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Brianne McClafferty
Alexander Blewett III School of Law

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RECAP: Cloud Peak Energy v. State Department of Revenue: Finding an “Apples to Apples” Comparison For the Market Value of Coal in Non-Arm’s Length Transactions

Brianne McClafferty

No. DA 14-0057

Montana Supreme Court

Oral Argument: Tuesday, November 25, 2014 at 9:30 a.m. in the Courtroom of the Montana Supreme Court, Joseph P. Mazurek Justice Building, Helena, Montana. The matter was taken into advisement at about 10:45 a.m.

I. BRENDEN R. BEATTY FOR THE PETITIONER

Brendan Beatty began his argument by encouraging the court to focus on three seemingly simple words “time of sale.” Beatty argued the time of sale of coal in Montana, is when the coal is severed from the earth and placed onto a railcar f.o.b. mine.¹ He argues this is the appropriate time to approximate market value for imputation of revenue purposes. Beatty asked the Court not to muddle through in the extensive briefing and facts involved in the case, but rather view the issue as a matter of law and decide the term “time of sale,” as contemplated in *Decker Coal Company v. Department of Revenue*,² to be when coal is prepared for shipment.

Several Justices sought clarification from Beatty on what point the price of coal is actually set, as they seemed to believe the price is set at the time of contract rather than at the time the coal is loaded onto the train. Beatty agreed, and explained the base price is set when an arm’s length contract is entered into, but the value is adjusted for additives and thus the exact price is not known until the transfer at the railcar occurs. Then Justice Shea explained the Court’s “bottom line” is to find a methodology which “compares apples to apples.” He pointed out it seemed the Department’s favored methodology, which compares actual sales prices, as opposed to negotiated arm’s length agreement prices, to determine market value of NAL agreements, would result in “inevitable disparity.” While Beatty conceded the Department’s method may result in a disparity in some instances, he argued that issue was one for the legislature to decide.

¹ Oral Argument Audiofile, *Cloud Peak Energy v. State Department of Revenue*, (Mont. Sept. 26, 2014)(No. DA 14-0057).

² *Decker Coal Co. v. Dep’t of Revenue*, 2 P.3d 245 (Mont. 2000).

Before changing gears to address the cross appeal issue, Beatty addressed what the Department sees as a possible evil of Clod Peak Energy's ("CPE") interpretation. He argued, if the Court adopted CPE's interpretation, CPE could enter into artificially low contracts, by waiting until the "bottom falls out of the coal market and arm's length transactions are lower." At this time, he argued, CPE could lock-in a low arm's length market price for the company's NAL contracts. He argued the Department's method would prevent these "suspect transactions." Beatty concluded on this issue by driving home the point he made in the beginning of his time, arguing the Montana Supreme Court has already decided coal is sold when it is extracted and prepared for shipment f.o.b mine, not when a piece of paper (agreement) is signed.

Pivoting to respond to CPE's cross appeal on additives, Beatty argued the administrative rule cited by the Respondent which eliminated a reference to "further processing" only applied to refined coal, which is not at issue here. He also argued the District Court was correct in determining the statute merely clarified the Department's existing practice of including other costs as part of the coal's value and the "prepared for shipment" language in the old statute meant the values for additives should be included in the price.

II. KYLE ANN GRAY FOR THE RESPONDENT

Kyle Gray began her argument explaining a rule of construction applied to tax statutes: when there is doubt in the meaning of a tax statute, the doubt is resolved in favor of the taxpayer and strictly construed against the Department. Gray distinguished this statutory rule of construction from the burden of proof CPE carries as the contesting party, which she argues was met in Judge Sherlock's District Court.

Gray then suggested the Department was "dancing around the holding" in *Decker Coal Company*, pointing out the dissent in that case actually concluded the sale occurred when coal was loaded onto the train. Quoting Justice Shea, Gray argued, the Court must "compare apples to apples," and adopting the Department's interpretation, ignores the fact that coal is an interchangeable commodity in the sense that one train car may contain coal from numerous contracts, entered into at different times, with different prices. Gray argued using market price at time of shipping, rather than the price of negotiated arm's length contracts when determining the price for NAL contracts is like comparing "apples to bananas." Pointing out the statutory language does not include "time of sale," but rather instructs the Department to find "market value," Gray assured the Court the most logical, relevant way to determine a NAL contract's market value is to use contemporaneous negotiated arm's length contracts. She argued this method makes sense because that is when the market forces are the same for both types of contracts.

Toward the end of her argument, Gray was asked to address the possible evil Beatty brought up in his argument—CPE’s ability to artificially manipulate the price of coal by renegotiating NAL agreements when the market has “bottomed out.” Gray responded by saying she “never understood that argument” because it assumes CPE would keep its prices low and take less than what it could get for coal in arm’s length transactions.

Before moving onto the additives issue on cross appeal, Gray argued where there is a NAL contract for coal the Department must impute the market value f.o.b. mine. To do that, and achieve an “apples to apples comparison,” she argues the Department cannot ignore the most relevant comparison—the time of sale comparison which is the arm’s length negotiated contract.

Addressing CPE’s cross appeal, Gray argued the legislature’s purpose in amending the statute at issue³ was to clarify an inconsistently applied Department practice and since the statute was applied inconsistently the pre-2009 statute should be construed in favor of the taxpayer. Before running out of time, Gray stressed that by interpreting the earlier version of the statute as containing language only present in the 2009 amended version, the Court would essentially be writing out the statute’s applicability date.

III. PREDICTION

Both interpretations of the statute have obvious merits, making the Justices’ decision difficult. However, in trying to find an “apples to apples comparison” for market value of NAL contracts, the Justices seemed persuaded by Respondent’s arguments for utilizing contemporaneous arm’s length sales contracts. On the additives issue, the Justices seemed persuaded the words “prepared for shipment” in the previous statute’s language should be given meaning, and thus the value of additives should be included in price. This author predicts the Court will affirm the District Court’s ruling on both issues.

Lower Court: Lewis and Clark County Cause No. BDV2012-239, Honorable Jeffery M. Sherlock, District Court Judge of the First Judicial District, Lewis and Clark County.

Attorneys for the Petitioner: Brendan R. Beatty and Courtney Jenkins, Special Assistant Attorneys General, Montana Department of Revenue.

³ See Mont. Code Ann. § 15-35-102 (2013).

Attorneys for the Respondent: Robert L. Sterup and Kyle Anne Gray,
Holland & Hart L.L.P., Billings, Montana.