. No new coal.

B. 12.5% royalty on 8580 and 9910 Leases. $150 acre/ft for water. No new coal. $10 million for backtaxes.

III. Peabody rejected Option A. As to Option B, they proposed no backtax payment; an option of new coal within the lease area until year 2000; setting a floating royalty at federal minimum surface mining level; and a cap on royalty plus tax at 20.5% of gross realization. After initial concern about the water rate, they accepted it. As to the 9910 Lease, they proposed a royalty reserve on their books for 1 year, pending Hopi approval of a similar lease. If not approved within 1 year, no additional royalty until approved. An upfront payment of $14.4 million, the amount due at 12.5% from August, 1984, plus 1985 taxes, would be paid upon approval.

IV. Navajo Nation wanted additional payment either for backtaxes or for bonus for new coal; floating royalty rate was not accepted—we wanted to preserve 10 year readjustment; a cap of 22.5% was proposed; 2 years royalty and term to get Secretary's approval was proposed; scholarship money was requested.

V. So Cal was pushing the federal minimum rate, with some sort of appeal provision. The indefiniteness of the "reasonable readjustment" bothers them and they wanted to correct it.

They feel our backtax claims are weak, given the lack of regulations, billings and any enforcement attempts prior to this year. The lack of clear title on the JUA lease for part of the 78-83 period they see as hurting our tax assertion.

VI. Summary

We seem agreed on:

1. Minimum 12.5% royalty—8580 and 9910 Leases
2. 150 acre/ft for water, adjusted by CPI
3. Scholarships—amount not set
4. Upfront payment—past due royalty at 12.5% plus '85 taxes
5. No contest of existing taxes

Differences exist as to:

1. Cap amount—20.5% or 22.5%
2. Floating royalty based on federal minimum surface mine rate or further readjustment at 10 year intervals
3. Backtax payments
4. New coal and/or bonus for new coal
5. Terms for dealing with Hopi interest in 9910 Leases.

We agreed to meet again on September 4, 1985 in Phoenix, Arizona.

/s/ MICHAEL C. NELSON
MICHAEL C. NELSON

MCN:cas

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

[CONFIDENTIAL]

PETERSON ZAH	*EDWARD T. BEGAY*
Chairman, Navajo	Vice Chairman, Navajo
Tribal Council	Tribal Council

[SEAL OMITTED]

September 5, 1985

Memorandum

To: Michael C. Nelson, Staff Assistant
Office of the Chairman

From: Akhtar Zaman, Director
Minerals Department

Subject: Summary of Negotiation, Peabody Coal Company (PCC)

This is in reference to your memorandum dated September 3, 1985 to the Chairman on the above subject. We have reviewed the negotiation status with PCC and have the following comments:

1. Minimum Royalty:

   (i) Lease No. 8580: The BIA has recommended a royalty rate on this lease be adjusted to 20% of the gross sale. Whatever royalty rate the Secretary decides upon it is hard to believe that he will adjust the royalty below 12½% as this is the rate applicable to Federal Coal leases.

Therefore, this royalty rate is no concession on the part of Peabody or its customers.

(ii) Lease No. 9910: The present royalty rate is 6.67% which is equally shared by the Hopi and the Navajo Tribes. An increase in the royalty to 12½% would mean that the Navajo Tribes royalty rate would increase from 3.335% to 6.25%. Assuming that the annual average production would be equal from the two leases (about 6,000,000 tons per year) for the next 5 years the increase in the Navajo Tribe's royalty would be about $3.42 millions. If the Hopi's do not agree to a 12½% royalty rate then after a year the royalty rate on this lease would revert to the current rate of 3.335%. There is no substantial economic advantage for the Navajo Tribe by increasing the royalty rate on lease no. 9910 to 12½% because the projected increase in revenue from this lease could be compensated if the royalty on lease no. 8580 is negotiated at a rate higher than 12½%.

2. CAP:

A Cap of 20.5% or more is reasonable for lease no. 9910 if it excludes all payments to the Hopi Tribe.

On lease no. 8580 we should have at least some idea on the effective Navajo Tribal Tax rate. Six months ago it was thought to be around 10-12% of the gross sale. Today it is rumored to be around 5-6%. The Tax Commission should be able to furnish a more clear idea on the tax

rate to the Chairman's Office. A 22.5% cap might not be bad because the coal supplied to the Navajo Generating Station is exempt from Tribal taxes anyway.

3. Water Rate:

   The rate of $150/ac./ft. with annual adjustment based on CPI is reasonable.

4. Scholarship:

   With the Negotiating Team, Peabody had agreed to $150,000/year contribution to the Scholarship Fund from both the leases with 2% increase for the next ten (10) years. The amount of $150,000-$200,000 per year could be agreed upon if Peabody agrees to an annual adjustment based upon CPI.

5. Back Taxes:

   The Tax Commission should provide the figures on past due taxes. While negotiating with Pittsburg and Midway Coal Company (P&M), the Tax Commission and also Attorneys with the Justice Department were confident that there taxes were collectible. If this is so, then why compromise on past due taxes? Moreover, P&M must have also studied the legality of past due Tribal taxes, otherwise they would not have paid $11 million dollars to the Tribe.

6. Up Front Payment:

   There is really no up front payment for lease 8580 because the Secretary cannot adjust the royalty at a date later than August 1984. Also, 1985 taxes are not past taxes and should be payable on time. Basi-

cally it is past due payment to the Tribe and must include interest payment too.

7. No Contest Of Existing Taxes:

The Supreme Court has decided in favor of the Navajo Tribe of its right to tax. Therefore, if negotiation fails and Peabody contest the Tribal taxes they are going to loose the case. (Does this mean that tax will be paid on coal supplied to the Navajo Generating Station?)

8. Floating Royalty Rate/10 year Adjustment Period:

With the Negotiating Team, Peabody had agreed to adjust the rate every ten (10) years so that it would not be less than the Federal rate. Moreover, the royalty once increased would not go down.

9. Navajo Coal/Bonus:

Peabody and Salt River Project (SRP) needs this additional coal otherwise the Navajo Generating Station's life would terminate with the term of the existing lease. After that how will the power plant receive coal from off the reservation without acquiring rights-of-way from the Tribe? It is therefore possible to negotiate a bonus payment for the additional coal.

10. Terms For Dealing With The Hopi Tribe:

If all other issues are resolved and the Hopi Tribe does not agree to an amended lease then the Secretary could be approached to resolve the dispute. Without an assurance that the Navajo Tribe would continue to receive the increased royalty from lease

9910 the agreement would be non-beneficial to the Tribe's interest.

The Navajo Nation is doing the Hopis a tremendous favor in terms of economic benefit by increasing the royalty rate on lease no. 9910 (which do not provide for royalty adjustment) at its own expense by agreeing to a royalty rate on lease no. 8580 which is significantly lower than that recommended by the BIA and waiving past taxes. What benefit or concessions will the Navajo Nation get from the Hopi Tribe?

11. Other Issues That Should Be Address:

    (i) Tribal rules and regulations.

    (ii) Guaranteed minimum royalty without credit against future production royalty.

    (iii) Assignment.

    (iv) Reducing the tax waiver provision of the Navajo Generating Station and the Coal supplied to the plant.

General Comment:

The BIA has made a decision that the royalty rate on lease 8580 should be 20% of the gross sale which Peabody has appealed. It is evident that the Secretary does not favor the rate recommended by the BIA. The issues should be thoroughly discussed with our lawyers and those directly involved in Peabody's appeal. The increase in royalty to 12½% on lease no. 9910 does not significantly increase the Tribal revenue. We recommend that we should go for a royalty rate higher than 12½%

on lease no. 8580 and should be prepared for a prolonged court battle with Peabody if necessary.

Furthermore, this is an excellent time to initiate a research and perhaps build a case against the Secretary for his failure in administering his trust responsibilities as mandated by the U.S. Congress. Some people believe that the Navajo Tribe was pressurized in signing off the power plant an the coal mining leases especially when the leases do not provide a fair economic return to the Tribe for its resources and exempting the Navajo Generating Station and the fuel supplied to it from Tribal Taxes.

If you have any questions, please contact me.

/s/ AKHTAR ZAMAN
AKHTAR ZAMAN

Concurrence:

/s/ MARTIN L. BEGAYE
MARTIN L. BEGAYE, Acting Executive Director
Division of Resources

[SEAL OMITTED]

COUNCIL OF ENERGY RESOURCE TRIBES

1580 Logan Street - Suite 400
Denver, Colorado 80203-1941
(303) 832-6600

September 6, 1985

Mr. Peterson Zah
Chairman
Navajo Tribal Council
P. O. Box 306
Window Rock, Arizona 86515

Dear Mr. Chairman:

Reference my telephone conversation with Mike Nelson concerning the Navajo Nation-Peabody Coal Lease #8580, I recommend adoption by Navajo Nation of the following settlement package.

1. Payment of $12.8 million for royalty for the period August 29, 1984 to August 29, 1985.
2. Payment of $10.2 million for royalty from February 1984 to August 1984 and prior years taxes.
3. Payment of $1.6 million for taxes in 1985.
4. $150/acre ft payment for water for 1985 to be escalated with the CPI annually thereafter.
5. $100,000, in 1985 prices, annual scholarship for Navajo students.
6. The maximum royalty/taxes and other fees of 20.5 percent on gross proceeds from the Black Mesa and Kayenta mines coal.

7. The royalty rate of 12½ percent applicable to Lease 8580 from 1984 to February 1, 1994.

8. The royalty rate for years beyond 1994 to be adjusted in conformity with the federal royalty rates.

9. Granting the right to Peabody to develop 270 million tons of coal beyond the reserve concession under Lease #9910.

I am confident that this package will provide a "reasonable" return to the Navajo Nation for its coal developed by the Peabody Coal Company. I am prepared and available to testify in support of the above package.

Wishing you continued success in serving the Navajo Nation.

Sincerely,

/s/ AHMED KOOROS
AHMED KOOROS
Chief Advisor for Economic Affairs

AK:sh

cc: Michael Nelson, Navajo Nation

September 23, 1985

MR. HOWARD P. ALLEN

Re: NAVAJO NATION ROYALTY AND TAX NEGOTIATIONS

The parties have negotiated a settlement package that would be good for both the Navajo Nation and Peabody/Customers. However, Peterson Zah will not take the package as written to the Navajo Tribal Council because it is only a good deal for the Navajos if the Hopi Tribe goes along. He refused to be dependent upon Hopi action.

The problem involves payment of increased royalties for coal mined from the Joint Use Area (JUA). This amounts to an increase of $4 million per year to the Navajos. Chairman Zah wants the increased payments to start as soon as the Navajo Tribal Council approves the package, regardless of whether the Hopis agree to similar terms.

This is not acceptable to Peabody/Customers because the coal in the JUA is owned jointly by both Tribes. We can't secure a legal minable interest in the Navajos' share of JUA coal just by paying them more money. Either the Hopis must also agree, or the mineral interest must be partitioned between the two tribes by Congress. The latter is probably not feasible.

Peterson Zah proposed an alternative involving paying 16½% royalty on the northern lease for 10 years, to satisfy both the royalty appeal and retroactive taxes. This gets him about the same money as 12½% on both leases and doesn't require Hopi action. However, this

higher royalty would be an unacceptable precedent for us.

Rather than declare an impasse, the parties agreed to hold negotiations open, pending discussions with the Hopi Tribe. A preliminary meeting with the Hopis indicated some willingness to talk. Another meeting has been set for September 30.

/s/ R.H. BRIDENBECKER
R.H. BRIDENBECKER

RHB: gw

Attachment A

1. $22.7 million paid upon settlement approval[1] including the following components:

   a. 12-½% royalty on 8850 lease calculated to February 1, 1984[2]

      Mohave Project: $6.6 million

      Navajo Project: $14.5 million

   b. Mohave Project payment of first half 1985 taxes: $1.6 million.

2. Satisfaction of all obligations for Navajo taxes applicable to Peabody's operations and interests at Black Mesa prior to 1985.

3. Dismissal of 8850 lease royalty appeal.

4. 12½% royalty on 8850 lease.

5. Navajo taxes and royalties capped at 20.5% of gross realization.

6. $150 per acre foot for water, escalated 100% by CPI.

7. $100,000 per year scholarship fund paid by Peabody to Navajo Nation.

8. Option for all surface mineable coal on 8850 lease, to be exercised on or before the year 2000.

9. Amendment to the 9910 lease, increasing royalty rate to 12½%, effective upon Peabody's obtaining

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[1] Some portion to be paid upon Council approval: balance upon Interior approval.

[2] Peabody willing to pay $3 million share.

authority to mine Navajo's share of surface coal in the lease.

10. Royalties on both leases to be adjusted to the greater of the federal minium rate or 12½% at 10-year intervals. If either party is dissatisfied with this result, negotiations may be initiated, with resolution by arbitration if agreement is not reached within 6 months.

11. The 20.5% cap will be subject to 10-year reopener with negotiation and arbitration as under 10.

Need my comments

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December 23, 1985

CONFIDENTIAL

MEMORANDUM

TO: Peterson Zah, Chairman
Navajo Tribal Council

FROM: Claudeen Bates Arthur, Attorney General
Department of Justice

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

This is my recommendation to reject Peabody Coal Company's offer to settle the appeal of the Navajo Area Director's adjustment of our royalty rate to 20% on Lease 8580. Attached is a draft of a proposed letter to the Deputy Assistant Secretary of Indian Affairs notifying him of our inability to resolve our royalty readjustment dispute with Peabody and requesting a written decision by him on the matter within 30 days.

Peabody's final offer set forth in the September 5, 1985 memorandum to you from Mike Nelson (copy attached) does not come close to the financial return we can obtain by continuing to defend Peabody's appeal of the adjustment of royalty on Lease 8580. Additionally, there are serious problems with Peabody's offer involving labor, taxes, water and sovereignty issues. The benefits of rejecting Peabody's offer and proceeding to defend Peabody's appeal of the Area Director's adjustment of the royalty rate are:

1. ~~Peabody would owe us at a minimum 12½ royalty on Lease No. 8580 from the date of the readjustment and inclusive of interest. I also believe that~~ We would preserve our rights to a royalty in excess of 12½% there is an excellent prospect for a much higher royalty rate than 12½% based upon the merits of the case. I anticipate a likely outcome of the royalty adjustment case before the Assistant Secretary of the Interior to result in at least 15% or 16% on Lease No. 8580, and a good possibility of 17% to 20%.

How much is this?

2. We ~~can likely begin~~ are entitled to collect at least 12½% royalties on Lease 8580, plus back royalties and interest from the date of adjustment (August 28, 1984), as soon as the Assistant Secretary of the Interior decides the appeal. ~~This is because there is no way Peabody could demonstrate any likelihood of prevailing on~~

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appeal for a lesser royalty rate. Thus, we should be able to obtain an order from the Assistant Secretary to pay the Tribe at least 12½% on production from August 28, 1985, forward during the pendency of any further appeal. I would estimate this will bring in approximately $15 million in back royalty and interest, plus 12½% on future production. Even under the worst case scenario, I believe we would begin receiving these royalties no longer than six months from now.

3. We could collect our back taxes, which are projected at $20-30 million. In the Pittsburg and Midway deal, we got $10 million for our back taxes, but Peabody is offering only one half of a years worth of taxes in the amount of $1.6 million.

4. We would prevent Peabody from shifting production to its 9910 Lease. As you may be aware, Peabody's negotiations with the Negotiating Team, as well as with myself last year, indicated Peabody refuses to obey their present lease requirement to equalize production on the two leases. Because of this the Navajo Area Director sent Peabody a letter on April 25, 1984 indicating that Leases 8580 and 9910 could be cancelled for this reason. (See, Exhibit 10 of Navajo Reply Brief).

The Peabody proposal has consistently been that we agree to not require equalization. This would allow them to shift production to Lease 9910, in which Public Law 93-531, 25 USC § 640d-6 gives the Hopis joint ownership and management. This would mean that Peabody after readjustment of the royalty rate on Lease 8580, might shift production to Lease 9910 to enjoy lower royalty costs (and possibly lower taxes because we may not have authority to impose our PIT on the Hopi's 50% interest and the Secretary of the Interior has already held that the Hopis cannot tax on Navajo Partition Lands (93% of Lease 9910)), and would also mean Navajos could lose jobs, because the Hopis are entitled to 50% employment on the 9910 Lease.

If we reject Peabody's offer we can go to the Secretary to enforce the existing equalization clause, which will assure 75% Navajo employment. Additionally, we can bring a suit to collect $3 million in existing damages for breaching the equalization clause.

5. Peabody has entered into coal supply agreements with participants of two power plants, the Mohave Generating Station in Nevada, and the Navajo Project at Page. In 1976 and 1977 these coal supply agreements were amended and the amendments anticipated the need to negotiate with the Navajo Tribe for additional lease acreage. Such negotiations were expected to result in a higher royalty rate. Therefore the amendments provided that any increase in royalties paid to the Navajo Tribe would be automatically passed through to consumers as an increase in the mine price of coal. This was documented in the

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exhibits submitted to the Deputy Assistant Secretary of Indian Affairs in our answer brief in the matter of the appeal of the Navajo Area Director's adjustment of royalty rate. (See, Exhibit 33 of Navajo Reply Brief).

Together, Leases 8580 and 9910 are limited to 200 million tons apiece. In the 1976 and 1977 coal supply amendments, Peabody committed itself to negotiate further with the Navajo Tribe because, while its rights under Leases 8580 and 9910 were limited to a total of 400 million tons, it assured the various participants of the power plants that it could supply coal from Leases 8580 and 9910 in excess of 400 million tons.

If we do not accept Peabody's offer they will ~~not~~ have ~~any rights to additional coal, and could be susceptible to allegations of breach of contract in their fuel supply agreements with the Mohave Generating Station and the Navajo Project.~~ This would provide us with bargaining strength in the context of encouraging further negotiations with Peabody to readjust the 9910 Lease. Additionally, it should be noted that Peabody's offer requires additional coal in the amount of 314 million tons on both leases, but only offers a bonus of $8.3 million on 97 million tons. Our experts advise us we should get a $35 million bonus for 314 million additional tons of coal.

6. In addition to 5, we believe we have other grounds to bring pressure on Peabody to negotiate readjustments on the 9910 Lease. For example, we believe that there are invalidities in the formation of Lease 9910, as well as existing lease violations, including violation of the equalization clause referred to in 4 above, so that we could bring a suit to cancel Lease 9910. Because the Hopi Tribe would be implicated in such an action, this strategy may bear additional benefits in the context of resolving other Navajo/Hopi issues, and most importantly does not put us in a position of asking the Hopis to consent to our deal.

7. The Peabody offer to pay $150 per acre foot of water also falls far short of the $600 to $700 per acre foot we have obtained from other lessees such as Chuska.

8. The Peabody proposal placing a cap of 20.5% of gross realization on the total amount of the royalties and taxes which the Tribe can obtain from Peabody, represents a waiver of future taxing power in exchange for very little. We are being asked to sacrifice our Tribal sovereign power to tax our resources in exchange for accepting a royalty rate less that we can expect to obtain by simply having the Assistant Secretary decide the Peabody appeal on the merits.

9. Peabody's proposal to raise the royalty rates to 12.5% on Lease 9910 is obviously contingent upon obtaining Hopi concurrence or

legislation splitting the mineral interest. The likelihood of these events occurring are low and, in any event, would require a considerable amount of time, further delaying when we can begin to receive the benefits to which the Tribe is entitled under its existing leases. Defending Peabody's appeal will not only bring in greater revenues, but will obtain these revenues more quickly. (We should not agree unless Peabody agrees to increase pay us money & to also pay the Hopis a similar amount if we are sue

It is my recommendation that we inform Peabody we cannot agree to their final offer, inform the Assistant Secretary that we have not reached an agreement with Peabody, and that we request an immediate decision on the merits of the case submitted to him last January.

Finally, I want to stress that if we were to accept Peabody's offer the Tribal Council would need to be made aware of all of these issues. I believe they would be highly concerned, as am I, about not only the financial considerations, but also with the issues of sovereignty, labor, taxes and water. Also, I want to recommend that if we send the attached proposed letter to Mr. Swimmer it is important that ~~we~~ hand-deliver it, ~~preferably by yourself, but, alternatively, by Eric or Roger.~~ Mr. Swimmer is new to the position of Deputy Assistant Secretary and should be welcomed to his new position and informed that we do not in any way attribute the delays in this appeal to him personally. ~~to you personally~~ indeque of

If you have any questions let us discuss them in the near future.

Claudeen Bates Arthur

CBA/RRH/ah
Attachments

cc: Louis Denetsosie, Deputy Attorney General, Department of Justice
R. Randall Harrison, Attorney, Department of Justice
Michael Nelson, Executive Assistant, Office of the Chairman
Eric D. Eberhard, Director, Navajo Nation Washington Office
Roger Boyd, Staff Assistant, Office of the Chairman

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35281

I would ask to remind the Sec of his trust responsibility to the Tribe — a good way to do this is to cite some cases re trust duties

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Commissioner of Indian Affairs
U.S. Department of the Interior
18th & C Streets
Washington, D.C. 20245

ATTN: Honorable Mr. Ross Swimmer
Deputy Assistant Secretary-
Indian Affairs

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

Dear Honorable Mr. Swimmer:

On June 18, 1984, the Area Director Donald Dodge, Navajo Area Office adjusted the royalty rate for coal mined under Lease No. 14-20-0603-8580 to 20% pursuant to the adjustment provisions of Article VI of the lease. On July 16, 1984, Peabody gave notice of appeal to the Commissioner of Indian Affairs. Briefing was completed by both parties on January 17, 1985. 25 CFR § 2.19 requires that the Commissioner, within 30 days after all time for pleadings (including extensions) has expired, to render a written decision or refer the appeal to the Board of Indian Appeals for decision. This duly promulgated regulation has the force and effect of law. See, Jicarilla Apache Tribe v. Andrus, 687 F.2d 1224, 1332 (10th Cir. 1982).

As the Navajo Tribe has repeatly pointed out, Peabody has sought extraordinary action on the part of the office of the Commissioner of Indian Affairs to either delay or preempt the orderly appeal process mandated by regulations promulgated by the Secretary of the Interior. Peabody has succeeded beyond any legitimate propriety in obtaining the assistance of the Department in delaying their increased royalty payments. During my trip to Washington, D.C. on , 1985, I met with Mr. John Fritz, Deputy Assistant Secretary for Indian Affairs to express my concern that no decision had been reached in this matter. However, Mr. Fritz explicitly stated that he would not decide Peabody's appeal until the Navajo Tribe made a final attempt to negotiate with Peabody to avoid further litigation.

Despite numerous attempts and the expenditure of substantial tribal resources, we have been unsuccessful in negotiating a new royalty rate on Lease 8580. Thus far, Peabody has succeeded in delaying the payment of fair royalties to the Navajo Tribe for almost 16 months, and the Navajo Tribe

35282

opposes strenuously any further delay. The Navajo Tribe is sacrificing in excess of a million dollars per month in revenues which are unavailable to meet the legitimate needs of the Navajo people. It should be emphasized, that Peabody has offered nothing which detracts from the propriety of the Area Director's action, and has refused the invitation to submit data relevant to its own appeal.

Therefore, this is to request, pursuant to 25 CFR § 2.19, that within thirty (30) days of this date you render a written decision on the above referenced appeal, or, within that time refer the appeal to the Board of Indian Appeals for its decision.

In closing, the Navajo Tribe urges, that a final decision for the Department upholding the Area Director be made with all deliberate speed. Additionally, it is respectfully requested that this letter be made a part of the administrative record in the appeal of Peabody.

Thank you for your interest in this matter.

Respectfully yours,

NAVAJO NATION

Peterson Zah, Chairman
Navajo Tribal Council

PZ/RPH/ah

cc: Counsel of Record

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ask him to enter to Peabody to an order requiring payment at (effective rate immediately) of 12 1/2 %

Also ask him to calculate the 1984 and 1985 value of royalties + pay him to us!

tell them we will go to federal Court to enforce the time limits and to obtain other remedies

Interest

35283

THE NAVAJO NATION

WINDOW ROCK, NAVAJO NATION
ARIZONA 86515

PETERSON ZAH	*EDWARD T. BEGAY*
Chairman, Navajo Tribal Council	Vice Chairman, Navajo Tribal Council

[SEAL OMITTED]

December 30, 1985

CONFIDENTIAL MEMORANDUM

To: Peterson Zah, Chairman
Navajo Tribal Council

From: Claudeen Bates Arthur, Attorney General
Department of Justice

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

This is my recommendation to reject Peabody Coal Company's offer to settle the appeal of the Navajo Area Director's adjustment of our royalty rate to 20% on Lease 8580. Attached is a draft of a proposed letter to the Deputy Assistant Secretary of Indian Affairs notifying him of our inability to resolve our royalty readjustment dispute with Peabody and requesting a written decision by him on the matter within 30 days.

Peabody's final offer set forth in the September 5, 1985 memorandum to you from Mike Nelson ("Attachment l") does not come close to the financial return we can obtain by continuing to defend Peabody's appeal of the adjustment of royalty on Lease 8580. Additionally,

there are serious problems with Peabody's offer involving labor, taxes, water, and sovereignty issues. The benefits of rejecting Peabody's offer and proceeding to defend Peabody's appeal of the Area Director's adjustment of the royalty rate are:

1. We would preserve our right to royalties in excess of 12½%. There is an excellent prospect for a much higher royalty rate than 12 ½% based upon the merits of the case. I anticipate a 1ikely outcome of the royalty adjustment case before the Assistant Secretary of the Interior to result in at least 15% or 16% on Lease No. 8580, and a good possibility of 17% to 20%. Royalties due to us under each of the above royalty rates are estimated on our current total production of 11 ½ million tons of coal per year as follows:

Royalty Rate	Royalty
NOW	$ 2,000,000
12½%	13,500,000
15%	16,700,000
16%	17,900,000
17%	19,200,000
20%	23,000,000

2. We are entitled to collect at least 12½% royalties on Lease 8580, plus back royalties and interest from the date of adjustment (August 28, 1984), as soon as the Assistant Secretary of the Interior decides the appeal. Interest on late

payments are due pursuant to 30 CFR § 211.67 (renumbered at 30 CFR § 218.200) in accordance with *Peabody Coal Co.*, IBLA 83-248 (1983) ("Attachment II"). The rate is determined in accordance with the Department of Treasury "Current Value of Funds Rate". Thus, we should be able to obtain an immediately effective order from the Assistant Secretary that Peabody pay the Tribe at least 12½% on production from August 28, 1985, forward during the pendency of any further appeal. I would estimate this will bring in approximately $17 million in back royalty and interest, plus 12½% on future production. Even under the worst case scenario, I believe we would begin receiving these royalties no longer than six months from now.

3. We would be entitled to collect our back taxes, which are projected at $20-30 million. In the Pittsburg and Midway deal, we got $10 million for our back taxes, but Peabody is offering only one half of a years worth of taxes in the amount of $1.6 million.

4. We would preserve our ability to bring an action before the Secretary to force Peabody to comply with their lease provision requiring the mining of coal on an equal basis from Lease 8580 and 9910. At the present time, Peabody is violating this provision. On April 25, 1984, the Navajo Area Director sent Peabody a letter indicating that they were in violation of such equalization provision, and indicated that Leases 8580 and 9910 could be cancelled for this

reason. (*See*, Exhibit 10 of Navajo Reply Brief). Peabody's blatant violation of the equalization provision has through 1983 cost the tribe $2.58 million, plus interest. ("Attachment III" - Analysis from Tribal Minerals Department).

The Peabody proposal has consistently been that we agree to not require equalization. Our agreement would endorse their actions and allow them to shift production at will. This would allow them to shift production to Lease 9910, in which Public Law 93-531, 25 USC § 640d-6 gives the Hopis joint ownership and management. This would mean that Peabody, after readjustment of the royalty rate on Lease 8580, might shift production to Lease 9910 to enjoy lower royalty costs (and possibly lower taxes because we may not have authority to impose our PIT on the Hopi's 50% interest and the Secretary of the Interior has already held that the Hopis cannot tax on Navajo Partition Lands (93% of Lease 9910)), and would also mean *Navajos would lose jobs*, because the Hopis are entitled to 50% employment on the 9910 Lease.

If we reject Peabody's offer we can go to the Secretary to enforce the existing equalization clause, which will assure 75% Navajo employment. Additionally, we can bring a petition before the Secretary to collect $3 million in existing damages for breaching the equalization clause.

5. Peabody has entered into coal supply agreements with participants of two power plants,

the Mohave Generating Station in Nevada, and the Navajo Project at Page. In 1976 and 1977 these coal supply agreements were amended and the amendments anticipated the need to negotiate with the Navajo Tribe for additional lease acreage. Such negotiations were expected to result in a higher royalty rate. Therefore the amendments provided that any increase in royalties paid to the Navajo Tribe would be automatically passed through to consumers as an increase in the mine price of coal. This was documented in the exhibits submitted to the Deputy Assistant Secretary of Indian Affairs in our answer brief in the matter of the appeal of the Navajo Area Director's adjustment of royalty rate. ("Attachment IV"—Exhibit 33 of Navajo Reply Brief).

Together, Leases 8580 and 9910 are limited to 200 million tons apiece. In the 1976 and 1977 coal supply amendments, Peabody committed itself to negotiate further with the Navajo Tribe because, while its rights under Leases 8580 and 9910 were limited to a total of 400 million tons, it assured the various participants of the power plants that it could supply coal from Leases 8580 and 9910 in a dedicated amount of 207 million tons to Mohave and 244 million tons to Navajo Project, an amount some 51 million tons in excess of their 400 million ton limit.

If we do not accept Peabody's offer they will have to provide coal to the stations from another source at a much higher price. This would provide us with bargaining strength in the con-

text of encouraging further negotiations with Peabody to readjust the 9910 Lease. Additionally, it should be noted that Peabody's offer requires additional coal in the amount of 314 million tons on both leases, but only offers a bonus of $8.3 million on 97 million tons. Our experts advise us we should get a $35 million bonus for 314 million additional tons of coal.

6. In addition to 5, we believe we have other grounds to bring pressure on Peabody to negotiate readjustments on the 9910 Lease. For example, we believe that there are invalidities in the formation of Lease 9910, as well as existing lease violations, including violation of the equalization clause referred to in 4 above, so that we could bring a petition before the Secretary to cancel Lease 9910. We could also bring an action in federal court after exhausting administrative remedies to seek damages for breach of equa1ization or for reformation of Lease 9910. We may also have grounds to sue the United States in the Court of Claims for breach of trust. Because the Hopi Tribe would be implicated by such actions, this strategy may bear additional benefits in the context of resolving other Navajo/Hopi issues, and most importantly does not put us in a position of *asking* the Hopis to consent to our deal.

7. The Peabody offer to pay $150 per acre foot of water also falls far short of the $600 to $700 per acre foot we have obtained from other lessees such as Chuska.

8. The Peabody proposal placing a cap of 20.5% of gross realization on the total amount of the royalties and taxes which the Tribe can obtain from Peabody, represents a waiver of future taxing power in exchange for very little. We are being asked to sacrifice our Tribal sovereign power to tax our resources in exchange for accepting a royalty rate less that we can expect to obtain by simply having the Assistant Secretary decide the Peabody appeal on the merits.

9. Peabody's proposal to raise the royalty rates to 12.5% on Lease 9910 is obviously contingent upon obtaining Hopi concurrence or legislation splitting the mineral interest. The likelihood of these events occurring are low and, in any event, would require a considerab1e amount of time, further delaying when we can begin to receive the benefits to which the Tribe is entitled under its existing leases. Defending Peabody's appeal will not only bring in greater revenues, but will obtain these revenues more quickly.

It is my recommendation that we inform Peabody we cannot agree to their final offer, inform the Assistant Secretary that we have not reached an agreement with Peabody, and that we request an immediate decision on the merits of the case submitted to him last January.

Finally, I want to stress that if we were to accept Peabody's offer the Tribal Council would need to be made aware of all of these issues. I believe they would be highly concerned, as am I, about not only the inadequacy of financial considerations, but also with the issues of sovereignty, labor, taxes and water. Also, I want

to recommend that if we send the attached proposed letter to Mr. Swimmer it is important that you call Mr. Swimmer. Mr Swimmer is new to the position of Deputy Assistant Secretary and should be welcomed to his new position and informed that we do not in any way attribute the delays in this appeal to him personally.

If you have any questions let us discuss them in the near future.

Claudeen Bates Arthur

CBA/RRH/ah

Attachments

xc: Louis Denetsosie, Deputy Attorney General, Department of Justice

R. Randall Harrison, Attorney, Department of Justice

Michael Nelson, Executive Assistant, Office of the Chairman

Eric D. Eberhard, Director, Navajo Nation Washington Office

Roger Boyd, Staff Assistant, Office of the Chairman

July 9, 1986

Mr. Howard P. Allen

RE: STATUS OF NAVAJO AND HOPI COAL ROYALTY AND TAX NEGOTIATIONS

We appear to have reached agreement in principle with both the Hopi negotiating team and Peterson Zah representing the Navajo Nation. The major points of agreement are summarized on the attachment. In brief, we have achieved our objectives: royalties set at the federal minimum level (12.5 %), exposure to the 20% royalty rate eliminated, Mohave's back tax problem resolved, a cap on future taxes established, all additional coal in the leasehold available for our use, and long-standing water related issues addressed productively.

* * * * *

/s/ R.H. BRIDENBECKER
R.H. BRIDENBECKER

RHB: br

cc: Mr. D.J. Fogarty

RECORD OF THE
JOINT MEETING
OF THE
ADVISORY COMMITTEE

&

BUDGET AND FINANCE COMMITTEE
&
ECONOMIC AND
COMMUNITY DEVELOPMENT COMMITTEE

&

RESOURCES COMMITTEE
AND
LABOR AND MANPOWER COMMITTEE

July 18, 1986

The meeting was called to order at 10:00 a.m. by Chairman Peterson Zah with a quorum present of the following Committee Members:

Advisory Committee: Wallace Archer, Larry Beck, Guy Gorman, Daniel Tso, John Perry, Jr., Willis Peterson, Thomas Boyd, Ernest Hubbell, Marshall Plummer, Dudley Yazzie, Frank John, Morris Johnson and Freddie Howard.

Budget and Finance Committee: Dean Paul, Reynold Harrison, Edith Yazzie, Marlin Scott, Roy Vandever, Robert Ortiz, Bobby Willeto, James Ashike, Nelson Gorman and Willie Grayeyes.

Economic and Community Development Committee: Roman Bitsuie, Johnny Descheney, Harvey McKerry and Harold Noble.

Labor and Manpower Committee: Stanley Yazzie, Tincer Nez and Jimmie Nelson.

Resources Committee: Andrew Benallie, Byron Huskon, Frank Gishey and Wallace Davis.

Also present were: Carl Beyal, Legislative Secretary; Albert Hale, Justice Department; Lorene Spencer, Secretary; Rena Morris, Legislative Reporter; Michael Nelson, Chairman's Office.

* * * * *

CHAIRMAN: Members of the Joint Committee: I'll give the floor to Mr. Nelson and Mr. Moore, I believe we have about seven or eight people who asked questions.

MICHAEL NELSON: Mr. Chairman Pro Tem, Members of the Joint Committee: See if I can take these in order, Mr. Yazzie asked the water use from the mines, from the Peabody slurry line, the effect on the water table, he along with a number of others wanted an alternative to the coal slurry line, this is something we've been raising with Peabody for a number of years and it was raised in the negotiations posed by the Navajo Nation and the Hopi Tribe, both tribes were very strong on that, as strong as we could be. The problem as I see it is Peabody does not recognize that there is a visible impact on the wells surrounding the area and we do not have data to counteract that. But Mr. Zaman's report shows and I would defer to him on this and allow him to tell you himself is that Peabody's total water usage over the life of the mine is less than one-half of 1% of the water that's in storage up there.

* * * * *

Mr. Boyd asked about back taxes, I believe Mr. Hale raised this back tax issue impact on the present tax issues, the way we value back taxes is something that will be in litigation and I would prefer that we deal with that in executive session. I would like to say that these numbers were provided to the Tax Commission by both Peabody and by myself a number of times and if Mr. Gorman has not been made privy to those numbers, that is really not our fault. They were made available, they have been available for about six weeks. As far as the date of imposition of back taxes, it is the date that the tax laws were passed by the Navajo Nation.

* * * * *

Mr. Gorman spoke about the Interior appeal, status of the Interior appeal is the Secretary had asked Peabody and the Navajo Nation to sit down and try to work out their differences on that. He has indicated an unwillingness to act on this until we have given it one last shot. The one last shot seems to have borne some fruit, should we seek not to go forward with these principles of agreement, I'm sure the Secretary could decide that royalty appeal. I would point out that the royalty appeal applies to the North Lease only, it does not apply to the South Lease, it would not change the rates that are presently received for our water at $5 per acre foot.

As far as whether we can have both royalty and taxes, only time can tell on that, again I'd like to reserve that for executive session. I'll kind of analyze this proposal, again the Tax Commission has been aware of this for some years. Mr. Tso was also concerned about altering the water sources, he brought up the point that you can't drink the coal and money and that's true however

you can use the money to develop water. Deep water is of no use to you unless you can get to it and its costs a great deal of money to get to it. Mr. Zaman can I'm sure give you the gallons per day figure on these wells. As far as transplanting the juniper trees, I believe the cost would be less to just grow new ones and I know Peabody is under an obligation under federal law, under the Surface Mining Reclamation Control Act to reclaim the areas that have been mined which I know includes replanting the shrubs. I'll defer to Mr. Zaman on that one. That's all I have, Mr. Chairman.

* * * * *

REYNOLD HARRISON:

* * * * *

I would be more in favor of additional information being presented and also on the issue of the backtaxes that's been presented. I think that's a concern of the Tax Commission. Also earlier there was a resolution that was passed where we did grant waivers in situations involving contractors. I can't really see the consistency. So in my opinion passing of this resolution at this time is premature. * * *.

* * * * *

COURT OF APPEALS STATE OF ARIZONA
DIVISION ONE

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1 CA-CIV 9317

MARICOPA COUNTY
SUPERIOR COURT
No. C-499407

PEABODY COAL COMPANY, A DELAWARE CORPORATION, PLAINTIFF-APPELLANT

v.

STATE OF ARIZONA AND ARIZONA DEPARTMENT OF REVENUE, DEFENDANTS-APPELLEES

[Filed: Feb. 27, 1987]

APPELLANT'S OPENING BRIEF

* * * * *

An examination of the degree to which the federal government and the Navajo Tribe control Peabody's activities must lead to the same conclusion here, i.e., that the state cannot lawfully impose an additional Transaction Privilege Tax on Peabody based on its gross proceeds or income from coal mining on the Navajo and Hopi Reservations.

The involvement of the United States in tribal affairs generally and coal-mining operations specifically is indeed vast. In 25 U.S.C.A. § 631, congress authorized

programs and expenditures to further the purposes of existing treaties with Navajo Indians and to make available the resources of their reservations for use in promoting a self-supporting economy and self-reliant community to lay a foundation upon which the Navajo and Hopi Tribes could engage in diversified economic activities. Funds were authorized to survey and study coal and mineral resources with preference for employment of Navajo and Hopi Indians. 25 U.S.C.A. § 633. Pursuant to 25 U.S.C.A. § 635, the Secretary of the Interior has adopted extensive regulations which govern Peabody Coal Company's operations and leases executed by virtue of the Indian Mineral Leasing Act of 1938, 25 U.S.C.A. §§ 396a, et seq.

The rules promulgated pursuant to 25 U.S.C.A. § 635 include requirements that all leases must be in a form approved by the Secretary of the Interior and subject to his written approval. 25 CFR § 162.5. No lease can be approved or granted at less than the fair annual rental. 25 CFR § 162.5(b). Satisfactory surety bonds may be required to assure performance of contractual obligations. 25 CFR § 162.5(c). Additionally, insurance in an amount adequate to protect any improvements must be provided. 25 CFR § 162.5(b)(e).

In addition to these general leasing regulations, others have been adopted specifically dealing with the leasing of tribal lands for mining. Pursuant to 25 CFR § 211.2, tribes may lease their land for mining purposes after advertising for bids (§ 211.3), with negotiated leases accompanied by a proper bond and other supporting papers to be filed with the Superintendent of the Bureau of Indian Affairs. However, the Secretary of the Interior may reject negotiated leases (25 CFR § 211.2)

and direct that they be advertised for bids subject to the Secretary's approval.

Pursuant to 25 CFR § 211.18, Peabody must allow any tribal agent or authorized representative of the Department of Interior to enter upon the leased premises for purposes of an inspection and must keep a full and correct account of all operations, making reports as required by the Interior Department regulations. In addition, the books and records showing the manner of operations and persons interested must be open at all times for examination.

In the event a lessee fails to comply with any provisions of a lease or the regulations, penalties can be assessed pursuant to 25 CFR § 211.22.

As if the foregoing were not enough, the Secretary has also adopted regulations dealing extensively with surface exploration, mining, and reclamation of lands on the reservation. The stated purpose of such surface exploration and reclamation requirements is encourage development of the mineral resources underlying Indian land where mining is authorized and to assure adequate measures are taken to avoid, minimize or correct damage to the environment and/or to the public health and safety. 25 CFR § 216.1. Other sections of 25 CFR discuss the technical examination of prospective surface exploration and mining operations, the basis for a denial of a permit or lease, approval of an exploration plan, and include rules relating to such matters as acid drainage, acid-forming materials, alluvial valley floors, land contours, aquifers, compaction, diversion of canals, floor irrigation, ground water, hydrological balance, enclosed basins, intermittent streams, overburden, productivity,

recharge capacity of the soil, road, runoffs, sediment ponds, sub-irrigation, surface coal-mining operations, reclamation operations, surface water, toxic-forming materials, waste and water tables. See, e.g. 25 CFR § 216.4, § 216.5, § 216.101.

The list of federal rules and regulations impacting Peabody's coal-mining operations on the Navajo and Hopi Reservations could go on almost ad infinitum. The foregoing represents a sampling, though, that should be sufficient to establish the fact that every aspect of Peabody's operations on the reservations is impacted by the federal government. Peabody's interests are impacted by 25 CFR only because its mining operations are on Indian lands. The entire subject matter of that part of the Code of Federal Regulations deals with Indians. Naturally, Peabody's activities are also governed by the rules set forth in 30 CFR, Mineral Resources. Even that part of the federal regulatory scheme has portions dealing specifically with Indian lands. See, e.g., Parts 750, 780, 816, 843.

* * * * *

Navajo Appeals
sent in from Navajo Area
Package is a screwed up mess
of 2 different and unrelated
appeals

DEPARTMENT OF THE INTERIOR

Bureau of Indian Affairs
WASHINGTON, D.C.

MEMORANDUM FROM: DATE 5-7-87

Deputy to the Assistant Secretary—Indian Affairs
(Trust and Economic Development)

TO JOE JOHNSTON

I am advised by the Navajo Area Office that the Black Mesa appeal is not a dead issue. Please review and then provide a briefing for me on its status. I recall that Whit Field believed that it should remain on hold. We should all meet on this, to see whether or not we can reach a solution.

Thanks.

Talk with Eric

talk with Whit (Kelly also?)

- Draft ~~status~~ rpt on { ① Peabody/Navajo negotiations ② MAS Appeal } For Ryan

- Ltr. to Wilson initialing status (above) } "NOT" WITHOUT WHIT'S APPROVAL

CAU-41-87

Class "B" Resolution
Area Approval Required

**RESOLUTION OF THE
NAVAJO TRIBAL COUNCIL**

Approving the Amendments to Coal Mining Leases No. 14-20-0603-8580 and No. 14-20-0603-9910 Between the Navajo Tribe and Peabody Coal Company

WHEREAS:

1. Lease No. 14-20-0603-8580, commonly referred to as the "North Peabody Lease", was made and entered into on February 1, 1964, between the Navajo Tribe and Sentry Royalty Company and this lease was approved by the designated representative of the Secretary of the Interior on August 28, 1964; and

2. Lease No. 14-20-0603-9910, commonly referred to as the "FJUA Lease", was made and entered into on June 6, 1966, between the Navajo Tribe and Sentry Royalty Company and this lease was approved by the designated representative of the Secretary of the Interior on July 7, 1966; and

3. Peabody Coal Company, a Delaware Corporation, has been assigned all of Sentry Royalty Company's right, title and interest in and to both of said leases; and

4. Peabody Coal Company has, pursuant to a package of amendments to both of said Leases, proposed to the Navajo Tribe to lease 90 million additional tons of surface mineable coal within the boundaries of the leasehold under Lease No. 14-20-0603-8580, and to lease the

Navajo Tribe's undivided one-half interest in 180 million additional tons of surface mineable coal within the boundaries of the leasehold under Lease No. 14-20-0603-9910; and

5. The Navajo Nation's representatives assigned to review and negotiate the amendments of said leases now recommend the approval of the amendments to said leases as attached hereto as Exhibits "A" and "B"; and

6. The Advisory, the Budget and Finance, the Resources, the Labor and Manpower and the Economic Development Committees of the Navajo Tribal Council after review of said amendments have determined it is in the best interest of the Navajo Nation to approve said amendments.

NOW THEREFORE BE IT RESOLVED THAT:

1. The Navajo Tribal Council hereby approves the amendments to Coal Mining Leases No. 14-20-0603-8580 and No. 14-20-0603-9910, as attached hereto as Exhibits "A" and "B" and they are incorporated herein by reference.

2. The Navajo Tribal Council hereby authorizes the Chairman of the Navajo Tribal Council to execute amendments to said leases substantially in the form of Exhibits "A" and "B" on behalf of the Navajo Nation.

CERTIFICATION

I hereby certify that the foregoing resolution was duly considered by the Navajo Tribal Council at a duly called meeting at Window Rock, Navajo Nation, (Arizona), at which a quorum was present and that same was

passed by a vote of 64 in favor, 3 opposed and 1 abstained, this 11th day of August, 1987.

/s/ ILLEGIBLE
Chairman
Navajo Tribal Council

UNITED STATES GOVERNMENT
MEMORANDUM

Date: Sept. 23, 1987

Reply to

Attn of: Assistant Area Director, Navajo

Subject: Peabody Coal Company's Amendments to Navajo Coal Lease Nos. 14-20-0603-8580 and 14-20-0603-9910

To: Division of Energy and Minerals Resources

Attached for your review, comments and recommendations is the Peabody Coal Company's amendments to Navajo Coal Lease Nos. 14-20-0603-8580 and 14-20-0603-9910 submitted by the Navajo Nation. Please 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.

Your prompt attention to this review is appreciated and if you should have any questions regarding this matter, please feel free to call our Minerals staff at telephone number (602) 871-5151, Extension 5342, or FTS: 479-5342.

/s/ ILLEGIBLE

Attachments

CONFIDENTIAL

[SEAL OMITTED]

THE NAVAJO NATION

PETER MacDONALD, CHAIRMAN
THE NAVAJO TRIBAL COUNCIL
JOHNNY R. THOMPSON, VICE CHAIRMAN
THE NAVAJO TRIBAL COUNCIL

For Immediate Release
November 18, 1987

Contact:
Micheal R. Upshaw
Attorney General

Karen Diakun
Press Officer
(602) 871-4941

RENEGOTIATIONS OF PEABODY COAL LEASE AMENDMENTS COMPLETED

Phoenix, Arizona—After 10 years of negotiations, the Navajo Tribe, the Hopi Tribe and Peabody Coal Company have agreed to sweeping amendments to the mining leases for the Black Mesa/Kayenta coal mines in Northern Arizona.

The lease amendments will sharply increase the revenue which both Tribes realize from the mines. The Navajo estimated income will increase from $4.75 million annually to $17.5 million a year. Although the Secretary of the Interior still must approve the lease amendment package, none of the parties involved anticipate a problem in securing that approval.

To be signing on behalf of the Navajo Tribe, Chairman Peter MacDonald described this as an excellent example of Navajos' determination and ability to deal reasonably with businesses on the Reservation while advancing the Tribe's economic interests. "We had believed for many years that the coal lease terms, which were negotiated in 1964 and 1966, were inadequate," said MacDonald. "At a royalty rate of only 38 cents per ton for much of the coal, the past rates failed to compensate the Tribe for the value of this critical natural resource. These amendments bring the Tribe's economic return more into line with open market rates."

MacDonald added that perhaps as significant as the economic benefits, is the establishment through these negotiations of an open line of communication with Peabody Coal Company and the utilities it supplies; Salt River Project and Southern California Edison. The Tribe hopes to use this opportunity to build a broader base of economic relationships with those companies.

Navajo Attorney General Michael Upshaw, who headed the Navajo negotiating team, expressed strong satisfaction with both the lease terms and the manner in which negotiations were conducted. Upshaw noted the Navajo and Hopi Tribes' cooperation during this year's negotiation, was "unprecedented but a key to achieving final agreement." Furthermore, Upshaw commended the Peabody Coal Company, Salt River Project and Southern California Edison for their cooperation in overcoming great obstacles during the negotiation period. "The Navajo Nation and Peabody Coal

Company and the power plants it supplies have greatly benefited by the negotiation process." said Upshaw. "Past misunderstandings have been clarified resulting in a closer and better business relationship."

The coal mines involved in the negotiations straddles both the Navajo and Hopi reservations, The negotiations leading to Friday's signing started nearly 10 years ago during a previous MacDonald administration. The Tribes finally were able to reach agreement early this summer, after the reelected MacDonald reopened negotiations. The terms of the lease amendments were approved by the Navajo and Hopi Tribal Councils late this summer.

In addition to increased coal royalties, the Navajo lease amendments also call for a detailed study of water use by the mines, substantial increases in fees for water use and the establishment of a Navajo scholarship fund to which Peabody will contribute at least $150,000 annually. Peabody also was granted the right to mine 270 million tons of coal beyond the 400 million tons under the original leases.

The official signing of the renegotiated lease will take place on Friday, November 20 at the Phoenix Hyatt Regency Hotel at 2 p.m. Representatives from the Navajo Tribe, Hopi Tribe, and Peabody Coal Company will be present at the signing.

SRP MEMO

Date: December 21, 1987

To: A. J. Pfister, General Manager

From: Darrell E. Smith, Director, Resource Planning

Re: Settlement with Navajo and Hopi Tribes

Leroy asked us to provide some additional information you requested regarding the referenced settlement.

1. The annual increase in royalty to the Tribes in total dollars and in dollars per ton.

   At the new 12.5% royalty rate, the annual royalties paid to the two Tribes will increase by approximately $18 million. The average royalty paid for coal from the Kayenta Mine (Navajo) will increase from $.95 per ton to $2.40 per ton, an increase of $1.45 per ton. Royalties for coal from the Black Mesa Mine (Mohave) will increase from $.62 per ton to $2.35 per ton, up $1.73 per ton.

2. The increase in costs to SRP in dollars per ton.

   For SRP's participation in the two plants, we will pay an average increase of approximately $1.50 per ton, just for royalties. Including additional costs for water, education payments and taxes, SRP's average price will increase by approximately $1.81 per ton.

3. The increase in costs to SRP customers in mills per kwhr as charged through the fuel escalator.

   Over the past couple of years we have amortized the back royalties for both Navajo and Mohave and the increased royalty rate has been used for budgeting and expensing Navajo and Mohave fuel costs. Therefore, the impact of the approval of the new lease amendments should be negligible.

Darrell E. Smith

DES:JJ:sla

cc: L. Michael, Jr.
R.L. Barnard
M.B. Ochotorena

Peabody

Memorandum

To: D.L. Stevenson Date: June 5, 1989

From: E.L. Sullivan

Re: Agenda for June 12-13, 1989 Trip to Washington, D.C.

* * * * *

Our meeting on Tuesday, June 13, with Mr. Barry Williamson, Director of the Minerals Management Service, is scheduled for 10:00 a.m. Also expected to attend this meeting are Mr. Whit Field and Mr. Mike Poling. Mr. Field is an attorney from the Department of the Interior's Solicitor's office. He is the Assistant Solicitor for Land and Minerals in the Division of Indian Affairs. He is also the individual who assisted Peabody in shepherding the amended leases through the Department in late 1987 and early 1988 for Secretarial approval. He is therefore familiar with the history of the leases as well as their language.

Mr. Polling, at the time that the amended leases were approved by the Secretary of Interior (Don Hodel at that time), was a special assistant to the Assistant Secretary for Land and Minerals (Mr. Steve Griles). He is now the Assistant Solicitor for Energy and Resources. He is also very familiar with the background of our leases and of the process Peabody went through in obtaining Secretarial approval. There may be others in attendance also, but we will not know that until the meeting.

* * * * *

DRAFT

Preliminary Findings and Opinion Concerning Taxation Issues Related to the Kayenta/Black Mesa Coal Operations

November 30, 1993

Prepared for:
Rothstein, Donatelli, Hughes, Dahlstrom, Cron & Shoenburg

234 North Central Avenue, Suite 722
Phoenix, Arizona 85004

Prepared by:
Resource Data International, Inc.

1320 Pearl Street, Suite 300
Boulder, Colorado 80302

Introduction

This report presents Resource Data International, Inc.'s (RDI) preliminary findings and opinion concerning certain taxation issues as they relate to the Kayenta/Black Mesa coal operations. While RDI has reviewed sufficient data to prepare these preliminary findings, it should be recognized that further analysis could result in minor corrections.

Peabody Coal Company (Peabody) operates two adjacent coal mines located on the Navajo Reservation near Kayenta, Arizona. The Kayenta coal mine supplies approximately 7.9 million tons of coal per year under a long-term contract to the Navajo Generating Station which is operated by Salt River Project. The Black

Mesa mine supplies approximately 5.0 million tons of coal per year under a long-term contract to the Mojave Generating Station which is operated by Southern California Edison Company (SCE). The selling price of the coal is currently between $18.50 and $22.00 per ton at the mine. The selling price is composed of the following elements:

- the cost of the coal (in the form of a royalty paid to the Navajo and Hopi, the owners of the coal,)
- the direct cost of mining and processing the coal,
- the amortization of capital invested in the mine (Peabody to date has made capital investments in excess of $275 million in the Kayenta and Black Mesa mines,)
- a return on the capital,
- federal Black Lung and Mined Land Reclamation taxes, and
- state and other federal taxes,
- the Business Activity Tax (BAT) and Possessory Interest Tax (PIT) assessed by the Navajo Nation on businesses operating on the Reservation.

RDI has been asked to address the question of whether the BAT and PIT are based upon the value of the mineral—i.e., the coal—or whether they are in fact based upon the value of other economic activity associated with mining and processing the coal. In order to address this question, RDI relies on its experience in evaluating coal properties, assessing the cost of producing and transporting coal, analyzing coal taxes and evaluating coal markets. It is RDI's opinion that the above-

described components of the coal price are reasonable and consistent with industry standards.

The compensation paid to the owners of the coal (the Navajo and Hopi) is 12.5% of the selling price and is the standard royalty received by the U.S. government for federally-owned coal, by state governments for state-owned coal and by many owners of privately-held coal reserves.

The federal Black Lung and Mined Land Reclamation taxes are the standard taxes assessed by the U.S. government on all surface mines in the country. State taxes include the transaction privilege tax and personal property taxes.

While the Navajo Nation wears one hat as a co-owner of the coal, and as such receives compensation for the value of the coal in the amount of 50% of the royalty payment, it also wears a second hat as the local government entity with jurisdiction over the mining operation itself. In this capacity, it collects taxes on the economic activity conducted within its jurisdiction and is required to provide standard government services to both the business and to the citizens within its jurisdiction. It is RDI's understanding that the BAT and PIT are taxes assessed on all similar businesses operating on the Reservation. As such, these taxes represent a tax on economic activity conducted within the jurisdiction, not a tax on the mineral. Such taxes are consistent with taxes assessed on coal mining operations within similar governmental jurisdictions throughout the western United States.

The balance of this report addresses various elements which are the basis of RDI's findings and opinions.

* * * * *

The Value of the Coal

The value of the coal is not an absolute. To wit, the market value of a ton of coal in Wyoming's Powder River Basin is $4.00; in Utah, the value of a ton of coal is between $20.00 and $30.00; and, as stated above, in the Kayenta/Black Mesa mines the value of a ton of coal is between $18.50 and $22.00 per ton. The value of coal is, in fact, a function of a number of factors including, but not limited to:

- Geography:

  The location of the coal reserve is perhaps the most important factor in its value. It can be argued that coal has little intrinsic value except in relationship to markets. Therefore, coal that is located near major transportation infrastructure—railroads, highways, slurry lines—is of value because it can readily be transported to market. The value of remote, isolated coal reserves must be discounted by the cost of building transportation linkages to the property.[*]

  Once the access to transportation has been established, the value of a remote property must be further discounted by the relative cost of

[*] In the West, the value of raw coal reserves typically runs between $0.01 and $0.10 per ton. The most recent transaction involving western coal reserves was Great Northern Properties' acquisition of 16 billion tons of reserves in Montana, North Dakota, Washington, and Wyoming from Burlington Resources. The sales price of the reserves was $0.01 per ton plus a potential royalty payment on any coal when it is ultimately mined. The bulk of the values lies in those reserves that adjoin two existing mines in Montana, and without the locational advantage of these two properties, the remainder of the reserves would have an even lower value.

transporting the coal to potential customers versus that of other producers since coal buyers evaluate fuel cost on a delivered price basis.

- Quality:

  The market value of the coal is directly related to its quality. For example, the higher the heating value of the coal per ton, the higher the economic value. Since buyers evaluate coal on a delivered price basis per unit of heating value, coals with higher heating value per ton have a higher value to the producers.

  Other critical quality factors include sulfur, moisture and the quantity and chemical properties of the ash. The value of these other quality factors is similarly determined in the marketplace by the buyer's ability to burn the coal under existing environmental standards as well as the cost to the consumer of removing impurities and handling the by-products of combustion.

- Mining Costs:

  The cost of mining the coal is directly related to its value. Hence, such factors as depth of the coal, seam thickness and other geological considerations are all critical to its so-called economic recoverability. As with other factors listed above, the cost of producing the coal will determine its competitiveness in the marketplace.

With these factors in mind, it is RDI's opinion that the value of the coal in Kayenta/Black Mesa reserves is based solely upon its quality and its ability to be mined and transported to its customers at a competitive market price, that is a price that enables the companies gen-

erating the electricity to offer their product (electric power) at a competitive price in the Western power grid. The reserve owners—the Navajo and Hopi—are compensated for the value of their asset solely via their royalty payments.

The Creation of the Market Value of the Coal

In order for the Kayenta/Black Mesa coal reserves to have any value in the marketplace, the Navajo entered into business arrangements with both the customers and producers of the coal.

In the case of the Navajo Generating Station, owned by a consortium of electric utilities and operated by the Salt River Project, the Navajo agreed to certain tax provisions in order to attract the level of private capital investment necessary to site and construct a major generating facility. This is by no means an uncommon practice. In fact, there are any number of examples in which political jurisdictions (cities, counties and states) offer tax agreements to businesses in order to create an economic base for their citizenry.

Hence, in order to create an economic environment within which the Kayenta coal reserves could be developed, the Navajo Nation agreed to forego significant potential tax revenues from the power plant and coal mine. And while the amount of taxes which would apply without the tax provisions can be calculated now that the economic enterprise is in place, there would have been no revenues (either in the form of taxes or coal royalties) had these concessions not been made and had the Navajo Generating Station gone elsewhere for coal. The Hopi Tribe was a direct benefactor of the Navajo agreements with the economic enterprise, since their portion

of the coal royalties could not have been realized without the Navajo Generating Station as a buyer.

A similar situation occurred with relation to the Black Mesa reserves, not through tax provisions, but rather through the Navajo's willingness to provide water and rights of way necessary for the coal slurry line that transports coal to the Mojave Power Plant—now the only means of delivering coal to a plant that has no other economically viable transportation options.

The Calculation of the Royalty Payment

Historically, royalty payments were calculated on a flat cents per ton basis. This, however, did not allow mineral holders to be compensated for the dramatic differences between the market value of coals, as illustrated above. Further, a fixed royalty did not enable mineral owners to share in price movements in the market place. Hence, led by initiatives of the federal government the structure of royalty payments has now been altered, leading to a calculation of royalties based upon the sales price of the coal.

In so doing, the mineral owner's royalty is calculated as a percentage of the sales price of the mined coal which includes all components in the cost of coal—operating costs, amortization of capital costs, profits and all taxes assessed by all jurisdictions. Because of this, the royalty paid to the mineral owners, both the Navajo and the Hopi, includes a percentage of those BAT and PIT taxes that are actually paid by Peabody Coal company for its mining operations. Such a practice is a standard industry practice enabling the reserve owner to participate in all components of the mine price. As such, the Hopi receive their share of the taxes collected by the

Navajo Nation with none of the responsibility for providing government services.

* * * * *

Conclusion

As a result of RDI's findings to date, it is RDI's opinion that the Navajo and Hopi, as owners of the Kayenta/Black Mesa coal reserves receive a "fair" compensation for the value of their mineral resources in the form of royalties consistent with standard industry practices.

Further, it is RDI's opinion that the BAT and PIT taxes collected by the Navajo Nation as the governmental jurisdiction responsible for providing serves are not taxes on the coal, but rather taxes on the economic activity necessary to mine and process the coal. Such taxes are typical of all governments with similar jurisdiction over other Western coal mines.

RDI believes that the tax concessions and provision of water rights offered by the Navajo Nation were vital to create a viable economic environment within which the coal could be mined and sold, thus creating a market, and, hence, value for the coal realized by both mineral owers, the Navajo and the Hopi.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

IN THE MATTER OF:

PEABODY COAL MINE

v.

THE NAVAJO NATION

DEPOSTION OF RONALD L. McMAHAN, Ph.D.

Feb. 1, 1994

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* * * * *

[60]

* * * * *

Q: You have before you, Mr. McMahan, a document that has been marked as Exhibit 6. Is that the preliminary report you just referred to?

A: Yes, it is.

Q: Has this report changed in any respect since you prepared it as of November 30, 1993?

A: I would say that between then and now, I have—while my opinions are contained in this report—I've refined those opinions and essentially restated them hopefully more concisely and clearly and prepared some notes that I brought today.

(Deposition Exhibit 7 was marked.)

Q: You've been handed what has been marked as Exhibit 7. Are these the notes that you just referred [61] to?

A: Yes.

Q: Would you please explain the relationship between Exhibit 6 and 7?

A: Exhibit 6 was a preliminary findings report and opinion that was submitted on November 30, 1993. Since that time, obviously, we've continued to work. In fact, Exhibits 3, 4, and 5 have been produced after that date. And the relationship between the two of them?

Q: Please.

A: Obviously, there's a lot more background information and verbiage in the draft opinion. The notes referred to as Exhibit 7, I guess, you know, were my attempt in the last couple of days to restate the opinions from the draft opinion a little more precisely.

Q: Okay. Do you plan to produce any other written materials—

A: If I'm asked to—

Q: —prior to the trial of the case?

A: If I'm asked to, I will. Yes, I've told you—

Q: Other than demonstrative—oh, yes, other than what you've already told me about.

[62]

A: Not other than what I've told you about. I've not been asked to.

Q: Do you plan to revise this document that's called Draft, Exhibit 6, and call it a final report at some time?

A: I don't plan to, I haven't been asked.

Q: And with regard to Exhibit 7, your notes, do you expect that you will continue to make further refinements in these opinions that have been expressed here in Exhibit 7?

A: I wouldn't exclude that possibility.

Q: Okay. Let me ask the question this way, Mr. McMahan. At this point in time, has Mr. Dahlstrom asked to you do any further work on these opinions other than the work you've already done?

A: No, he hasn't.

Q: Do you expect that the opinions that you have expressed here in Exhibit 6 and Exhibit 7 will be substantially the opinions that you will express at the trial of this case?

A: Yes, I do.

Q. And you're suggesting, as every expert in the world does, that you may be refining those opinions as time goes on, correct?

A: That's correct.

* * * * *

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

DEFENDANT'S RESPONSES TO PLAINTIFF'S INTERROGATORIES (FIRST SET)

[Filed: Aug. 1, 1994]

* * * * *

Interrogatory # 13.

What is the nature and extent of the United States Bureau of Reclamation's interest in and responsibility to defray costs and expenses of the Navajo Project?

DEFENDANT'S RESPONSE TO INTERROGATORY #13:

The Navajo Project is comprised of four major components: the Navajo Generating Station (NGS) near Page, AZ; the Black Mesa & Lake Powell Railroad; the Western Transmission System; and the Southern Transmission System. The Bureau of Reclamation (BOR) has

no ownership interest in these facilities; such ownership is held by the Salt River Project Agricultural Improvement and Power District (SRP). The BOR is entitled to 24.3% of the electrical production of the NGS and similar percentages of the carrying capacity of the transmission systems. See, Colorado River Basin Project Act, 82 Stat. 885 as codified at 43 U.S.C.A. §1523 [sec. 303(b)]. The BOR bears responsibility for the construction costs and the operating expenses of the Navajo Project in direct proportion to its entitlement shares (24.3%) in the Navajo Project.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Mar. 30, 1995]

FIRST AMENDED COMPLAINT

INTRODUCTION

1. This claim seeks damages for the breach of contractual, statutory and fiduciary duties owed by the United States to the Navajo Nation. The breach of such duties occurred both on December 14, 1987, when the Secretary of the Interior approved amendments to coal lease no. 14-20-0603-8580 between the Navajo Nation and Peabody Coal Company, and on December 18, 1987, when the Acting Assistant Secretary—Indian Affairs vacated the decision dated June 18, 1984 of the Navajo Area Director adjusting the royalty rate of that lease to 20%, and declaring such decision to be of no force and effect.

JURISDICTION

2. This court has jurisdiction over this claim pursuant to 28 U.S.C. § 1491 and 28 U.S.C. § 1505.

PARTIES

3. Plaintiff Navajo Nation, also known as the Navajo Tribe of Indians, is a federally recognized Indian tribe. The Navajo Nation owns beneficial interest in land and minerals in Arizona, New Mexico and Utah, including the land and minerals leased to Peabody Coal Company under coal lease no. 14-20-0603-8580.

4. The United States of America is a sovereign nation which holds title in trust for the Navajo Nation to the land and minerals leased to Peabody and which owes contractual, statutory and fiduciary duties to the Navajo Nation, including such duties related to the leasing of the coal resources of the Navajo Nation.

STATEMENT OF FACTS

5. On August 28, 1964, the United States, acting through the Assistant Area Director of the Navajo Area Office of the Bureau of Indian Affairs, approved mining lease no. 14-20-0603-8580 ("the Lease") between the Sentry Royalty Company and the Navajo Tribe. Sentry's interest in the Lease was subsequently assigned or otherwise transferred to the Peabody Coal Company ("Peabody"). Article V of the Lease called for payment of royalties to the Navajo Nation of between $.20/ton or $.375/ton, depending on the price of the coal and whether the coal was used on or off the Navajo reservation. Article XXII of the Lease required the lessee to comply will all lawful resolutions adopted by the Navajo Tribal Council. Article VI of the Lease provided, *inter*

alia, that its royalty provisions 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 the lease, and at the end of each successive ten-year period thereafter.

6. Peabody subsequently entered into contracts for the sale of the coal under the Lease to utilities operating or owning interests in power plants located on or near the Navajo Reservation.

7. In September 1979, the Area Director of the Navajo Area Office of the Bureau of Indian Affairs (the "Area Director" of the "B.I.A.") notified Peabody that it was in violation of the Lease and that such violation warranted his consideration of cancelling the Lease. Later in 1979, the Navajo Nation requested the Area Director to suspend lease cancellation proceedings because Peabody had expressed an interest in negotiating amendments to the Lease, including adjusting the royalties under Articles V and VI thereof. In early 1980, Peabody, the Navajo Nation and the United States began negotiations to adjust the royalties of the Lease. Such negotiations continued through the end of 1983.

8. The B.I.A. sought the opinions of experts working for the United States on the proper adjustment of the royalties in the Lease. On June 6, 1984, the Bureau of Mines issued its report and concluded that. even under certain assumptions unfavorable to Peabody's profitability. Peabody would be able to achieve a discounted cash flow rate of return of 20.85% if the royalty rate were adjusted to 20.0%. Also on June 6, 1984, the Mining Engineer, Division of Energy & Mineral Resources, Department of the Interior, issued his report and recommended that the royalty rate be adjusted to not less

than 25% of Peabody's gross revenue, with provision for further adjustment every five years.

9. The Mining Engineer stated that his recommendation was preliminary, and that more accurate cost figures for Peabody's operations were needed. The United States did not obtain and analyze more accurate cost figures for Peabody's operations, because Peabody successfully resisted divulging its cost data to the United States.

10. On June 18, 1984, the Area Director notified Peabody that the royalty rate for the Lease was adjusted to 20.0% under Article VI thereof. Also on June 18, 1984, the Area Director notified the Navajo Nation of his decision to so adjust the royalty rate and that such adjustment would be effective August 28, 1984.

11. Peabody appealed the Area Director's decision to the Commissioner of Indian Affairs, Department of the Interior. Briefing was completed. The Navajo Nation urged that a decision be made on Peabody's appeal with all deliberate speed.

12. On April 16, 1985, the Navajo Tribal Council resolutions enacting the Navajo Business Activities Tax and the Navajo Possessory Interest Tax, applicable to Peabody, were held to be lawful. *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195 (1985).

13. By July 5, 1985, Peabody had learned that a decision of its appeal was imminent and apparently would favor the Navajo Nation. On July 5, 1985, Peabody wrote directly to the Secretary of the Interior and requested that he (1) assume direct responsibility for the appeal and (2) either postpone a decision to allow for a "voluntary settlement" between Peabody and the Na-

vajo Nation or decide the appeal in Peabody's favor. The Navajo Nation strenuously opposed Peabody's request.

14. Prior to July 17, 1985, a decision, final for the Department and affirming the Area Director's decision to adjust the royalty rate to 20%, had been drafted for and awaited the signature of John Fritz, Deputy Assistant Secretary for Indian Affairs. On July 17, 1985, the Secretary of the Interior instructed Fritz to withhold the decision and to "inform the involved parties that a decision on this appeal is not imminent." On August 29, 1985, the Associate Solicitor for Indian Affairs wrote to the Navajo Nation, stating that "a decision on the appeal is currently being considered by the Deputy Assistant Secretary—Indian Affairs and his staff." Through 1987, the Secretary's July 17, 1985 memorandum to Fritz governed the Department's conduct and was construed as instructions to withhold the decision. At no time prior to the filing of this lawsuit was the Navajo Nation informed of the draft decision of Fritz, or the Secretary's memorandum to Fritz or of its construction or operation within the Department.

15. From the time of the Area Director's decision to adjust the royalty to 20.0% in June 1984 through December 1987, Peabody paid royalties to the Navajo Nation on the basis of the 1964 Lease, *i.e.*, between $.20/ton and $.375/ton.

16. The Navajo Nation and Peabody negotiated terms of amendments to the Lease, culminating in an agreement amending the Lease executed by the Navajo Nation and Peabody on November 20, 1987. The Secretary of the Interior approved the amendments to the Lease on December 14, 1987.

17. The amendments to the Lease included the following terms, detrimental to the Navajo Nation:

a. The royalty rate was adjusted to 12.5% of gross realization received by Peabody for the coal, the Area Director's decision to adjust the royalty rate to 20.0% was required to be vacated, and the royalty calculations were tied to then-existing rules on coal product valuation;

b. The Navajo Nation was required to forgo its taxes on the business activities and possessory interests of Peabody, the Black Mesa Pipeline. Inc, the Black Mesa and Lake Powell Railroad, and the participants of the power plants on and near the Navajo Reservation for tax years 1978 through 1985;

c. The ability of the B.I.A. to adjust the royalty in the future was deleted from the lease;

d. The Navajo Nation was required to lease an additional 90 million tons of coal to Peabody on the above terms, and was further limited in its ability to impose its full possessory interest tax on these 90 million tons of coal until the year 2005;

e. The Navajo Nation was required to agree at some unspecified time in the future to tease to Peabody an unidentified 2000 acres of land at $50 per acre, to grant its consent to unspecified rights-of-way desired by Peabody, and to consent to assignments of the leasehold which Peabody may grant;

f. The Navajo Nation was required to confirm onerous and improvident tax waivers in a power

plant lease, approved by the United States in breach of trust;

g. The Navajo Nation was required to agree to cap the total of royalties and Navajo taxes, including taxes on both Peabody, and other entities such as the Black Mesa Pipeline, Inc., any other transporter of the coal, slurry line, railroad and related facilities, at 20.5 %;

h. The Navajo Nation was required to diminish its own sovereignty by consenting to suits in non-Navajo courts, agreeing not to raise its sovereign immunity as a defense in such suits and agreeing not to raise the requirements of exhaustion of tribal remedies as a defense in such suits.

18. On December 18, 1987, the Acting Assistant Secretary–Indian Affairs vacated the Area Director's June 18, 1984 decision adjusting the royalty under lease No. 14-20-0603-8580 to 20% and declared it to have no force and effect. The December 18, 1987 decision of the Acting Assistant Secretary–Indian Affairs was final for the Department of the Interior.

FIRST CLAIM FOR RELIEF

19. Pursuant to the laws of the United States, the United States has claimed and exercised broad authority and control over the leasing of coal it holds in trust for the Navajo Nation, including but not limited to:

a. the power to grant or deny applications for prospecting permits;

b. the power to grant or deny applications for associated rights-of-way and surface leases;

c. the custodianship of documents related to the leasing of coal, and the power to require lessees to submit documents on their activities conducted on the leasehold;

d. the power to require restoration of the leased land and to require compliance with environmental laws;

e. the power to approve or disapprove coal leases and the terms thereof;

f. the power to determine the compensation to be granted by lessees to the Navajo Nation;

g. the power to audit the books of and monitor the activities of lessees to ensure compliance with lease terms;

h. the power to determine the qualifications of lessees, to limit the acreage of leases, to require bonds of lessees, to set the term of leases, to reserve the right to buy the coal produced from such leases, to determine the manner and frequency of payments, to set standards for diligent development and to enforce them, to set royalty rates, to enact measures designed to prevent waste, to approve assignments and overriding royalties, to collect fees for its activities and to cancel leases.

20. The leasing of coal of the Navajo Nation is subject to a comprehensive statutory and regulatory scheme of the United States, executed by agencies of the United States including the Bureau of Indian Affairs, the Office of Surface Mining Reclamation and Enforcement, the Bureau of Land Management, the Minerals Management Service and other agencies. *E.g.*, 25 U.S.C.

§ 396a; 25 U.S.C. §§ 2101-2108; 30 U.S.C. §§ 1701-1757 (1982); 25 C.F.R. Parts 200, 211 and 216 (1993).

21. In addition to a general congressional policy supporting Indian tribal self- sufficiency, the United States is committed to a policy of combatting hunger, disease, poverty and demoralization of Navajos, of creating and maintaining a self-supporting Navajo economy and self-reliant Navajo communities, and of establishing a stable foundation on which the Navajos may attain standards of living comparable to those enjoyed by other citizens. 25 U.S.C. § 631 (1982).

22. The United States has fiduciary duties to the Navajo Nation relative to leases of coal of the Navajo Nation, including:

a. the duty to ensure that the Navajo Nation receive the greatest revenue for the leased coal;

b. the duty to manage the coal resources and land for the benefit of the Navajo Nation;

c. the duty of loyalty to the Navajo Nation and a duty to administer the coal solely in the interest of the Navajo Nation;

d. the duty not to delegate its authority to others and to act without unreasonable delay;

e. the duty to exercise reasonable skill and diligence with respect to the coal, to employ its greater skill, knowledge and expertise in furtherance of the trust, and to enforce claims against others.

23. The United States violated its statutory and fiduciary duties to the Navajo Nation by, *inter alia*, approving the amendments to the Lease on December 14, 1987,

causing economic loss to the Navajo Nation, a diminution of the value of the trust *res,* and harm to the sovereignty of the Navajo Nation.

24. As a result of such approval of the amendments to the Lease, the Navajo Nation has been damaged in the amount of $600,000,000.

SECOND CLAIM FOR RELIEF

25. The Lease constitutes a valid contract or contract implied-in-fact between the United States and the Navajo Nation respecting the adjustment of the royalty, such contract evidenced by consideration, offer and acceptance, mutuality of intent and definiteness of terms. The Lease originally called for an obsolete, onerous and improvident cents-per-ton royalty when approved by the United States in 1964. The lease, however, allowed for the unilateral adjustment of the royalty by the United States in twenty years to ensure that the revenues to the Navajo Nation would be adjusted to a reasonable level.

26. The United States determined that a royalty adjustment of at least 24.44 % was reasonable given the profitability of Peabody's mine and the unique nature of the coal reserve leased to Peabody under the Lease. On information and belief, a royalty rate higher than 24.44% would have been reasonable.

27. The United States breached its contractual duty to the Navajo Nation to adjust the royalty.

28. As a result of the breach by the United States of the duty under contract or contract implied-in-fact to adjust the royalty, the Navajo Nation has been damaged in the amount of $600,000,000.

PRAYER FOR RELIEF

WHEREFORE, the Navajo Nation prays that this Court:

a. Assume jurisdiction of this action;

b. Award the Navajo Nation damages in the amount of $600,000,000 or such other amount as may be proven at trial for its First Claim of Relief;

c. Award the Navajo Nation damages in the amount of $600,000,000 or such other amount as may be proven at trial for its Second Claim of Relief; and

d. Award the Navajo Nation its fees, costs and such other relief as this Court deems just.

Respectfully submitted,

NORDHAUS, HALTOM,
TAYLOR, TARADASH & FRYE

/s/ ILLEGIBLE
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UNITED STATES FEDERAL COURT OF CLAIMS

No. 93-763L

NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DEPOSITION OF COLLEEN KELLEY

Taken in behalf of the Plaintiff
Sept. 22, 1995

* * * * *

[68]

Q If you look on the back page now, page 7, this indicates that you drafted this effort.

A Started drafting, yeah.

[69]

Q Okay. And what is this document?

A It's going to be a decision letter in the appeal, by—to be signed by presumably Deputy Assistant Secretary.

Q Okay. And basically, without going through all of the verbiage here, the conclusion of this decision is

that—is to uphold the 20 percent adjustment, correct?

A Right, it's affirming the Area Director's decision.

* * * * *

[70]

* * * * *

Q Well, if this one was drafted on—initially apparently started the drafting on June 18, apparently that's—

A Right.

* * * * *

Mineral Revenues 1996

Report On Receipts From Federal And Indian Leases

U.S. Department of the Interior
Minerals Management Service [MMS]

* * * * *

Table 47. General Federal and Indian mineral lease terms (cont.)

Coal Leases on Federal Lands: Leases Issued Through August 4, 1976

Customary Royalty Rate	$0.15 per ton underground and $0.175 per ton surface mines.
Annual Rent and Other Fees	Rent $1 per acre credited against royalty payments for the lease year. Minimum royalty: per lease terms.
Duration of Lease	Indefinite period with 20-year re-adjustments.
Size of Lease	Not more than 46,080 acres in one state and not more than 100,000 acres in the United States for one or more leases.

Bonding Requirements	Nonproducing leases: $5,000 or amount equal to annual rent rounded to $1,000, whichever is greater. Producing leases: 3 months' production royalty.

Coal Leases on Federal Lands: Leases Issued or Readjusted After August 4, 1976

Customary Royalty Rate	Readjusted and new leases: 8% of value of production for underground mines and 12½% of value of production for surface mines.
Annual Rent and Other Fees	Rent $3 per acre not credited against royalty payments. Lease filing fee: $250. Transfer fee: $50.
Duration of Lease	20 years; continued if producing in commercial quantities, subject to readjustment every 10 years.
Size of Lease	No more than 46,080 acres in one state and no more than 100,000 total acres in the United States.
Bonding Requirements	Nonproducing leases: $5,000 or amount equal to annual rent rounded to $1,000, whichever is greater. Producing leases: 3 months' production royalty.

Coal Leases on Indian Lands

Customary Royalty Rate	Varies according to lease terms and amendments. Generally 6¼% to 12½% of value of production.
Annual Rent and Other Fees	Rent varies. Average rent $2 per acre. Advance royalties payable up to $1 million annually.
Duration of Lease	Varies by lease terms.
Size of Lease	Varies.
Bonding Requirements	Lease: $500 to $2,000 depending on acreage. State: $75,000 depending on acreage. Nationwide: $75,000 or determined by the Secretary.

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

VIDEOTAPED DEPOSITION OF JOHN W. FRITZ

Taken Mar. 13, 1996
Commencing at 10:15 A.M.

* * * * *

[166]

* * * * *

Q Okay. Now let me make sure that I correctly understood your previous testimony. The Secretary effectively assumed jurisdiction over this appeal by issuing Exhibit 43, is that correct?

[167]

A I thought he did. He said stop, so I did, which then from my perspective means that he's taking it, whether I handed it off to him or not.

Q Mm-hmm.

A He's got it and it's like the tar baby, he's got ahold of it, he gets to handle it now.

Q Okay.

A If I would have been clever enough to do what Gjelde said, I would have done it in the previous fall, said here, Judge, you're a Judge, take it. But, you know, I'd been trying to move this whole decision process along. So the reality is that when I got the information here, it says, he says, where is the specific language, "I suggest that you inform the informed 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," bang.

* * * * *

[171] * * *.

Q He, as I understand it, the Secretary has authority over the entire department?

A Absolutely.

Q And he could pick cases from wherever he wants to?

A Absolutely. And he can not only pick them, he can put them wherever he wants to for decision-making purposes.

Q Now what was your view or what is your view of the propriety of what the Secretary did here in Exhibit 43?

A He can do that since he is the Secretary. So whether I viewed it to be appropriate considering all the

work and effort that I put into it or not, that's irrelevant. Could he do it, absolutely. Did he do it, absolutely. And so at that juncture, I mean, he could pick it up and move it.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DEPOSITION OF
ROBERT HENRY BRIDENBECKER

Monday, June 3, 1996

* * * * *

[100] * * *.

* * * * *

BY MR. FRYE:

Q In the July of 1985 time period, were you aware that a decision had been drafted for the signature of the deciding official that would have upheld the 20 percent royalty rate?

A Maybe. I don't recall ever seeing this document, but—

Q Okay, so you may have heard that the department had reached that tentative decision, at any rate, but had not issued any formal decision on the appeal?

A Right. I don't know that I was ever aware that the department had reached a tentative decision. I mean this is a draft of something, I don't know anything more about it than that.

Q Right. Okay, I want to try to be as precise as I can be.

Is it your testimony that you were aware that a decision had been drafted for the signature of the deciding official in the appeal that would have, [101] if it had been released, upheld the 20 percent royalty rate?

A I think—I think so, yeah.

Q Do you recall how you obtained that knowledge?

A No. I would assume it was from Peabody.

Q Who at Peabody were you talking with around this time concerning this appeal?

A Well, I think in most of the time it had been either Kenny Moore or Greg Leisse. I'm not sure whether they were both active at this time, I assume so.

* * * * *

[SEAL OMITTED]

THE NAVAJO NATION
MINERALS DEPARTMENT
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ALBERT A. HALE
PRESIDENT

THOMAS E. ATCITTY
VICE PRESIDENT

April 24, 1997

MEMORANDUM:

TO: Akhtar Zaman, Director
Minerals Department

FROM: Ram S. Das, Mining Engineer
Minerals Department

SUBJECT: **Resource Data Information—Summary of Findings and Conclusions**

The summary of "Findings and Conclusions" of RDI's survey of Tax-Royalty burdens at Western U.S. Coal mines was reviewed. I have the following concerns and comments.

1) **Tax Royalty Burden:** PWCC's tax-royalty burden is considered low when compared with certain federal leases in the Power River Basin in Wyoming and the Crow Reservation in Montana. It should be noted that the coal mines in those regions are blessed with thick coal seams and very low stripping ratios which allow them to sale [*sic*] the coal at a very low price

compared to the coal sold from the Kayenta and the Black Mesa mines. Therefore, a percentage based analysis is misleading. I suggest that the tax-royalty burden comparison should be based on cents per million BTU.

2) **Straight Royalty:** Two federal leases in Montana and one lease in Colorado have been cited to have higher royalty rates than the standard 12.5% rate. The analysis does not mention if the lease(s) constitutes the whole mine or small portion of the mine. Sometimes it is advantages [*sic*] for companies to pay a higher premium for small tracts if those tracts hampers their mining operation. Again the final decision would be influenced by the mining and fuel costs.

3) **Bonus Payment:** I agree that the bonus we received was low. We did acquire information from the different BLM offices in 1985-1987 regarding bonus received for federal leases. However, during the negotiations with Peabody, this issue was compromised considering the overall benefit to the Nation. It should be noted that the royalty rate for lease 9910 was increased when it provided for no royalty adjustment, the water payment was substantially increased, some bonus was received and Peabody contributes to the Navajo Scholarship Program

4) **Sulfur Dioxide Emission:** The consultant has compared the Black Mesa coal with the Illinois Basin coal and provides no advantage to the Navajo Nation for developing a proposal based on this fact. We all know that the sulfur content of the Illinois Basin coal is high and as a result, coal production in the Basin has substantially declined over the years.

5) **Captive Markets & Guaranteed Return:** The consultant failed to consider the simple fact that a coal mine is not developed unless there is a coal sales agreement between a supplier and buyer. The rate of return and cost adjustments are built into the agreement which reduces the economic risk. It should also be noted that the agreement between Peabody and its customers do not allow Peabody to sale [*sic*] all the coal it can mine. If cheaper electricity is available in other areas, it affects Peabody's sales.

The above-mentioned comments should not be taken negatively. I am trying to visualize Peabody's counter arguments if the Navajo Nation's proposal is based on RDI's above mentioned recommendations. In my opinion, the final recommendations that Peabody could bear an additional royalty burden between 8-17% has little value to the Task Force in developing a proposal. Since the final fuel cost (if the quality requirement is met) is most important to the utilities, all cost should be broken down into cents per million BTU rather then on a percentage of gross value. For example, the Jacobs Ranch Mine in Wyoming has a royalty burden of 26% and 14% for coal sold at $3.40/ton and $6.63/ton, respectively. The royalty burden in the FOB fuel cost translates to 5.023 cents/MM BTU and 5.274 cents/MM BTU with the assumption that the coal has a calorific value of 8,800 BTU/lb. Peabody's 12,300 BTU/lb coal is sold at $22/ton. The royalty burden in the FOB cost is 11.179 cents/MM BTU. If the total FOB mine price is considered the FOB fuel costs for the Jacobs Ranch Mine in 19.3182 cents/MM BTU and 37.6705 cents/MM BTU compared to Peabody's 89.4309 cents/MM BTU. This

example illustrates that Wyoming coal, with a lower calorific value, is still more attractive to utilities because of the low cost even though the percentage royalty is higher.

My recommendation is that the approach that should be taken is to collect enough data to back up the Navajo Nation's proposal that in spite of the proposed royalty increase, the fuel cost of their customers would be still very competitive in this region. The approach would also be very useful if the issue goes to arbitration.

Please advise if you have any questions.

/s/ RAM S. DAS
RAM S. DAS

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF PERRY SHIRLEY

Dec. 12, 1997

I, Perry Shirley, do hereby declare pursuant to 28 U.S.C. § 1746 that:

1. I am the Assistant Director of the Navajo Nation's Minerals Department.

* * * * *

9. Because of the unique provisions in the 8580 Amendments regarding computation of royalties and subsequent rules adopted by the Department of the Interior regarding the same, the Navajo Nation's royalties for the coal under lease by virtue of the 8580 amendments is less than the 12½% minimum now required for federal coal mined by surface mining techniques.

10. I have reviewed documents of the Southern California Edison Company ("Edison") that indicate that the

8580 Amendments required the Navajo Nation to forgo back taxes and back royalties that Edison estimated at $88 million. If these estimates are reasonable, the effective royalty rate for coal mined under the 8580 amendments is substantially less than 12½% of gross proceeds.

11. The coal mined by Peabody under the 8580 amendments is, relative to other coal leased by the Navajo Nation to the Pittsburgh & Midway Coal Mining Company ("P&M") and BHP (formerly Utah International, Inc.), better quality coal and coal with a higher energy (BTU) content. The 8580 Coal is "compliance coal" under federal EPA guidelines; the Navajo coal mined by P&M and BHP is not.

12. I know the above facts on my personal knowledge, and they are true to the best of my information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *12th* day of December, 1997.

/s/ PERRY SHIRLEY
PERRY SHIRLEY

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Dec. 15, 1997]

PROPOSED FINDINGS OF UNCONTROVERTED FACT

Plaintiff Navajo Nation files this Proposed Findings of Uncontroverted Fact pursuant to RCF 56(d)(1). * * *.

* * * * *

THE ORIGINAL PERMIT AND LEASE

9. Fifteen years after DOI reported that the median education level for Navajo Indians was less than first grade, the Advisory Committee of the Navajo Tribal Council (since renamed the Navajo Nation Council) authorized the Chairman of the Council to execute with the Sentry Royalty Company both an exclusive drilling and exploration permit and a lease for coal for a 40,829 acre area. Resolution No. ACF-19-63 (Feb. 15, 1963), I App. 98. Sentry Royalty company was then a wholly-owned subsidiary of Peabody Coal Company ("Peabody"). Vijai N. Rai, Ph.D, " A Report on the Issue of Royalty Rate Adjustment for Lease No. 14-20-0603-

8580 (Kayenta Coal Mine) Navajo Reservation" 8 (1985), I App. 562.

10. The Drilling and Exploration Permit ("Permit") was executed the same day as that authorization, February 15, 1963, and it committed the Navajo Nation to terms and conditions of a lease form attached as Exhibit B thereto. Permit at 1 (Feb. 15, 1963), I App. 100.

11. That lease form required royalty payments of between $.20 and $.30 per ton of coal produced. However, it also allowed the Secretary of the Interior to adjust the royalty to a reasonable level after twenty years. *Id.*, Ex. B at 3, 5, I app. 108, 110.

12. A lease following the form of Exhibit B to the 1963 Drilling and Exploration Permit but increasing the royalty rate was signed in January 1964 by Ralph E. Bailey for Sentry Royalty Company and Raymond Nakai, the Chairman of the Navajo Tribal Council. Mining Lease between Sentry Royalty Company and the Navajo Tribe (approved Aug. 28, 1964), I. App. 127.

13. That lease was approved under the Indian Mining Leasing Act of 1938 by the Assistant Area Director, United States Bureau of Indian Affairs ("BIA"), on August 28, 1964, and given BIA lease number 14-20-0603-8580 (hereinafter, the "8580 Lease"). Field Dep. at 165-66, II App. 1043-44; 8580 Lease at 1, 24, I app. 127, 150.

* * * * *

THE REGULATORY AND POLICY FRAMEWORK

32. The original 8580 Lease and the 1987 amendments to the 8580 Lease were approved under the Indian Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a-g

("1938 Act"). *E.g.,* Field Dep. at 165-66, II App. 1043-44; Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary-Indian Affairs at 5 (Dec. 1, 1987), I App. 719.

33. The 1938 act detail[s] uniform leasing procedures designed to protect the Indians." *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759, 764 (1985). The basic purpose of the 1938 Act is to maximize revenues to the tribes. *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195, 200 (1985).

* * * * *

APPROVAL BY SECRETARY HODEL

* * * * *

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

340. The approval of the lease amendments was done under the 1938 Act, not the Indian Mineral Development Act of 1982. Field Dep. at 166, II App. 1044; Winstead Dep. at 112, III App. 1666; Hughes Dep. at 158, II App. 1210; Memorandum from Acting Associate Solicitor, Indian Affairs, to Assistant Secretary—Indian Affairs 5 (Dec. 1, 1987), I App. 719.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

BRIEF IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON THE ISSUE OF LIABILITY ON ITS FIRST CLAIM FOR RELIEF

[Filed: Dec. 15, 1997]

STATEMENT OF THE QUESTION INVOLVED

Did the approval of coal lease amendments by the Department of the Interior ("DOI") in December 1987 breach the Government's trust duty to the Navajo Nation where DOI (1) possessed unilateral authority under the original lease to adjust the royalty rate; (2) determined that a royalty rate of 20% was reasonable and adjusted it to 20% in 1984; (3) upon Peabody Coal Company's appeal of the adjustment conducted additional studies supporting the 20% royalty rate and prepared for the signature of the deciding official a decision document in 1985 affirming the 20% royalty rate as final for the Department; (4) leaked the pendency of that decision to Peabody; (5) suppressed that decision as a direct

result of *ex parte* communications by a close personal and professional associate of Secretary Hodel who acted as Peabody's consultant; (6) concealed from and misled the Navajo Nation about the *ex parte* contacts and the Secretary's suppression of the decision; (7) provided sensitive information to assist Peabody in its negotiations; and (8) in late 1987 approved in a "rush job" at Peabody's behest lease amendments with an effective royalty rate less than the federal minimum of 12½%?

STATEMENT OF THE CASE

INTRODUCTION

* * * * *

The lease at issue in this case (the "8580 Lease") presented the Navajo Nation with one significant opportunity to climb from a welfare economy to a self-sufficient development economy. Although the 8580 Lease executed in 1964 specified unconscionably low royalties of not more than 37½¢ per ton, Ex. 3, I App. 130, Article VI of that lease provided for a reasonable adjustment of that royalty rate in 1984. *Id.*, I. App. 133. The Bureau of Indian Affairs ("BIA") did so, raising the royalty rate to 20%. Ex. 39, I App. 287. This case is about the scuttling of that well-founded decision by the Secretary of the Interior at the secret behest of Peabody, Ex. 90, I App. 595, and the Secretary's approval in December 1987 of lease amendments that lowered the effective royalty rate not to only well below 20%, but even below the minimum 12½% royalty Congress had set for leasing of federal coal.

* * * * *

STATEMENT OF FACTS

* * * * *

The deal also eliminated the "extremely valuable" right of Secretarial adjustment, Aubertin Dep. Vol. II at 23-24, II App. 835-36; Ex. 108, I App. at 650-51, in breach of trust, Ryan Dep. at 42-44, III App. 1481-83. The United States has never relinquished that right for federal coal, Hodel Dep. at 88-89, II App. 1146-47, and the 8580 Lease authorized the elimination of that right only in the event of termination of the Navajo Tribe. Ex. 3, I App. at 133-34; Fritz Dep. at 54, II App. 1062. The lease amendments imposed an effective royalty rate well below even the federal minimum of 12½%. Ex. 136, III App. 1817.

* * * * *

III. THE GOVERNMENT BREACHED ITS FIDUCIARY DUTIES IN THIS CASE.

A. *The Government's Trust Duties Under the 1938 Act Require DOI to Maximize Lease Revenues for the 8580 Coal.*

"[T]he 1938 Act's basic purpose [is] to maximize tribal revenues from reservation lands." *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195, 200 (1985) (Burger, C.J., for a unanimous Court). Thus, this court's predecessor determined that, under the 1938 Act, the United States' "general fiduciary obligation was to develop a mineral lease program which would provide the *highest possible financial return*" to the Navajo Nation. *Navajo Tribe of Indians v. United States*, 9 Cl. Ct. 227, 238 (1985) (emphasis added).

* * * * *

Here, it is undisputed that the Government *minimized* the revenues to the Navajo Nation by scuttling a well-supported 20% royalty decision and approving lease amendments with a facial 12½% "absolute minimum" rate and with an effective royalty rate even below that. So contravening the central duty imposed by the 1938 Act constitutes a comprehensible breach of trust. *See Mitchell v. United States*, 229 Ct. Cl. 1, 13-14, 664 F.2d 265, 274 (1981), *aff'd,* 463 U.S. 206 (1983).

* * * * *

C. *The Federal Government Violated Its Most Fundamental Trust Duties Here.*

1. Duty of Care

This Court has characterized the trustee's duty to exercise skill and care in managing Indian property over which the Government has comprehensive authority as a duty to "exercise reasonable management zeal to get for the Indians the best rate[.]" *Mitchell,* 229 Ct. Cl. at 15-16, 664 F.2d at 274. The United States must not simply obtain the "floor" minimum established by statute, it must strive for the "ceiling." *Id.*; *see supra* part III.A (concerning basic duty imposed by 1938 Act).

* * * * *

Instead, Secretary Hodel became "sympathetic to Peabody's concerns," Ex. 90, I App. 595, and DOI aligned itself with Peabody against the Navajo Nation. At Peabody's *ex parte* behest and without notice to the Navajo Nation, Hodel instructed Fritz to suppress the decision upholding the 20% royalty rate, and forced the Na-

vajo Nation into negotiations that DOI had tilted in favor of Peabody, Edison and SRP. Then, after the Navajo Nation endured 2½ *more* years of 37¢ per ton royalties, Secretary Hodel approved lease amendments that superficially called for the "absolute minimum" royalty rate of 12½% and actually imposed an effective royalty rate even less than that. DOI did this without performing any economic analysis of the 8580 Amendments, without determining a proper bonus, without considering the relative bargaining positions of the parties, and without considering market conditions at the time.

Here, by the companies' own estimates, Secretary Hodel's approval of the lease amendments immediately cost the Navajo Nation $89,000,000 in back taxes and royalties, and reduced the royalty rate for coal mined under the 8580 Lease from its fair market value of at least 20% to an effective royalty rate below the "absolute minimum" of 12½%, at a cost of $347,000,000 to the Navajo Nation for just a part of that coal. Such a disparity between the revenues to be received from the trust resources and their true economic value "will suffice *without more* to establish the trustee's liability." *Coast Indian Community*, 213 Ct. Cl at 154, & n.45, 550 F.2d at 653-54 & n. 45 (emphasis added).

* * * * *

CONCLUSION

In this case, the DOI knew that a proper and fair royalty rate for the 8580 Lease was 20% and had the power and duty to impose that rate on Peabody. Instead, DOI acceded to Peabody's concededly improper *ex parte* advances, suppressed a decision on the merits affirming the 20% rate, ignored the tribal beneficiary's

consistent pleas for a decision on the Appeal, wilfully misled the Navajo Nation on the status of the Appeal, and approved negotiated amendments with an effective royalty rate even less than the "absolute minimum" of 12½%.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

BRIEF IN SUPPORT OF DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGEMENT ON ALL LIABILITY ISSUES AND IN RESPONSE TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON THE ISSUE OF LIABILITY ON PLAINTIFF'S FIRST CLAIM FOR RELIEF

[Filed: Mar. 17, 1998]

* * * * *

The Secretarial Decision to Defer Appeal Decision in Favor of Negotiations

On July 17, 1985, a memorandum bearing the signature of Secretary Hodel was delivered to Mr. Fritz who took it as a directive not to issue a decision on the Peabody royalty appeal at that time.[6] DPF 49; I-PA 613.

[6] The parties to the instant case learned through discovery of Peabody-submitted documents that Peabody attorneys had drafted and, through Hulett's meeting(s) with the Secretary, submitted to Mr. Hodel

Secretary Hodel testified that he does not recall then seeing or signing the memorandum but does not dispute that he may have signed it or that it expressed his general view on resolving such issues. DPF 51-52.

* * * * *

Further, the fact that the Department of the Interior has promulgated comprehensive regulations governing the *operation* of approved leases—including regulations governing rights-of-way over Indian lands, 25 C.F.R. Part 169 (1985); surface exploration, mining operations and reclamation, 25 C.F.R. Parts 216 (1985) and 200 (1993); and the payment of rents and royalties, 25 C.F.R. Part 211 (1985)—does not mean that the regulations governing the *approval* of leases and lease amendments are so comprehensive as to give rise to a claim for money damages based on an alleged duty to optimize lease returns by virtue of approval itself.

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the July 17, 1985, memorandum sent to Mr. Fritz. DPF 50; I-PA 595-598.

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

NAVAJO NATION'S CONSOLIDATED RESPONSE TO DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT ON LIABILITY ISSUES AND REPLY IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON THE ISSUE OF LIABILITY ON ITS FIRST CLAIM FOR RELIEF

[Filed: June 5, 1998 (corrected)]

* * * * *

* * *. While damages for this case necessarily remain to be determined, the fact that DOI approved a royalty rate structure here that resulted in Navajo coal royalties being less than the minimum required for federal coal clearly indicates liability here. PPF 247, 315.

* * * * *

The Department knew that the Navajo Nation's 8580 coal was exceptionally valuable. The Department's studies uniformly showed that the proper royalty rate for

the 8580 coal was at least 20%. The Department had the sole responsibility and authority to adjust the royalty rate to that reasonable level under Article VI of the 8580 Lease. Its technical and legal staff prepared and finalized a decision doing so, as "final for the Department." At the *ex parte* behest of Peabody, however, Secretary Hodel suppressed that decision. DOI then requested the Navajo Nation to restart negotiations at a district bargaining disadvantage known to DOI, camouflaged Hodel's improper actions with knowingly misleading communications, and allowed those negotiations to continue for over two years, in violation of 25 C.F.R. § 211.2. Finally, at the end of those improperly extended negotiations, DOI later casually approved lease amendments that called for the Navajo Nation to forfeit over $89,000,000 in back royalties and taxes and set a facial 12½% royalty rate—the federal minimum. The true royalty rate was even less than that. *See* PPF 234-247.

The fact that the true royalty rate was less than the federal minimum is alone sufficient to establish a breach of the duty care. See PPF 43; *Felix S. Cohen's Handbook of Federal Indian Law* 537 & n. 71 (R. Strickland, *et al.*, eds. 1982). * * *.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Bohdan A. Futey

NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DEFENDANT'S REPLY TO PLAINTIFF'S CONSOLIDATED RESPONSE TO DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGEMENT ON LIABILITY ISSUES

[Filed: Aug. 3, 1998]

* * * * *

* * *. Specifically, under the IMLA and its implementing regulations, there is an important distinction between the scope of the Secretary's responsibilities in approving leases and amendments thereto, and the scope of his responsibilities in the subsequent management and administration of those leases. While the Secretary's duties in the administration of mineral leases are admittedly quite comprehensive, *see* 25 C.F.R. Part 169 (1985) (rights-of-way); Part 211 (1985) (payment of rents and royalties); Part 216 (1985) and Part 200 (1993) (surface exploration, mining operations and reclamation) (I-PA 29-85), and might therefore give rise to a claim for

money damages if breached, the Secretary's duties in approving leases and lease amendments, *see* 25 C.F.R. § 211.2 (1985) (I-PA 45), are much narrower and do not give rise to such a claim.

* * * * *

ANALYSIS OF ROYALTIES AND TAXES FOR REOPENER OF PWCC NAVAJO COAL LEASES

Prepared for:

David K. Isom Law Offices

Prepared By:

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August 23, 1998

1. Introduction and Conclusions

Peabody Western Coal Company (PWCC) developed and now operates the only coal mines in Arizona, known as the Black Mesa and Kayenta Mines ("the Mines"). The Navajo Nation ("Navajo") are seeking to increase the royalty rates and royalty/tax caps applicable to the two leases amended in 1987 between PWCC and the Navajo relating to the Mines.

PWCC has requested that Fieldston Consulting (Fieldston) research two issues:

1) the prevailing royalty rates in coal leases that are comparable to the leases at the Mines, and

2) the prevailing combined royalty and tax burdens that are imposed on coal mining operations comparable to the Mines.

Upon completing its analyses of royalty rates and royalty/tax burdens, Fieldston reached the following conclusions:

- **all 471 federal, state, and Indian coal leases in the eight western coal producing states that were signed or readjusted from 1988 through 1996 had royalty rates of 12.5 percent or less. Therefore, the market for coal lease royalties provides no justification for an increase in the royalty on the Mines to a rate higher than 12.5 percent, and**

- **under the current royalty/tax cap, the PWCC royalty/tax cap burden is at the high end of the range of royalty/tax burdens for surface operations in comparable coal production areas. The data do**

not support raising the royalty/tax cap in the coal leases between PWCC and the Navajo Nation.

The first portion of this report addresses the prevailing royalty rate issue; the second portion addresses the royalty/tax cap issue.

2. Prevailing Royalty Rates

Fieldston retrieved publicly available information on all federal, state and Indian leases signed or readjusted between 1988 and 1996[1] which were applicable to the coal reserves in the eight western coal-producing states in the U.S.[2] The total number of leases signed or readjusted during this period of time was 471.[3] We found that:

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[1] Fieldston is providing to the counsel to the Navajo a complete compendium of coal lease summaries that support our analyses, and will provide that the compendium to the arbitration panel upon request. This compendium, which is in excess of 800 pages, includes summaries for all federal, states, and Indian coal leases in the eight coal producing western states that were signed or readjusted from 1988 through 1996.

[2] Those states are Arizona, Colorado, Montana, New Mexico, North Dakota, Utah, Washington and Wyoming. Although there are coal reserves elsewhere (e.g., in Idaho where there is no coal production), and though there may be leases in effect, they were not germane to this analysis. Coal leases which may be in effect in Alaska were also not considered.

[3] Twenty-three leases had royalty rates for underground mines only. The remaining 448 were for coal leases with a surface royalty rate assigned to them.

All 471 coal leases reviewed have royalty rates of 12.5 percent or less.

It is also important to note that the two Navajo leases to coal suppliers other than PWCC also have royalty rates of 12.5 percent.[4]

Fieldston did not review leases that:

1) involved private coal reserves (because such leases are not easily accessible and, in any event, constitute only a small portion of all leases; in 1996 more than 80 percent of western coal production was from federal, state and Indian leases), and

2) were outside of the western U.S. (because distant coal reserves are not relevant[5]).

Leases prior to 1988 were deemed to be irrelevant for the task of determining appropriate royalty rates for a 1997 re-opener. However, because the Navajo claimed that their 1987 royalty rates were reasonably low,[6] Fieldston examined market conditioned prior to 1988 by

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[4] While neither the Navajo leases nor lease summaries were available for our review, we verified the 12.5 percent royalty rates in these leases with executives from regional generating companies who have direct knowledge of the content of the leases.

[5] These distant coal reserves supply different electricity markets and different non-electric markets (e.g., metallurgical processes), have dramatically different coal quality and mining characteristics (e.g., higher sulfur, higher heat content), and are predominantly held by private mineral owners whos leases are not publicly available. However, Fieldston is familiar with the eastern U.S. coal markets and is confident in stating that the preponderance of prevailing royalty rates in the East are 12.5 percent or less.

[6] Paragraph 42 of the Navajo Nation's Arbitration Statement, June 23, 1998.

extending its research to include leases with surface royalties that were signed or readjusted between 1985 and 1987. Again, we found that all federal, state, an Indian coal leases with surface royalties in the western U.S. that were signed or readjusted from 1985 through 1987 also had royalty rates of 12.5 percent or less. In fact, Fieldston had to go back to the late 1970s before we were able to find any coal leases with royalty in excess of 12.5 percent.

In the Navajo Nations's Expert Witness Statements, Exhibit C of the McMahan and Myers statement lists five leases from the late 1970s that had royalty rates in excess of 12.5 percent. Exhibit 2.1 includes information that places five "comparable" leases in perspective. We believe it is unreasonable to reach back almost 20 years to find examples to justify a current royalty rate. The energy and natural resource markets were very different during the late 1970s as the U.S. was absorbing the impacts of a second oil shock. Additionally, western coal leasing had just resumed following a leasing moratorium that had lasted for several years while the leasing program was revamped.

The McMahan and Myers examples lose any remaining applicability when one closely examines the circumstances of each lease. For example, it is true that the Western Energy lease MTM35734 for the Rosebud Area A-B had its royalty rate set to 21 percent in August of 1979. What the Navajo's experts fail to mention is that the lease was subsequently included in a Logical Mining

Unit (LMU).[7] At that time, the royalty rate became 12.5 percent in January 1980. That mine and the other three mines covered by the leases referred to in Navajo Exhibit C are no longer operating.

[7] A Logical Mining Unit is the combination of relatively small, private, state or federal tracts by the U.S. Department of the Interior to form a consolidated parcel that is economically feasible to mine.

Exhibit 2.1 Status of Navajo "Comparables"

Lease Number	State	Lessee	Eff. Date	Royalty Rate %	Disposition
COC 19885	CO	Seneca Coal Co.	6/1/79	17.08	Mined out, Relinq filed 2/24/98
COC 20900	CO	Twenty Mile Coal Co.	11/1/78	16.00	Surface mined out, Underground reserves added at 8%
COC 22644	CO	Twenty Mile Coal Co.	7/1/79	18.30	Surface mined out, being held for reclamation
MTM 35734	MT	Western Energy	8/1/79	21.00	Included in an LMU at the Rosebud Mine, 5/24/93, with royalty rate of 12.5 percent
MTM 35735	MT	Western Energy	8/1/79	21.00	Royalty rate reduced to 12.5 percent, mined out 11/17/88

To recap, Fieldston examined all federal, state, and Indian coal leases in the western U.S. that were signed or readjusted from 1988 through 1996.[8] All 471 leases had royalty rates of 12.5 percent or less. Therefore, we conclude that the market for coal lease royalties provides no justification for an increase in the royalty on the Mines to a rate higher than 12.5 percent.

* * * * *

[8] After this period, the Hopi and PWCC amended the lease for the Hopi one-half interest in the reserves in question and have agreed to a variable rate lease applying to the Hopi share of royalties applicable to the Mines. The details are confidential and not available.

MONTANA INDIAN LEASES

State	Nation	LEASE NUMBER	LESSEE	OPERATOR	MINE NAME	COUNTY	EFF. DATE	ADJ. DATE	MINE TYPE	ROYALTY RATE %	ACRE-AGE
MT	CROW	14-20-0252-4088	WESTMORELAND RESOURCES		ABSALOKA	BIG HORN	11/26/74	12/2/94	S	Variable	16131

Total Acres	16,131
No.of leases	1

Sources: Actual coal leases, Keystone Coal Industry Manual 1996 and Dept. of Interior's Mineral Revenues 1996.

Note: The variable royalty rate for the Crow lease is based on customers and production levels, but never exceeds 12.5%.

IN THE ARBITRATION OF COAL ROYALTY RATES AND ROYALTY TAX/CAP RATES

NAVAJO NATION, CLAIMANT

v.

PEABODY WESTERN COAL COMPANY, RESPONDENT

FINAL ARBITRATION AWARD

Based upon the stipulation of the parties, the Arbitration Panel hereby enters the following Award in this matter. From and after the date of this Award:

1. The royalty rate in Article IV of Coal Mining Lease No. 14-20-0603-8580, as amended, is 12.5% and the royalty/tax cap in Article XXXV is 20.6%.

2. The royalty rate in Article III of the Coal Mining Lease No. 14-20-0603-9910, as amended, is 6.25% and the royalty/tax cap in Article XXXII is 14.25%

IT IS SO ORDERED this 16th day of September, 1998.

_*X*_Concur ____Dissent _*X*_Concur ___Dissent

/s/ JAMES MOELLER
Honorable James Moeller

MARK R. STEINBERG
Mark R. Steinberg

___Concur ____Dissent

_____
John E. Moye

IN THE ARBITRATION OF COAL ROYALTY RATES AND ROYALTY TAX/CAP RATES

NAVAJO NATION, CLAIMANT

v.

PEABODY WESTERN COAL COMPANY, RESPONDENT

FINAL ARBITRATION AWARD

Based upon the stipulation of the parties, the Arbitration Panel hereby enters the following Award in this matter. From and after the date of this Award:

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2. The royalty rate in Article III of the Coal Mining Lease No. 14-20-0603-9910, as amended, is 6.25% and the royalty/tax cap in Article XXXII is 14.25%

IT IS SO ORDERED this 18th day of September, 1998.

___Concur ___Dissent ___ Concur ___Dissent

_____ _____

Honorable James Moeller Mark R. Steinberg

_*X*_Concur ___Dissent

/s/ JOHNE.MOYE

John E. Moye

LEASE AMENDMENT AGREEMENT
between
THE NAVAJO NATION
and
PEABODY WESTERN COAL COMPANY

THIS LEASE AMENDMENT AGREEMENT ("Agreement") is entered into this 15th day of September 1998, by and between THE NAVAJO NATION ("Navajo Nation") and PEABODY WESTERN COAL COMPANY ("PWCC"), hereafter collectively referred to as "the parties," to those certain coal leases, originally entered into by and between the Navajo Nation and PWCC's predecessor in interest, known as Lease No. 14-20-0603-8580 ("Lease No. 8580") and Lease No. 14-20-0603-9910 ("Lease No. 9910"), as amended to date (collectively "Coal Leases").

WHEREAS, the Navajo Nation and PWCC engaged in arbitration under the terms of the Coal Leases for determination of royalty rates and royalty/tax caps applicable at least through December 14, 2007; and

WHEREAS, the parties hereto negotiated and agreed to resolve all matters at issue in the arbitration in accordance with the terms and conditions contained in this Agreement and in the Settlement Agreement between the parties of even date.

IN CONSIDERATION OF the covenants, promises, terms and conditions contained herein and in the separate Settlement Agreement between the parties of even date, the parties agree:

1. Following Navajo Nation Council approval of this Agreement, the parties shall jointly submit it to the

Secretary of the Interior ("Secretary") for his approval. This Agreement shall become effective on the date such approval is executed by the Secretary, without delegation ("the Lease Amendment Effective Date"). Upon such approval by the Secretary, this Agreement shall constitute an amendment to Lease No. 8580 and to Lease No. 9910.

2. PWCC shall make certain lump sum payments to the Navajo Nation each year, as follows:

a. For 1998, PWCC shall pay a lump sum of $1,000,000 within 10 days of the Lease Agreement Effective Date if but only if the Lease Amendment Effective Date is on or before March 31, 1999. If the Lease Amendment Effective Date is on or after April 1, 1999, no payment shall be made under this paragraph 2 for 1998.

b. If the Lease Amendment Effective Date occurs in a calendar year subsequent to 1998, then for the calendar year in which the Lease Amendment Effective Date occurs, PWCC shall pay a lump sum of $3,500,000 within 10 days of the Lease Agreement Effective Date if this date is on or before March 31 of that year. If the Lease Amendment Effective Date is on or after April 1, PWCC shall pay $3,500,000 multiplied by a fraction, the numerator of which is the number of days remaining in the calendar year after the Lease Amendment Effective Date, and the denominator of which is 365. For any calendar year (after 1998) that fully expires before the Lease Amendment Effective Date no payments shall be made under this paragraph 2.

c. For each calendar year through 2007 after the calendar year in which the Lease Amendment Effective Date of this Agreement occurs, PWCC shall pay $3,500,000 under this paragraph 2 on or before December 14 of the previous calendar year (e.g., assuming the Lease Amendment Effective Date had previously occurred, the payment for 2005 would be made on or before December 14, 2004).

3. The payments provided in paragraph 2 above shall not be royalty bearing, shall not be included in the royalty/tax cap, and are not and shall not be deemed to be royalties or effective royalties. Such payments shall have no precedential value whatsoever, nor shall they be used in any future coal royalty or royalty/tax cap reopener proceedings under the Coal Leases. Further, the amounts will not escalate. Those amounts shall be allocated between the two leases as follows:

a. The payments allocated to Lease No. 8580 shall equal the total payment multiplied by a fraction, the numerator of which is the total royalties paid to the Navajo Nation under Lease No. 8580 for the calendar year for which the payment is made, and the denominator of which is the total sum of royalties paid to the Navajo Nation under Lease No. 8580 and Lease No. 9910 for the calendar year for which the payment is made, and

b. The payments allocated to Lease No. 9910 shall equal the total payment multiplied by a fraction, the numerator of which is the total royalties paid to the Navajo Nation under Lease No. 9910 for the calendar year for which the payment is made, and the denominator of which is the total sum of

royalties paid to the Navajo Nation under Lease No. 9910 for the calendar year for which the payment is made.

4. Beginning on the Lease Amendment Effective Date, all royalties under the Coal Leases shall be calculated in accordance with the provisions currently in the Coal Leases, except that gross realization shall be calculated notwithstanding any impact of the 5% limitation contained in Article IV(a)(ii) of Lease No. 8580 and Article III(a)(ii) of Lease No. 9910 as to any changes in the federal royalty calculation methodology that occurred or is alleged to have occurred prior to September 14, 1998.

5. Except as provided in this Agreement all provisions of the Coal Leases shall remain the same.

6. By his signature below, each of the undersigned representatives of PWCC and of the Navajo Nation agrees, accepts and acknowledges that he has the authority to enter into this Agreement

NAVAJO NATION, Lessor

By ILLEGIBLE
Date: Oct. 9, 1998

PEABODY WESTERN COAL COMPANY, LESSEE

By ILLEGIBLE
Date: Sept. 15, 1998

APPROVED:

By ILLEGIBLE
Secretary of the Interior
Date: Mar. 29, 1999

Secretarial Approval of Lease Amendment Agreement between the Navajo Nation and Peabody Western Coal Company

The Lease Amendment Agreement ("Lease Amendment") between the Navajo Nation ("Nation") and Peabody Western Coal Company ("Peabody") is an amendment of coal mining Lease No. 14-20-0603-8580 in effect since February 1, 1964 and Lease No. 14-20-0603-9910 in effect since June 6, 1966 ("Leases"). The Leases were modified on November 20, 1987 ("1987 Lease Amendments") to provide, among other things, for a coal royalty rate and royalty-tax cap "reopener" every ten years. On March 6, 1997, the Nation invoked the reopener procedures for the Leases. The Nation and Peabody subsequently negotiated the Lease Amendment and the Nation submitted the Lease Amendment for approval by the Secretary of the Interior pursuant to 25 C.F.R. § 211.20(d). Based upon a review of all of the terms of the Lease Amendment and subject to the following clarifications and findings, I do hereby approve the Lease Amendment.

Best Interest Finding Pursuant to 25 C.F.R. § 211.43

The Lease Amendment sets forth royalty rates that are consistent with the minimum requirements provided by 25 C.F.R. § 211.43(a). Therefore, the Department of the Interior ("Department") is not required to make a determination that the Lease Amendment is in the best interest of the Nation. Nonetheless, in a memorandum entitled *Amendments to Coal Mining Lease Nos. 14-20-0603-8580 and 14-20-0603-9910 Between The Navajo Tribe and Peabody Western Coal Company*: *Review and Assessment*, the Department has determined

that the Lease Amendment, with increased bonus payments, is in the best interest of the Nation.

Elimination of the 5% Limitation

The 1987 Lease Amendments included protection in Article IV(a)(ii) of Lease No. 8580 and Article III(a)(ii) of Lease No. 9910 in the event of a modification of the method of calculation of gross realization under the federal regulations by limiting the result of such a modification to no more than 5% of gross realization. In the Lease Amendment, the parties have agreed to adjust gross realization to eliminate prospectively any impact that the 5% limitation may have had on the calculation of gross realization.

Non-Application of Indian Coal Valuation Regulations

When the Leases were first executed in 1964 and 1966, and when they were amended in 1987, the Department had promulgated only one set of regulations to apply to federal and Indian coal leases. Since 1987, the Department has promulgated separate Indian Coal Valuation Regulations, codified at 30 C.F.R. Subpart J (Sections 206.450 through 206.464), to apply to coal leases on Indian land.

Paragraph 3 of the 1987 Lease Amendments states that gross realization is to be calculated "in accordance with the method utilized by the United States Government for computing royalties on federal coal leases." The Lease Amendment does not amend this paragraph. The Department believes that Paragraph 3 of the 1987 Lease Amendments means that the Indian Coal Valuation Regulations will not apply for computing royalties due on coal produced under the Leases.

Royalty Effect of Bonus Payments

In addition to royalty payments that Peabody must make to the Nation under the Leases, Paragraph 2 of the Lease Amendment states that Peabody is to pay the Nation annual lump sum bonus payments. Paragraph 3 of the Lease Amendment provides that the annual bonus payments "shall not be royalty bearing, shall not be included in the royalty/tax cap, and are not and shall not be deemed to be royalties or effective royalties." But for the royalty waiver in paragraph 3, those annual bonus payments may qualify as royalty bearing under the Leases if Peabody's coal purchaser reimburses it for the payments. Such a reimbursement would be royalty bearing if it is determined that the reimbursement is a payment for the coal and, therefore, should be included in the calculation of gross realization. However, the Hopi Tribe ("Tribe") is not a party to the Lease Amendment and has not executed a royalty waiver on annual bonus payments in its lease for Joint Use Area ("JUA") coal. Therefore, any annual bonus payments that are reimbursed by Peabody's coal purchaser for JUA coal may be royalty bearing under the Tribe's lease.

Executed this the *29th* day of March, 1999.

/s/ BRUCE BABBIT
BRUCE BABBIT
Secretary of the Interior

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF AKHTAR ZAMAN

Feb. 14, 2000

I, Akhtar Zaman, do hereby declare pursuant to 28 U.S.C. § 1746 that:

1. I am the Director of the Navajo Nation Minerals Department, located in Window Rock, Arizona. As Director, I am the official custodian of records maintained in the Department's files.

* * * * *

6. The Navajo Nation Minerals Department, on a daily basis, works closely with federal agencies, offices, and personnel in their management, control, and oversight of the Navajo Nation's coal resources, including accountability for royalty revenues paid in consideration of Navajo Nation coal.

7. The various federal agencies which regulate coal mining activities on the Navajo Reservation are as follows:

- Bureau of Land Management (BLM)
- Office of Surface Mining Reclamation and Enforcement (OSM)
- Bureau of Indian Affairs (BIA)
- Minerals Management Service (MMS)
- Office of Mine, Safety and Health Administration (MSHA)
- U.S. Environmental Protection Agency (USEPA)

8. The BLM is responsible for resource recovery, including inventory of coal reserves. BLM staff routinely visits, inspects, and evaluates the surface coal mining operations located on the Navajo Nation, including the Black Mesa and Kayenta mines of Peabody Western Coal Company (Peabody). BLM authorizes or denies all coal mining plans and any changes in mining plans. BLM monitors the by-pass of any coal seams that are required to be mined under an approved mining plan.

9. The OSM is responsible for establishing mined land reclamation requirements, monitoring of coal surface mining reclamation activities and enforcing the provisions of the Surface Mining Control and Reclamation Act of 1977. The OSM issues 5-year mining permits for surface coal mines on the Navajo Nation and enforces the terms and conditions of these permits. Peabody has filed with the OSM an original mining permit application for its Black Mesa and Kayenta Mines, which Peabody routinely updates to comply with OSM requirements.

10. The BIA is responsible for the issuance of coal exploration permits and mining leases on the Navajo Nation. The BIA coordinates with other federal agencies (e.g., BLM, OSM, MMS) to assure that the interest of the Indian lessor is protected with respect to every aspect of coal mining operations, including surface mining activities, royalty and rental payments, valuation of coal resources, and others. The BIA Division of Energy and Mineral Resources is responsible for running economic mining models for new mining projects and any changes to existing mining projects, and to determine the overall economic value of such proposals to assist in maximizing revenues from mineral (including coal) development on the Navajo Reservation.

11. The MMS is responsible for monitoring and accounting royalty receipts, conducting audits, collection of audit discoveries, and performing coal product valuation for the determination of proper royalty payments due the Navajo Nation.

12. The MSHA is responsible for mine safety and health inspections of coal mines in the Navajo Nation, including Peabody's mines, and enforcement of the Federal Mine Safety and Health Act of 1977, to assure the protection of mine workers.

13. The USEPA is responsible for issuing water discharge permits to the coal operators on the Navajo Nation, including Peabody, investigation of citizen complaints related to environmental concerns, mitigation of air and water pollution from the mining operations, and other responsibilities inherent in protecting the air and water quality of the Navajo Nation.

14. Attached hereto as Exhibit "A" is a Table of Contents for Peabody's mining plan for the Black Mesa and Kayenta mines, with a photograph of the many volumes containing all documents pertaining to the permit. These materials have been prepared in the regular course of business activity by Peabody, and have been filed with the OSM and the Navajo Nation pursuant to federal statutory and regulatory requirements. These volumes are kept in the custody of personnel at the Navajo Nation Minerals Department in Window Rock, Arizona, according to the Minerals Department's regular course of governmental business.

15. Attached hereto as Exhibit "B" is a list of additional documents, which have been prepared and submitted by Peabody concerning the mining operations at the Black Mesa and Kayenta mines. These materials have been prepared in the regular course of business activity by Peabody, and have been filed with the OSM and the Navajo Nation pursuant to federal statutory and regulatory requirements. A photograph of these documents is also included in Exhibit B. These volumes are also kept in the custody of personnel at the Navajo Nation Minerals Department in Window Rock, Arizona, according to the Minerals Department's regular course of governmental business.

16. In contrast with the voluminous coal surface mining permit application and related documentation, a lessee may drill an oil and gas well by submitting to the BLM a one-page document such as that attached hereto as Exhibit "C."

17. In my routine duties as Director of the Navajo Nation Minerals Department, I and my staff regularly

coordinate with federal officials from the agencies listed above in performing the functions described. Based on my personal experience, it is my professional opinion that the federal government exercises extensive and pervasive management and control over virtually all aspects of the development of the Navajo Nation's coal resources, from initial exploration and drilling, leasing, permitting, mine development, operation and royalty accounting and audits, to the final stages of land reclamation and mine closure. Federal management and control over Indian coal resources is at least equal to, and in many cases much more extensive and pervasive than, that concerning Indian oil and gas resource development.

18. I know the above facts based on my personal knowledge and they are true to the best of my information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *14th* day of February, 2000.

/s/ AKHTAR ZAMAN
AKHTAR ZAMAN

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF PERRY SHIRLEY

Feb. 16, 2000

I, Perry Shirley, do hereby declare pursuant to 28 U.S.C. § 1746 that:

1. I am the Minerals Royalty and Audit Director of the Navajo Nation Minerals Department, located in Window Rock, Arizona. I have served in this position since November, 1992. For the past fifteen years, I have been directly involved in minerals royalty management matters for the Navajo Nation.

* * * * *

18. I am familiar with MMS royalty management policy. Based on personal experience as Minerals Royalty and Audit Director of the Navajo Nation Minerals Department and my experience working with MMS, it is my professional opinion that MMS treats coal royalty management in a manner that is similar to oil and gas. For example,

a. solid mineral royalty payor instructions are prepared and provided by MMS to coal royalty payors in a similar manner as to oil and gas payors;
b. verification of coal royalty payments by MMS is conducted in a similar manner as verification of oil and gas royalty payments;
c. enforcement procedures utilized by MMS for coal audit issues are similar to the enforcement procedures utilized by MMS for oil and gas audit issues;
d. the appeal procedures available to aggrieved coal payors are similar to the appeal procedures available to oil and gas payors; and
e. many of the MMS and Interior Board of Land Appeal decisions concerning royalty management of coal frequently rely on previous decisions relating to royalty management of oil and gas.

To the most practical extent possible, MMS treats coal in a similar fashion as oil, gas and other solid minerals.

19. I know the above facts based on my personal knowledge and they are true to the best of my information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *16* day of February, 2000.

/s/ PERRY SHIRLEY
PERRY SHIRLEY

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

MEMORANDUM IN SUPPORT OF MOTION TO ALTER OR AMEND JUDGMENT

[Filed: Feb. 18, 2000]

The Court issued its Opinion and Judgment on cross-motions for summary judgment on the issue of liability, dismissing the complaint on February 4, 2000. The Court found in no uncertain terms "that the United States violated the most fundamental fiduciary duties of care, loyalty and candor" in the transactions at issue. *Id.* at 13. However, the Court concluded that "the trust relationship necessary for our jurisdiction does not exist." *Id.* at 2; *see also id.* at 13 ("These violations, serious as they are, do not themselves confer jurisdiction on this Court, nor entitle plaintiff to money damages."). The Navajo Nation respectfully submits that the finding of lack of jurisdiction is based on an erroneous theory of the law not advanced by the United States at any time, and statements of fact that contravene the record. The Court disregarded the significant factual and legal con-

cessions made by Defendant. The Court's critical determination that the leasing of oil and gas is subject to more comprehensive federal control than coal is not supported by applicable law or the record. The Court should amend its findings and conclusions and enter a new judgment to prevent a manifest injustice.

* * * * *

2. A close look at the federal statutory and regulatory scheme establishes that federal control or supervision over Indian coal resources is at least as comprehensive as that over oil and gas.

Federal management of Indian coal leasing is not only as comprehensive as that for Indian oil and gas resources, it is much more broad and detailed. Regulation of mineral leasing on Indian lands in general is governed by three statutes, the Indian Long-Term Leasing Act of 1909, 25 U.S.C. § 396 (concerning allotted lands and amended only in 1955), the Indian Mineral Leasing Act of 1938 ("IMLA"), 25 U.S.C. §§ 396a-396g (largely unchanged since enacted), and the Indian Mineral Development Act of 1982 ("IMDA"), 25 U.S.C. §§ 2101-2108. Because the Peabody mines are on unallotted tribal land and Lease 8580 and the lease amendments at issue in this case were approved pursuant to the IMLA, not the IMDA, Lease 8580 and the lease amendments are governed only by the IMLA. *See* PPF nos. 13, 32, Lease 8580 at 1, I App. 127. Given that the Indian Long-Term Leasing Act consists of only one, generally worded, one-paragraph section, that Act and its implementing regulations which trace the IMLA regulations cannot reasonably establish greater and more judicially enforceable duties than the IMLA, or provide a proper basis for distinguishing *Pawnee*. *Compare* 25 U.S.C. §§ 396a-396g

and 25 C.F.R. Part 211 *with* 25 U.S.C. § 396 and 25 C.F.R. Part 212. *Cf.* Op. at 20. The IMDA is not in issue here.

* * * * *

3. The record establishes that the 1987 lease amendments violated the DOI policy requiring a minimum of 12½ percent royalties for surface mined Indian coal.

The record also contradicts the Court's statement regarding the value of the negotiated lease amendment and the Interior policy requiring tribal mineral royalties of at least 12.5 percent. The Court noted that the negotiated amendments "preserv[ed] the adjustment of the royalty rate at 12.5 percent," Op. at 9, and that "there is no claim by the Navajo [N]ation that the 1987 approval of Lease 8580, with royalties of 12.5 percent, ran afoul of that policy." *Id.* at 22. In fact, the record establishes that "[t]he true, effective royalty rate of the 8580 Amendments is below the federal minimum of 12½%," PPF no. 247 (citing Shirley Decl., III Pl. App. 1816), and that the method used for calculating royalties under the lease amendments "resulted in royalty payments lower than the minimum allowable for federal coal." PPF no. 315 (citing Bertholf Dep. at 93-94, II Pl. App. 902-03). The United States did not refute these findings. *See* Def.'s Statement of Genuine Issues at 19-20 (commenting on PPF no. 247 only regarding settlement of a 5% cap in prior litigation), 23 (not responding to PPF no. 315). The opinion should be corrected accordingly.

* * * * *

AFFIDAVIT OF EDWARD L. SULLIVAN, JR.

Feb. 1, 2002

* * * * *

EDWARD L. SULLIVAN, JR., being first duly sworn upon his oath, deposes and says:

1. I am currently employed by Peabody Holding Company, Inc. ("PHC") in the capacity of Senior Counsel. In this position, I serve as primary in-house counsel to PHC's affiliate Peabody Western Coal Company ("PWCC").

2. In my capacity as in-house counsel, I have otherwise become familiar with numerous documents reflecting the relationship between Sentry Royalty Company ("Sentry"), PWCC's predecessor-in-interest, and both the Navajo Tribe and the Hopi Tribe. Included among, but not limited to, such documents are drilling and exploration permits, the coal mining leases (Lease No. 14-20-0603-8580 (Navajo Lands Only), Lease No. 14-20-0603-9910 (Navajo Portion of Joint Use Lands), Lease No. 14-20-0450-5743 (Hopi Portion of Joint Use Lands)) and the amendments thereto that Sentry entered into with the Navajo Tribe and the Hopi Tribe in order to mine coal on the Navajo and Hopi Reservations in northeastern, Arizona. PWCC's coal mining operations in Arizona are located on the Navajo and Hopi Reservations in Arizona, subject to these leases with the respective tribes. PWCC's coal mining operations provide coal to the Salt River Project Improvement and Power Dis-

trict ("SRP") generating station in Page, Arizona and Southern California Edison's Mojave generating station.

3. In my capacity with PHC, I have become aware that on or about May 8, 1961, the Advisory Committee of the Navajo Tribal Council issued Resolution ACMY-65-61. A true and correct copy of the resolution is attached hereto and marked as **Exhibit A.**

4. In ¶ 1 of the resolution, the resolution grants the Chairman of the Navajo Tribal Council the authority to grant Sentry a permit to the exclusive right to drill and explore for coal on Navajo Tribal lands for a period of two (2) years, on behalf of the Tribe, subject to the approval of the Secretary of the Interior or his authorized representative. Paragraph 2 of the resolution identifies that the time period of two (2) years is to begin upon the date of the approval of the drilling and mining exploration permit by the Secretary of the Interior or his authorized representative. The resolution bears a receipt date by the Bureau of Indian Affairs in Washington, D.C. of July 18, 1961. (*See* **Exhibit A**)

5. On or about May 13, 1961, representatives of The Navajo Tribe (the "Permittor") and Sentry (the "Permittee") executed the Drilling and Exploration Permit (the "1961 Navajo Permit"). A true and correct copy of the relevant portions of the 1961 Navajo Permit are attached hereto and marked as **Exhibit B**.

6. In ¶ 1 of the 1961 Navajo Permit, Sentry is granted the exclusive right to drill and explore for coal upon Navajo Tribal land for a period of two years from the date of approval by the Secretary of the Interior and the option of entering into a lease in the form of Exhibit B to the 1961 Navajo Permit. Furthermore, in ¶ 9, the

1961 Navajo Permit requires Permitee to commence coal prospecting operations within ninety (90) days of the approval of the permit by the Secretary of the Interior. I understand that Sentry complied with that obligation. (*See* **Exhibit B**)

7. In ¶ 10 the 1961 Navajo Permit further requires Sentry to give employment preference to members of the Navajo Tribe. In ¶ 12, the 1961 Navajo Permit states the permit is not assignable without the prior approval of the Advisory Committee of the Navajo Tribal Council and the Secretary of the Interior.

8. The 1961 Navajo Permit was signed and is dated February 6, 1962 by James F. Canan, Assistant Area Director, Bureau of Indian Affairs, Department of the Interior. (*See* **Exhibit B**)

9. It is my understanding, in part based on a review of the 1961 Navajo Permit and the history of PWCC's leasing rights in Arizona, that the form of both the Lease attached as Exhibit B to the 1961 Navajo Permit and the 1961 Navajo Permit itself were drafted by the Secretary of Interior or his authorized representative and presented to Sentry.

10. It is my understanding that no meaningful bargaining took place over the terms included in either the 1961 Navajo Permit or the form of Lease by Sentry with either the Secretary of Interior or the Navajo Tribe.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF STEWART L. UDALL

Aug. 6, 2004

I, Stewart L. Udall, do hereby declare that:

1. I was the Secretary of the Interior from 1961-1969.

2. As Secretary of the Interior, I was personally involved in the planning and decision making culminating in the leasing of Navajo and Hopi coal to the Peabody Coal Company, and the related power plants, water development, and infrastructure.

3. That coal leasing and related development was the centerpiece of the resources development program under the Navajo and Hopi Rehabilitation Act of 1950.

4. In such planning and decision making, I acted in the capacity as trustee for the Indians, as I understood the law to require, and I believed then and do believe now that such trusteeship was of paramount importance in the Department of the Interior's implementation of

the development program under the Navajo and Hopi Rehabilitation Act of 1950.

5. I know the above facts on my personal knowledge and they are true to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 6th day of August, 2004.

/s/ STEWART L. UDALL
STEWART L. UDALL

DECLARATION OF CHARLES J. CICCHETTI IN SUPPORT OF THE NAVAJO NATION

Aug. 20, 2004

Charles J. Cicchetti states under oath and on personal knowledge:

1. I am an adult resident of the State of California. My business address is Pacific Economics Group, 201 South Lake Avenue, Suite 400, Pasadena, California 91101. I am a co-founding member of Pacific Economics Group. I am also the Jeffrey J. Miller Chair in Government, Business and the Economy at the University of Southern California. I know the facts stated herein on my personal knowledge and they are true to the best of my information, knowledge and belief.

2. I actively consult with clients on energy and environmental matters, market issues, fair market value, and antitrust policies, particularly as those policies relate to energy and communication industries.

3. I earned a B.A. degree in Economics from Colorado College in 1965 and a Ph.D. degree in Economics from Rutgers University in 1969. From 1969 to 1972, I engaged in post-doctoral research at Resources for the Future.

4. I commenced my professional career by serving as chief economist for the Environmental Defense Fund and was a faculty member at the University of Wisconsin from 1972 to 1985, ultimately earning the title of Professor of Economics and Environmental Studies.

From 1975 through 1976, I served as the Director of the Wisconsin Energy Office and as Special Energy Counselor for the Governor. In 1977, I was appointed by the Governor as Chair of the Public Service Commission of Wisconsin ("PSCW") and held that position until 1979 and served as a Commissioner until 1980. In 1980, I co-founded the Madison Consulting Group, which was sold to Marsh and McLennan Company in 1984. In 1984, I was named Senior Vice President of National Economic Research Associates, and held that position until 1987. From 1987 until 1990, I served as Deputy Director of the Energy and Environmental Policy Center at the John F. Kennedy School of Government at Harvard University. From 1988 to 1992, I was a Managing Director and, ultimately, Co-Chairman of the economic and management consulting firm Putnam, Hayes & Bartlett, Inc. In 1992, I formed Arthur Andersen Economic Consulting, a division of Arthur Anderson [*sic*] LLP. In 1996, I left Arthur Andersen to co-found Pacific Economics Group. In 1998, I accepted the Jeffrey J. Miller Chair at the University of Southern California.

5. In the course of my career, I have published a number of articles on energy and environmental issues, public utility regulation, competition and antitrust. A complete list of my publications is appended to this affidavit as Appendix A. Additionally, I have on many occasions given expert testimony in court and administrative proceedings. A list of the proceeding in which I have provided expert testimony since 1980 is also included in Appendix A and a summary of my pre-1980 testimony is shown in Appendix B.

* * * * *

9. On May 14, 2004, Mr. Judah Rose testified before the CPUC (Docket No. A.02-05-046) on behalf of the Hopi Tribe. Mr. Rose is a most credible expert, who testified that as recently as the 2001-2003 time period, the delivered prices (using a coal slurry line) for coal from the Black Mesa Mine to the Mohave Generating Station have been $1.32 per MMBTU. My own independent analysis verifies this conclusion.

10. This current 2001-2003 delivered price is below the twenty-year old Fair Market Value Test prices I used in my 1983 PNM testimony for western utilities ($1.3581/MMBTU) and southwestern utilities ($1.446/MMBTU), as shown in Table 1 above. Using the same tests I used in 1983, I have reviewed the Fair Market Value for Mohave Generating Station coal. I would find that twenty years later, the $1.32/MMBTU price that the utilities paid for coal delivered to the Mohave Generating Station was below Fair Market Value.

11. I conclude that the Mohave Generating Station's delivered prices for coal have been very good for the coal buyers, the Mohave Generating Station's owners, because they are paying less today than Fair Market Value in 1982. In relative terms it is even worse for the Navajo and Hopi. In the past twenty years, there has been significant inflation, and $1.00 today was worth only about $0.51 in 1982. The sellers are not quite receiving a 1982 Fair Market Value in 2003. Indeed, the $1.32/MMBTU delivered price today is equal to only about a $0.67/MMBTU delivered price in 1982, which is significantly below the Fair Market Value Tests I performed in the early 1980's and even less than the price PNM paid WCC in 1982.

12. The 1987 lease amendments to the Peabody lease with the Navajo provided for facial 12.5% royalty rate. That royalty rate, as well as any and all subsequent payments, resulted in coal being conveyed up to the present at substantially less than the Fair Market Value of the coal. If the royalty rate had been higher, such as the 20% initially the BIA's Navajo Area Director imposed and that officials of the Department of the Interior recommended on Peabody's appeal to the Commissioner of Indian Affairs, the Navajo Nation would have received a payment that would have come closer to the Fair Market Value of the coal.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *18th* day of August 2004.

/s/ CHARLES J. CICCHETTI
CHARLES J. CICCHETTI

UNITED STATES COURT OF FEDERAL CLAIMS

Case No.: 93-763L

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

AFFIDAVIT OF MARK P. BERKMAN, PH.D.

Aug. 20, 2004

Mark P. Berkman, being sworn states:

1. I am a vice president of Charles River Associates (CRA), an economics and management consulting firm with offices throughout the country and abroad. I submit this affidavit to address several questions regarding the economics of the coal lease between the Navajo Nation and Peabody Coal Company (Lease 14-20-0603-8580 as amended, hereafter, the Peabody lease) administered by the United States.

I. Qualifications

2. I have over twenty-five years of experience regarding resources economics and policy. My clients in this area have included the Crow Tribe, the Arapaho and Shoshone Tribes, the Navajo Nation, Montana Power, Central and Southwest Energy Inc., Ontario Hydro, the New York City Law Department, and the U.S. Depart-

ment of Justice. During the course of my career I have evaluated coal resources and coal contracts, defined coal markets, and forecasted coal prices. I have also evaluated land, water, oil, and natural gas, and other natural resources. I have provided testimony regarding these matters before the Courts, the U.S. Congress, and various public utility commissions. My analyses and testimony have been cited with approval by the Courts on several occasions, including the U.S. Supreme Court in *Crow Tribe of Indians v. The State of Montana* and the United States District Court Northern District of New York in *The Cayuga Indian Nation of New York et. al. v. George E. Pataki as Governor of the State of New York.*[1]

3. Prior to joining CRA in 2002, I was a vice president of National Economic Research Associates (NERA). Previously, I was a research fellow at the University of Pennsylvania and a budget and policy analyst at the Congressional Budget Office. I earned a bachelor's degree in urban affairs and economics at George Washington University, a master's degree in planning and policy analysis from Harvard University, and a PhD from the University of Pennsylvania's Wharton School program in managerial science and applied economics. A copy of my resume is presented as Exhibit 1.

II. Purpose and Summary

4. Counsel for the Navajo Nation has asked me to answer the following questions regarding the Peabody lease:

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[1] 139 L. Ed. 2d 33; 1997 U.S. LEXIS 4746 and 165 F. Supp 2d 266; 2001 U.S. Dist. Lexis 16030, respectively.

a. Was the compensation received by the Navajo Nation up-front for this lease equivalent to what the federal government would have received for a federal lease?

b. Was the twenty percent royalty rate requested by the Navajo and rejected by the U.S. Department of Interior economically justified?

5. Based on my analysis and review of the record, I have determined that the Navajo Nation did not receive as much compensation up-front for the Peabody lease as would have been expected by comparison to federal leases, and that a 20 percent royalty was justified on an economic basis.

* * * * *

IV. Review of Navajo Compensation from the Peabody Lease

12. Based on my review of Navajo compensation from the Peabody Lease, I have concluded that the Navajo received less compensation than the federal government would have for similar coal. This is the case for two reasons: First, the federal government obtained higher up-front bonuses on its leases, even for coal of lesser quality, and poorer proximity to prospective purchasers. Second, the Navajo were required to waive taxes in order to conclude the lease amendment. The federal government made no such concessions on its leases. In addition, there is substantial evidence that the Navajo could have charged a higher royalty—at least 20 percent—without making their coal resource uneconomic.

A. The Adequacy of the Up-Front Bonus

13. Federal leases during the period of the Peabody lease amendment typically included an up-front bonus payment (typically paid on a per acre basis) and a running royalty rate of 12.5 percent (the royalty floor established by the Federal Coal Lease Act Amendments of 1976). The rate could be higher depending on the expected value of the coal and the size of the up-front bonus. There are a number of instances where companies agreed to royalties above 12.5 percent in exchange for somewhat smaller up-front bonuses. Peabody agreed to pay 17.08 percent on an operation in Colorado. Western Energy agreed to pay 21 percent royalties on portions of its Rosebud operations.[8] Colo Yampa Coal Company paid 18.3 percent royalties on a Colorado lease.[9] In at least one circumstance, in exchange for virtually no up-front payment, a royalty rate of 17.08 percent was agreed to by the government and Peabody Coal Company.

14. As described above, the Navajo received only $1.5 million as up-front bonus and at the same time had to waive Business Activity Tax and Possessory Interest Tax revenues and penalties for the period 1978 through 1984 that Peabody owed the Nation. This bonus translates to $0.014 per ton, which is considerably below the

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[8] Listed in a memo from Ken Moore to Gary Stuckey, "Re: Federal Royalty Rates," December 21, 1981, NNP072555. This memo also included four deep coal mining operations with royalties above the 8 percent minimum rate. Peabody offered $35.35/acre as a bonus with a rate of 17.08 percent on 125 acres.

[9] Lease number C22644, listed in Appendix-1 of "Reasonableness of the Lease 8580 Royalty Rate: The Navajo Nation v. The United States," by Resource Data International, 1986.

$0.05 per ton requested for federal leases.[10] Thus, the Navajo lost over $3 million compared to the typical federal value.[11] The waiver cost the Navajo Nation another $19.7 million from the Black Mesa Mine at the time.[12]

15. The Nation was also forced to concede its right to raise the royalty rate to 20 percent, representing an even more costly concession.

16. I have examined a study conducted by RDI for the Navajo in 1995 found that, even accounting for bonuses that are scheduled at later milestones, the Peabody bonus to the Navajo was well below other federal leases on a net present value basis.[13] The RDI study discounted future bonuses at several discount rates, resulting in figures below those I calculated. The RDI study also compared total tax and royalty burdens of Navajo coal to other mines in the western United States. This comparison shows a lower burden for Navajo coal.

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[10] Based on 90 million tons of additional coal. See "Fair Market Value Policy for Federal Coal Leasing, report of the Commission," February 1984, p. 314, federal value. Note that even if future bonuses identified in the lease amendment are considered on a present value basis, the bonus per ton is only $0.057 per ton, based on 90 million tons, or $0.026 per ton, based on 197 million remaining tons.

[11] Calculated as (.05 - .016) x 90,000,000 = 3,060,000

[12] A draft version of a presentation regarding Indian Lease negotiations to the Board of Directors and Management Committee of Southern California Edison indicates a "do nothing" scenario would result in $33 million in back tax liability. From R.M. Bertholf to R.H. Bridenbecker, "Subject: Indian Lease Negotiations," August 6, 1987, 0000635-0000637.

[13] Resource Data International, "Reasonableness of the Lease 8580 Royalty Rate: The Navajo Nation v. The United States" prepared for the Navajo Nation, 1996, p. 11.

17. Thus, at the signing of the 1987 lease amendment, the Navajo Nation actually suffered a substantial up-front loss rather than a bonus, never to be offset by a higher royalty rate or scheduled future bonuses.

B. The Economics of the 20 Percent Royalty

18. Based on my analysis and a review of studies conducted in the mid 1980's, I have concluded that: 1) a royalty rate above the 12.5 percent minimum for federal leases was justified by the coal quality and proximity to customers, and 2) a 20 percent royalty could have been absorbed by Peabody and/or the power plant owners and ratepayer without adverse consequences. Peabody's mining operations would have remained highly profitable even it if absorbed 100 percent of the increased royalty. Southern California Edison, Salt River Project, and the other owners of the Mohave and Navajo power plants would have continued to find these plants among the least expensive fossil-fired source of power available.

1. Coal Quality Considerations

19. Coal mined under the Peabody leases is of high quality with respect to its high energy content (btu/lb) and its low sulfur content (lbs(SOx)/ton). This makes it a particularly attractive fuel to power plants. In addition, two power plants, Mohave Generating Station and Navajo Generating Station, were designed and located to take advantage of this coal. As shown in Exhibit 2, Navajo coal had an average btu content of 11,600mmbtu/lb between 1978 and 1986, compared to a regional average of 9,800 mmbtu/lb. Similarly, Navajo coal's sulfur content during this period averaged .53 percent by weight, compared to a regional average of .58 percent by weight.

20. These coal quality characteristics should have enabled the Navajo to demand a royalty rate above the federal floor of 12.5 percent. A review of coal prices to electric utilities between 1979 and 1987 confirms this. I relied on regression analysis to compare coal prices, controlling for coal quality (btu content, sulfur content, moisture level, and ash) and transportation costs, and found that, based on the quality of coal obtained from the lease, the market would have paid as much as $12.39/ton more for Navajo quality coal (this difference is about 50 percent more than the actual price). Exhibit 3 summarizes the results of the regression analysis. This indicates that Navajo coal was under priced and would have easily remained competitive with a 20 percent royalty.

2. Royalty Impact on Power Plant Economics

21. Because of its low cost and high quality, a royalty increase of 20 percent would not have substantially altered the economics of the Mohave and Navajo plants. I have compared the merit order of power plants in the region where these plants operate, with and without the 20 percent royalty, to demonstrate this point. Merit order reflects the relative operating costs of plants available within a particular electricity reliability area available to meet electricity demand. Plants will be brought on line in the order of their operating costs from lowest cost to highest as demand increases. For example, in 1984, without the 20 percent royalty, Mohave ranks 29th out of 83 plants in the merit order and Navajo ranks 8th in the Western States Co-Ordin-

ating Council (WSCC) reliability region.[14] Adding the 20 percent royalty barely changes this order. Navajo's rank remains unchanged while Mohave's rank only increases from 29th to 31st. Modest changes would also have occurred in 1987. Navajo's rank would have increased from 14th to 15th and Mohave's rank would rise to 32nd to 33rd. These findings are summarized in Exhibit 4. Both plants would have continued to run to meet base load demand under the revised ranks. They would have remained considerably less expensive to operate than many other available plants. Consequently, the utilities would have continued to find it attractive to operate these plants even with the royalty increase. The effect on stockholders and ratepayers would depend on how the increase is treated by public utility commissions. Regardless, the magnitude of the cost increase would not result in either a notable reduction in utility rates-of- return or higher electricity rates.[15]

3. Royalty Impact on Mine Economics

22. To demonstrate that Peabody's mining operations would continue to be profitable even if it were to absorb all of the royalty increase, I conducted discounted cash flow (DCF) analyses. I measured Peabody's internal rate of return from this analysis and compared

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[14] The United States is divided up into numerous reliability areas to co-ordinate electricity generation and transmission for purposes of improved reliability.

[15] According to the Southern California Edison 1988 Annual Report, total operating revenue was $5,932,906,000. The incremental costs associated with a 20 percent royalty on Peabody's gross realization passed through to SCE would have been $25.8 million in 1988 (this includes increase royalties at both mines to both Navajo and Hopi). This represents less than one half of one percent of SCE's revenue.

it to Peabody's cost of capital. Provided that this rate of return equals or exceeds the cost of capital, it is highly likely that Peabody would find it profitable to continue mining. Exhibit 5 presents the results of my DCF analyses. The analysis indicates that even if Peabody had absorbed all of the 20 percent royalty increase, its rate of return would have remained impressive. The DCF is based on the U.S. Bureau of Mines analysis presented in 1984.[16] The BOM study calculated royalties as a percent of total revenue, rather than as a percent of gross realization as specified in the amended lease. I modified the BOM study to calculate royalties as a function of gross realization in the manner consistent with the Federal Coal Lease Agreement Act. This correction has the effect of increasing royalty as a percent of revenue. Additionally, I evaluated the DCFROR at a fixed price of $17.71. This was the price reported by the Salt River Project and compiled in the coal transportation rate database.[17] These corrections do not change the conclusion of the BOM study. The mine would remain economic with a 20 percent royalty. According to my calculation, the DCFROR in 1984 was 28.17 percent at a royalty rate of 20 percent.

23. Thus, increasing the royalty from 12.5 percent to 20 percent was consistent with the quality of the coal and could have been readily absorbed by either Peabody, or Southern California Edison or both. Therefore, the Secretary of the Interior's rejection of the 20 percent in favor of the 12.5 percent royalty rate approved in the 1987 lease amendment was not based on sound economics.

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[16] United States Bureau of Mines, June 6, 1984.

[17] http://www.eia.doe.gov/cneaf/coal/ctrdb/database.html

4. Review of Contemporaneous Studies

24. I have also reviewed a number of studies conducted for the Department of Interior, the Navajo Nation and Peabody in the mid 1980's, as well as one completed within the last ten years. All but two of these studies concluded, consistent with my findings above, that the Navajo could have charged a 20 percent royalty without fear of rendering their coal uneconomic. These studies relied on a two basic approaches-comparables and discounted cash flow. The comparables approach is often problematic because it is difficult to find true comparables or to control for observed differences (regression analysis may provide the means to accomplish the latter). Consequently, the discounted cash flow approach is generally preferred. Analysts at the United States Bureau of Mines, the Mining Section of the Energy and Mineral Resources Division of the Bureau of Indian Affairs, and Schwab all determined that a 20 percent royalty rate could be achieved based on cash flow analyses.[18] These studies were available to the Secretary of Interior at the time the lease amendment was approved. One study prepared by the Bureau of Indian Affairs was intended as a preliminary study to facilitate

[18] These studies included: "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," June 6, 1984; Philip Perlewitz and Robert Davidoff, U.S. Bureau of Mines, "An Engineering and Economic Analysis of the Kayenta Lease Area," Mail Slip Dated April 24, 1985; and Philip Perlewitz and Robert Davidoff, U.S. Bureau of Mines, "Addendum to an Engineering and Economic Analysis of the Kayenta Lease Area," May 6, 1985. Also, Schwab and Associates, "Study of the Value of the Navajo Coals," April 1982.

royalty negotiations.[19] The BIA estimated that a 20 percent royalty rate on coal from the Kayenta Mine would yield a discounted cash flow rate of return (DCFROR, also called the internal rate of return or IRR) of 34.9 percent; at a 30 percent royalty, the DCFROR would be 26.4 percent. This study was handicapped by the lack of direct information on Peabody operating expenses and remaining expenditures from primary capital investment. It assumed that all primary capital expenditures had been paid. A series of studies by the Mineral Availabilities Office of the U.S. Bureau of Mines examined the DCFROR in greater detail. The last of these studies supplemented capital and operating expense data with information from the Kayenta Mine Plan submitted to the Office of Surface Mining.[20] Information from the Kayenta Mine Plan included a list of major equipment, recent crusher and conveyor installations, reclamation costs, seam thickness and overburden depth. This study assumed $100 million in remaining capital expenditures. When the price of coal was assumed to be constant at $17/ton, the DCFROR at Kayenta was estimated to be 32 percent at a 12.5 percent royalty rate and 21.5 percent at a 20 percent royalty rate. The Navajo Area Director reviewed these studies and concluded that the BIA study underestimated costs, but that the Bureau of

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[19] Memo from Mining Engineer, Division of Energy & Mineral resources, Golden CO, to Area Directory, Navajo Area Office, "Subject: Adjustment of Navajo Coal Lease No. 14-20-0603-8580 ("Kayenta"); Peabody Coal Company", June 6, 1984.

[20] Philip Perlewitz and Robert Davidoff, U.S. Bureau of Mines, "Addendum to an Engineering and Economic Analysis of the Kayenta Lease Area," May 6, 1985, pp.6-11.

Mines study justified changing the royalty rate to 20 percent.[21]

25. The Peterson study and the 1982 Peabody study are the only 1980's era studies to conclude that a 20 percent royalty rate was unreasonable. Peterson's conclusion, however, does not appear to be based on a proper economic rationale. The study authors determined that since Peabody's capital investments were made based on expectations in 1964, a royalty rate of this magnitude would be unreasonable. Expectations in 1964 are irrelevant to business investment decisions in 1984 or 1987. Capital investments made in 1964 are sunk costs. The proper evaluation must be forward looking, considering expected future costs and investment requirements against expected future revenues. The Peabody study's conclusion is contradicted by my analysis and those identified in the previous paragraph.

V. Conclusion

26. The Navajo Nation has been prevented from obtaining the revenues from the Peabody lease that would have been expected. There is convincing economic evidence that the Nation's request for a 20 percent royalty would not have rendered its coal uneconomic. Peabody, the utilities, or some combination could have absorbed this increase without substantial reductions in profits or electricity price increases. The Navajo Nation was also force to accept a small bonus and to waive back taxes as lease amendment concessions, despite the quality of the coal and its value to Peabody and the utilities. The need

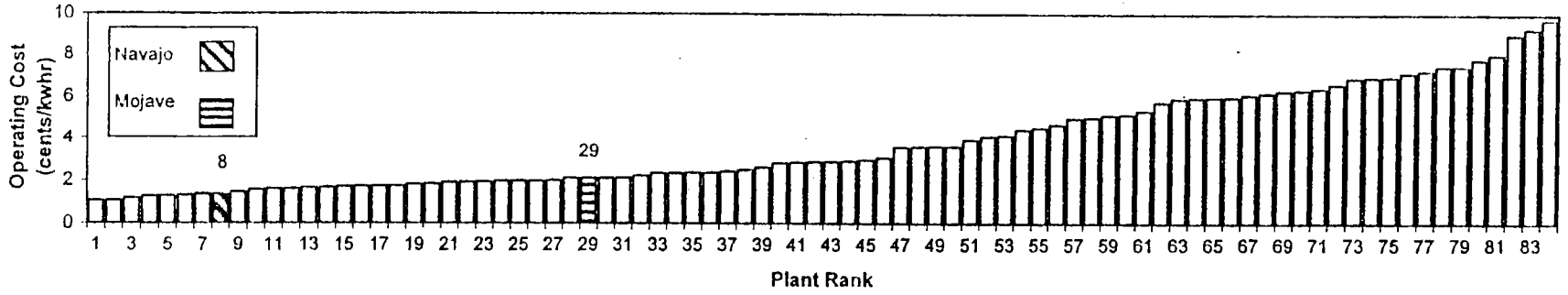
[21] Memo: "Proposed Royalty Adjustment of Navajo Coal Lease No. 14-20-0603-8580 (Kayenta Coal Mining Lease by Peabody Coal Company)," June 15, 1984, from the Area Director.

for these concessions is not apparent in view of the benefits of Navajo coal enjoyed by both Peabody and the utilities.

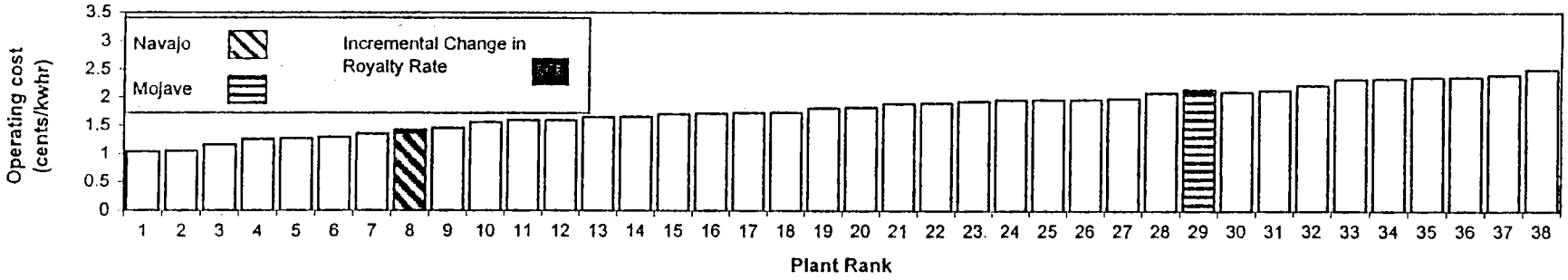
/s/ MARK P. BERKMAN
MARK P. BERKMAN

Exhibit 4

1984 Operating Costs at Mohave and Navajo Plants Relative to Others in the WSCC Region



Even With the Addition of the Navajo's Proposed 20% Royalty Rate



Their Ranking Does Not Change Substantially

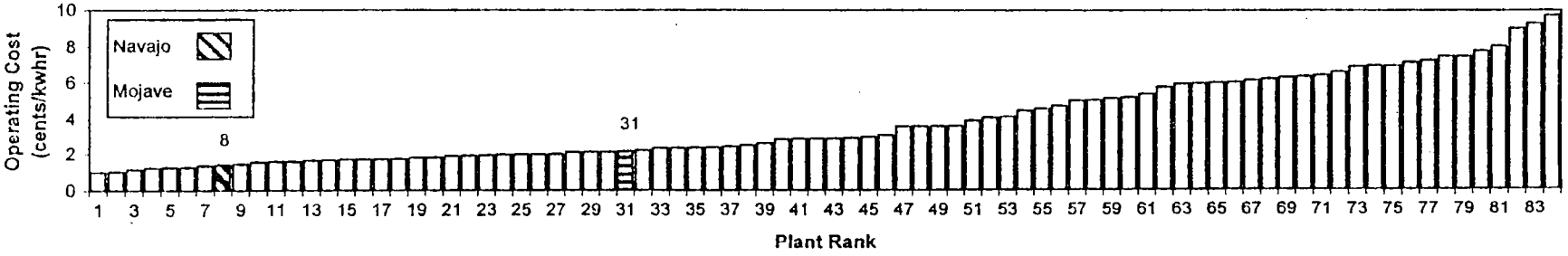
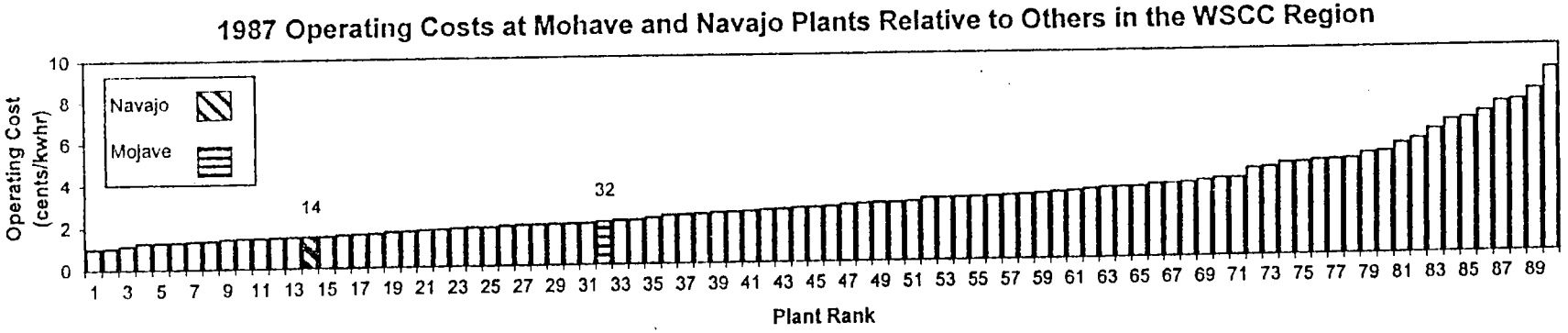
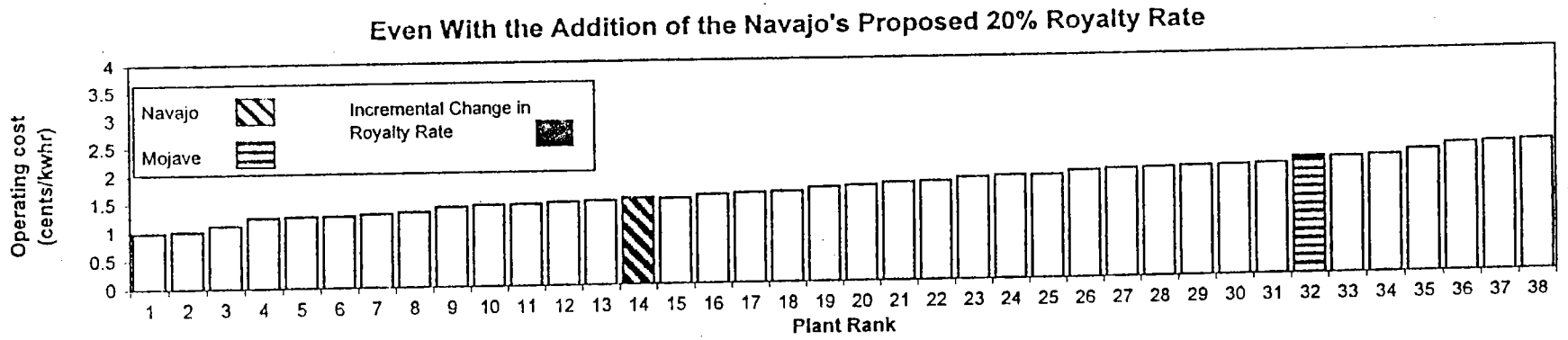


Exhibit 4


1987 Operating Costs at Mohave and Navajo Plants Relative to Others in the WSCC Region
Operating Cost (cents/kwhr)
Navajo
Mojave
14
32
Plant Rank


Even With the Addition of the Navajo's Proposed 20% Royalty Rate
Operating cost (cents/kwhr)
Navajo
Mojave
Incremental Change in Royalty Rate
Plant Rank

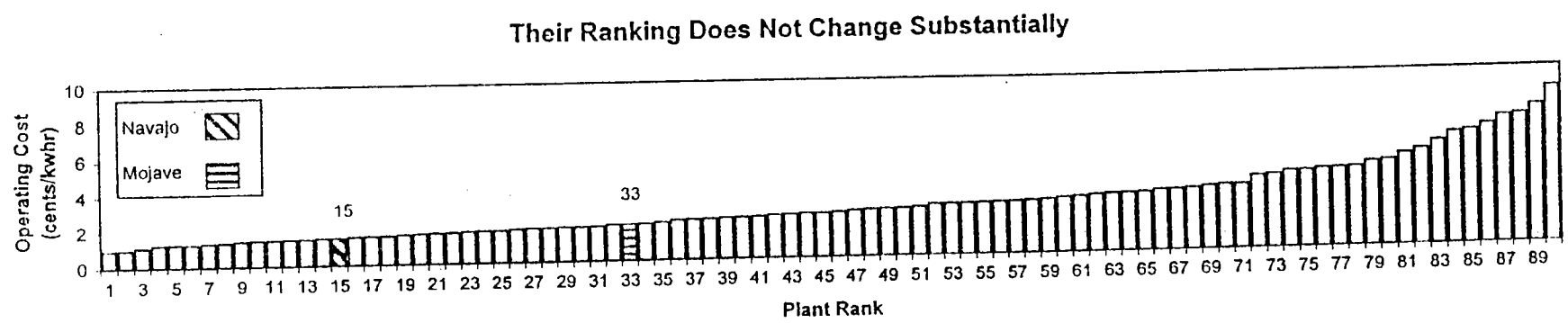

Their Ranking Does Not Change Substantially
Operating Cost (cents/kwhr)
Navajo
Mojave
15
33
Plant Rank

Exhibit 5

Peabody's Continued Operations at the Kayenta Mine Would Generate a Substantial Rate of Return Even Asorbing a 20 Percent Royalty

Bureau of Mines Cost Parameters		DCFROR	NPV [1]
Royalty Rate:	12.5%	50.99%	$197,172,940
Royalty Rate:	20%	28.17%	$102,507,457

Notes:

[1] Assuming a discount rate of 10.83% in 1984 at 30:70 debt:equity ratio.

[2] These calculations are based on a version of the Bureau of Mines discounted cash flow analysis modified to reflect the gross realization formula used by the Department of the Interior. In addition, bonuses equal to $1.5 million in 1987 and $1 million in 1997 were subtracted from net operating profit. The model assumed a coal price of $17.71/ton, based on the price the Salt River Project paid to Peabody Coal Company in 1984, as reported on the FERC Form 580 and available in the Coal Transportation Rate Database, http://www.eia.doe.gov/cneaf/coal/ctrdb/database.html.

[3] This model reflects the conservative assumption that Peabody incurs all royalties.

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

BRIEF OF THE NAVAJO NATION ON REMAND FROM THE FEDERAL CIRCUIT

[Filed: Aug. 24, 2004]

* * * * *

* * *. The effective royalty rate in the resulting "negotiated" lease amendments was "well below the rate that had previously been determined appropriate by those agencies responsible for monitoring the federal government's relations with Native Americans," 46 Fed. Cl. at 226-27, and well below the federal minimum rate. Having learned that Peabody favored the deal, *see* I App. 698, Hodel approved it in December 1987 without any economic analysis and over the objections of the Director of the Office of Trust Responsibilities. 46 Fed. Cl. at 224; *Navajo Nation*, 263 F.3d at 1340 (Schall, J., concurring and dissenting). * * *.

* * * * *

In this case, the Department conveyed the Navajo Nation's exceptional coal for consideration that was "well below the rate that had previously been determined appropriate by those agencies responsible for monitoring the federal government's relations with Native Americans." 46 Fed. Cl. at 226-27. That royalty rate was also well below fair market value, *see* Ex. 8, and below the minimum set for Indian coal and for the Government's own coal, *see* 30 U.S.C. § 207(a); 54 BIAM O, § 604.05 (1984); Ex. 9. The Navajo Nation has always relied on this undisputed fact. *See*, Plaintiff's Motion for Summary Judgment (Dec. 15, 1997) at 25, 40, 49; III App. 1817; Plaintiff's Proposed Findings (Dec. 15, 1997) Nos. 247, 315; Navajo Nation's Consolidated Response (June 17, 1998) at 8, 33; Motion to Alter or Amend Judgment (Feb. 18, 2000) at 36-37. Even the sum of royalties and taxes cannot approach 20%, because more than half of the coal mined by Peabody cannot be taxed under the provisions of the Navajo Generating Station plant site lease. *See* Navajo Proposed Findings nos. 246, 299; *Navajo Nation*, 537 U.S. at 499 n.7.

* * * * *

UNITED STATES COURT OF FEDERAL CLAIMS

No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF MICHAEL C. NELSON

Apr. 19, 2005

I, Michael C. Nelson, do hereby declare that:

1. I served as Special Staff Assistant in the Office of the Chairman of the Navajo Tribal Council from April 1983 until I was selected as Counsel to the Chairman in 1985, a position that I held until January 1987.

2. I was actively involved in the Navajo Nation's attempt to adjust the royalty rate of a Peabody coal lease, the so-called North Lease or the "8580 Lease." This effort initially involved a readjustment decision by the Navajo Area Director of the Bureau of Indian Affairs, which adjusted the royalty rate to 20% (see I App. 287) but which was appealed by Peabody and its customers (see I App. 290-94). After a considerable period of time after the briefing in that appeal, the appeal was not decided. The Chairman of the Navajo Tribal Council then made the decision to try to negotiate a resolution

with Peabody. I assisted Chairman Zah in those negotiations and attended the negotiation sessions with him[.]

3. Throughout the negotiations, I did not know that:

a. Detailed and thorough studies had been completed by the United States Bureau of Mines and the Bureau of Indian Affairs technical staff related to the proper royalty rate to determine whether the Area Director's decision should be upheld (see I App. 499-563);

b. Those studies concluded that the 20% royalty rate of the Area Director would still permit Peabody to make ample profits, that the 20% rate was reasonable and supportable, and that the Area Director's royalty adjustment should be affirmed (see I App. 518, 541, 553, 563);

c. A final decision based on those studies upholding the 20% royalty rate had been prepared by the deciding official with the assistance of his technical staff and legal counsel, and that such decision had been reviewed, copied and checkmarked for distribution to counsel of record in the administrative appeal of Peabody and its customers (see I App. 566-71);

d. Peabody's lawyer in the administrative appeal then prepared a lobbyist recommended by the Southern California Edison Company (one of Peabody's two principal customers and one of the other appellants in the administrative appeal) to meet with Secretary Hodel to get Hodel to order the deciding official to suppress the de-

cision upholding the 20% royalty rate and mislead the Navajo Nation (see I App. 593; 595-98);

e. Secretary Hodel did meet with the Peabody lobbyist and agreed to sign a memorandum prepared by Peabody's lawyer in the administrative appeal directing the deciding official to suppress the decision and mislead the Navajo Nation (see I App. 595-98);

f. Peabody and its customers were immediately informed of the success of their ex parte efforts (see I App. 595, 614).

4. I know the above facts on my personal knowledge and they are true to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *19th* day of April, 2005.

/s/ MICHAEL C. NELSON
MICHAEL C. NELSON

UNITED STATES COURT OF FEDERAL CLAIMS

Case No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF BRITT E. CLAPHAM, II

Apr. 19, 2005

I, Britt E. Clapham, II, do hereby declare that:

1. I am an attorney presently on contract with the Navajo Nation. During the period between March 6, 1997 and September 15, 1998, I was a supervising attorney employed in the Navajo Nation Department of Justice, with the title of Senior Assistant Attorney General. During that time period, I actively participate in negotiations and an arbitration between the Navajo Nation and Peabody Western Coal Company ("Peabody" or "PWCC") undertaken pursuant to the coal lease amendment to the North lease (the "8580 Lease") approved in 1987 that is the subject of the above-entitled cause and supervised all Navajo Nation attorneys, both within the Navajo Nation Department of Justice and outside counsel, who participated in such negotiations and/or arbitration.

2. By letter dated March 6, 1997, the Navajo Nation notified Peabody Western Coal Company ("PWCC" or "Peabody") of the Nation's intent to initiate negotiations with PWCC with respect to the royalty payment provisions of both of the coal leases between PWCC and the Navajo Nation, as those leases were amended in 1987. In that letter, the Navajo Nation stated that it was "preserv[ing] its claim in Navajo Nation v. United States, No. 93-763L, pending before the United States Court of Federal Claims, that the 1987 Coal Lease amendments, including but not limited to the provision substituting arbitration for Secretarial authority to adjust the royalty rate, were approved in beach of trust, and that Peabody, its customers and agents induced that breach" notwithstanding the initiation of such negotiations. A true and correct copy of that letter is attached hereto as Exhibit A. The Navajo Nation similarly preserved its claims when it invoked arbitration by letter dated February 2, 1998 (at page 3 thereof), a true and correct copy of which is attached hereto as Exhibit B.

3. To the best of my knowledge and recollection, at no time after March 6, 1997 during the negotiations or the subsequent arbitration with Peabody that culminated in a settlement of the arbitration in September 1998 did Peabody ever refer to or challenge such statement of non-waiver.

4. Among other things, the arbitration settlement provided for an additional annual payment of $3.5 million to the Navajo Nation through the year 2007. Such additional annual payment and other terms were memorialized in an amendment to the 8580 Lease and the lease of jointly-owned Navajo and Hopi coal (the "9910 Lease").

5. As part of the arbitration settlement agreement, the Navajo Nation was required to obtain approval of such lease amendment from the Secretary of the Interior. The Navajo Nation transmitted its request for such approval to the Secretary in October 1998. In January 1999 I was appointed Acting Attorney General of the Navajo Nation and served in that capacity until May 1999, during which period I assumed responsibility for tracking the requested approval of such lease amendment. In early March 1999, I received a phone call from David Etheridge, an attorney in the Solicitor's Office of the Department of the Interior. Mr Etheridge informed me that the DOI wanted to discuss whether the Navajo Nation would agree to an additional term to be added to such lease amendment by the Department to the effect that the Navajo Nation would ratify the validity of the 1987 lease amendments to both leases approved in December 1987. During a subsequent conference call with Mr. Etheridge and another federal attorney, Mr. Etheridge was informed that the Navajo Nation would not agree to such additional term proposed by the Department of the Interior because such a term could impact ongoing litigation. Secretarial approval subsequently issued on March 29, 1999.

6. I know the facts stated in this Declaration on my personal knowledge and they are true to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *19th* day of April, 2005.

/s/ BRITT E. CLAPHAM, II
BRITT E. CLAPHAM, II

UNITED STATES COURT OF FEDERAL CLAIMS

Case No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF PETERSON ZAH

Apr. 20, 2005

I, Peterson Zah, do hereby declare that:

1. I was Chairman of the Navajo Tribal Council from January 1983 through January 1987. As Chairman, I was both the chief executive officer of the Navajo Nation and I also presided over the meetings of the Navajo Tribal Council, the Navajo Nation's legislature.

2. I was actively involved in the Navajo Nation's attempt to adjust the royalty rate of a Peabody coal lease, the so-called North Lease or the "8580 Lease." This effort initially involved a readjustment decision by the Navajo Area Director of the Bureau of Indian Affairs, which adjusted the royalty rate to 20% (see I App. 287) but which was appealed by Peabody and its customers (see I App. 290-94). After a considerable period of time after the briefing in that appeal, the appeal was not decided. Bleak economic conditions on the Navajo Reser-

vation did not permit me to allow the situation to languish indefinitely, I felt, and I made the decision to try to negotiate a resolution with Peabody.

3. When I made this decision, I did not know that:

   a. Detailed and thorough studies had been completed by the United States Bureau of Mines and the Bureau of Indian Affairs technical staff related to the proper royalty rate to determine whether the Area Director's decision should be upheld (see I App. 499-563);

   b. Those studies concluded that the 20% royalty rate of the Area Director would still permit Peabody to make ample profits, that the 20% rate was reasonable and supportable, and that the Area Director's royalty adjustment should be affirmed (see I App. 518, 541, 553, 563);

   c. A final decision based on those studies up holding the 20% royalty rate had been prepared by the deciding official with the assistance of his technical staff and legal counsel, and that such decision had been reviewed, copied and checkmarked for distribution to counsel of record in the administrative appeal of Peabody and its customers (see I App. 566-71);

   d. Some one in the Department leaked the decision to Peabody before the deciding official had the opportunity to sign it (see I App. 574);

   e. Peabody's lawyer in the administrative appeal then prepared a lobbyist recommended by the Southern California Edison Company (one of Peabody's two principal customers and one of

the other appellants in the administrative appeal) to meet with Secretary Hodel to get Hodel to order the deciding official to suppress the decision upholding the 20% royalty rate and mislead the Navajo Nation (see I App. 593; 595-98);

f. Secretary Hodel did meet with the Peabody lobbyist and agreed to sign a memorandum prepared by Peabody's lawyer in the administrative appeal directing the deciding official to suppress the decision and mislead the Navajo Nation (see I App. 595-98);

g. Peabody and its customers were immediately informed of the success of their ex parte efforts (see I App. 595, 614), but, by contrast, the Associate Solicitor for Indian Affairs Tim Vollmann (who had once worked for me and who had named his son Peterson Zah Vollmann) sent a false and misleading letter to me as Chairman of the Navajo Tribal Council about six weeks later misrepresenting the state of affairs (see I App. 622; cf. I App. 620).

4. I went into the negotiations with Peabody, Edison, and the Salt River Project Agricultural Improvement and Power District without this critical information. Had I known the true state of affairs, I would not have pursued those negotiations, but would have considered other remedies.

5. The person who assisted me in the negotiations was Michael C. Nelson. We handled the negotiations personally.

6. I know the above facts on my personal knowledge and they are true to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this *20* day of April, 2005.

/s/ PETERSON ZAH
PETERSON ZAH

UNITED STATES COURT OF FEDERAL CLAIMS

Case No. 93-763L
Judge Lawrence M. Baskir

THE NAVAJO NATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DECLARATION OF MARK P. BERKMAN, PH.D.

Apr. 21, 2005

I, Mark P. Berkman, do hereby declare that:

1. I have previously executed an affidavit that was filed on August 24, 2004 as Exhibit 9 to Brief of the Navajo Nation on Remand from the Federal Circuit. This Declaration supplements that affidavit and addresses matter raised in the Supplemental Brief of the United States on or about March 23, 2005.

2. The Supplemental Brief of the United States does not alter my conclusions for several reasons. First, the United States cites the undated publication of the Mineral Management Service ("MMS") and the 1996 MMS report entitled "Mineral Revenues 1996" attached as Exhibits N and O to the Supplemental Brief, but those reports are misleading. They reflect "customary" royalty rates for federal leases, presumably in 1996, but they do not show any "customary" royalty rates for Indian coal

leases even in 1996. Moreover, information regarding royalties in federal coal leases at or near the time of the royalty adjustment at issue in the above-entitled action shows that even federal coal lease royalties were not standard, and varied significantly. Moreover, federal revenues from coal leasing also include a competitive bid bonus, which can be substantial based on the characteristics of the coal. My earlier affidavit in this case refers to some of these leases, and I relied in part on an internal Peabody memorandum dated December 21, 1981, which is attached hereto as Exhibit A for the convenience and review of the court. *See* Affidavit of Mark P. Berkman, Ph.D. at 7, ¶ 13 & n.9.

3. The United States references the Fieldston study in support of the reasonability of the 12.5% royalty rate, but this study is also misleading. The Fieldston study examined the royalty rates of 471 leases but did not examine the bonuses associated with these leases. As discussed above, in the absence of a fair bonus, the 12.5% royalty rate is not reasonable. *See* affidavit of Mark P. Berkman, Ph.D. at 8, ¶ 14. Other aspects of the Fieldston study are misleading. The Fieldston study examined the royalty/tax burden in terms of dollars per ton, but a more accurate characterization of quantity is in dollars per unit of energy. Table 1 uses data from the Fieldston study combined with my analysis of the Coal Transportation Resource Database to estimate the royalty/tax burden in terms of mm btu instead of dollars per ton.[1] Of the eight regions examined by Fieldston in

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[1] 1. Fieldston Consulting, "Analysis of Royalties and Taxes for Reopener of PWCC Navajo Coal Leases," August 23, 1998, pp. 5-6.

2. Coal Transportation Rate Database (CTRDB) aggregating data from the FERC Form 580. CTRDB available at http//www.eia.doe.gov/

1988, Arizona (comprised of the Black Mesa and Kayenta Mines) ranked second in dollars per ton. When examined in terms of dollars per mm btu, Arizona ranks fifth. Note that I have not examined Fieldston's calculation of these figures nor their source data. Other issues make Black Mesa and Kayenta mines particularly profitable, such as low transportation costs and low sulfur content (see Table 1). These issues of quality, quantity, profitability also need to be considered in determining the reasonableness of the 12.5% royalty rate.

4. I am informed that the Supplemental Brief also includes exhibits that reflect royalty rates for Navajo coal leases with Utah Construction Company and the Pittsburg & Midway Coal Mining Company. Both apparently include a 12.5% royalty rate and a 20.5% royalty-tax cap. If so, this supports the opinions I expressed in my earlier affidavit, because the quality of the coal subject to the Utah Construction Company lease has much lower heat value (8811 mm btu per lb. As opposed to an average of 11,786 mm btu per lb. Of the coal leased by Peabody) and is of a much inferior quality (0.76% sulfur by percent of weight as opposed to 0.52% for the coal leased to Peabody.) Similarly, the comparison with Pittsburg & Midway highlights the greater value of the coal leased to Peabody. The Peabody coal is supplied to two captive customers by dedicated transportation facilities, whereas Pittsburg & Midway had and has no such customers nor is it operated as part of mine-mouth electrical generation facility. The Pittsburg & Midway mineable coal reserves are almost played out, and that company ex-

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cneaf/coal/page/database.html[.] Information on the FERC form available at http://www.ferc.gov/docs-filing/hard-filing/form-580/overview.asp

pects to cease operations within approximately five years. The quality of the Pittsburg and Midway coal, like the quantity, is also inferior to the coal under lease to Peabody, with the Pittsburg & Midway coal having a heat value of 9945 mmbtu/lb.

5. Lastly, the United States claims that 1997 amendments to the Peabody lease agreements reaffirmed the 12.5% royalty rate, but this time period is irrelevant to the period at issue. Market conditions in the 1990s were greatly different than those in the mid 1980s. For example, in the 1990s, coal was in great supply due primarily to the Power River Basin, and this drove down coal prices.

6. I know the above facts on my personal knowledge and they are true to the best of my knowledge, information and belief.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 21st day of April, 2005.

/s/ MARK P. BERKMAN
MARK P. BERKMAN, Ph.d.

Table 1. Royalty/Tax Burden and Coal Characteristics.

STATE	1988 ROYALTY/TAX BURDEN AND COAL CHARACTERISTICS					
	$ / ton	mm btu / lb	$ / mm btu	Sulfur Content (% wt)	Sulfur Content (lbs/trillion btu)	Transportation Costs ($ / mm btu)
	[1]	[2]	[3]=2000*[1]/[2]	[4]	[5]=1,000,000*([4]/100)/[3]	[6]
Montana	$4.07	9,043	$0.90	0.547	0.605	N/A
Wyoming (PRB)	$2.90	8,642	$0.67	0.363	0.420	$16.92
New Mexico (Navajo)	$5.29	9,840	$1.08	0.538	0.546	$3.36
Arizona (PWCC)	$5.41	12,323	$0.88	0.540	0.438	$2.92
New Mexico (Federal)	$6.31	10,376	$1.22	0.603	0.581	$2.76
Wyoming (Southern)	$4.66	10,156	$0.92	0.571	0.563	$11.52
Colorado	$4.13	11,040	$0.75	0.426	0.386	N/A [a]
Utah (Underground)	$4.34	11,705	$0.74	0.511	0.436	$7.90

Sources:

[1] Fieldston Consulting, "Analysis of Royalties and Taxes for Reopener of PWCC Navajo Coal Leases," August 23, 1998, pp.5-6.

[2],[4],[6] CRA Analysis of Coal Transportation Resource Database.

Notes:

[a] There was one observation available for Colorado where transportation costs were $23/mm btu, but most observations for Colorado were missing data on transportation costs.

FORM 16C

PEABODY COAL COMPANY

COMPANY MEMORANDUM

TO: Ken Moore DATE: December 21, 1981

FROM: Gary Stuckey GWS

Re: Federal Royalty Rates

608

Federal law sets minimum royalty rates of 12 1/2% for surface-mined coal and 5% for deep coal. The Department of the Interior has made a policy decision that deep coal will have an 8% minimum royalty unless a lessee can show that a lower rate is warranted by some unusual circumstance.

The following table shows which leases have royalties above the 12 1/2% and 8% rates.

Lease	Company	Reserves	Acreage	Sale Date	Royalty
C-16284	Energy Fuels Corp.	1,800,000	263	6/21/77	15.5%
U-33454*	Swisher Coal Co.	3,300,000	440	9/21/78	9.5%
U-28247*	Coastal States Energy	13,700,000	2632	10/02/78	11.68%
C-20900	Energy Fuels Corp.	1,000,000	419	9/26/78	16.0%
C-19885	Peabody Coal Co.	1,690,000	125	4/10/79	17.08%
U-32083*	Kaiser Steel Corp.	2,600,000	476	12/05/78	9.20%
M-35734	Western Energy	11,800,000	480	3/30/79	21.0%
M-35735	Western Energy	10,700,000	446	3/30/79	21.0%
C-22644	Energy Fuels Corp.	15,600,000	1790	4/24/79	18.3%
U-25683*	Braztah Coal	21,600,000	1173	8/08/79	10.4%

* Deep Coal

In addition, there were three lease offerings with royalty rates in excess of 20% and no acceptable bids.

It should be noted that since the implementation of the new leasing program, all tracts have been offered at 12 1/2% or 8%. Bonus bids, however, have been substantial.

CONFIDENTIAL

cc Frank Farnsworth
Greg Leisse
Jerry Grow
Frank McCormack

Exhibit A