National Wildlife Federation • Montana Wildlife Federation
Association of Northwest Steelheaders

May 7, 2015

Via regulations.gov and email at armand.southall@onrr.gov

Office of Natural Resources Revenue
PO Box 25165, MS 61030A
Denver, CO 80225

Re: ONRR-2012-0004

To Whom It May Concern:

Thank you for the opportunity to comment on the Department of the Interior Office of Natural Resources Revenue (ONRR) Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Proposed Rule.[1] National Wildlife Federation (NWF) and its affiliates Montana Wildlife Federation (MWF) and Association of Northwest Steelheaders (Steelheaders) have a long history of protecting the important natural resources and wildlife on our federal and tribal lands. Federal coal leasing has serious impacts on these lands including destruction and degradation of wildlife habitat. Coal leasing also leads to coal combustion and resulting carbon pollution emissions. Climate change caused by carbon pollution emissions threatens all wildlife. Climatic disruption could result in the extinction of half of all species if emissions are not quickly reduced.[2] Given the impacts of coal mining to wildlife and federal and tribal lands, it is critical that royalty payments from coal leasing on federal and tribal lands are fair and regulations be reformed to ensure coal companies cannot escape paying royalties at fair market rates.

As such, NWF, MWF and Steelheaders applaud ONRR's attempt to reform the federal coal royalty system to close existing regulatory loopholes through which coal companies are effectively evading paying royalties.[3] Reform is long overdue. An outdated royalty

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[1] 80 Fed. Reg. 608 (Jan. 6, 2015).
[2] International Panel on Climate Change, 4th assessment report: http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf.
[3] U.S. Department of the Interior, Interior Announces Initial Steps to Strengthen Federal Energy Valuation Rules, Expand Guidance on Federal Coal Program (Dec. 19, 2014), *available at*

system that was last revised 25 years ago allows for generous subsidies to the industry in the form of royalty rate reductions, unwarranted transportation and washing allowances, and a system that sets royalties on prices that do not reflect the market cost of coal.

The result is that U.S. taxpayers and the states that share in these royalty collections are receiving substantially less than the 12.5% royalty rate required by law for surface mines. A recent expert analysis concluded that coal companies pay an effective royalty rate of 4.9% due to reductions and subsidies, considerably less than the 12.5% rate mandated by the Mineral Leasing Act of 1920.[4]

The Need for Reform

Fair royalty payments will end effective and unnecessary subsidies to the coal industry, bring hundreds of millions of dollars in royalty payments to the federal and state governments that can help preserve wildlife habitat, and slow carbon emissions spurred by subsidized coal mining. As domestic demand for coal continues to decline due to market changes, the industry is seeking to increase its export business and sell coal overseas. Current royalty regulations make it easier for coal companies to exploit these foreign markets without paying the public its due. Coal companies are taking advantage of current regulations by selling federal coal at depressed prices to affiliated companies to escape higher, fairer royalty payments. After this initial sale, the affiliated companies are then selling the same coal on the export market for almost ten times its domestic value without having to pay royalties on the subsequent higher priced transaction.[5]

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http://www.doi.gov/news/pressreleases/interior-department-announces-initial-steps-to-strengthen-federal-energy-valuation-rules-expand-guidance-on-federal-coal-program.cfm.

[4] MARK HAGGERTY, HEADWATERS ECONOMICS, AN ASSESSMENT OF U.S. FEDERAL COAL ROYALTIES: CURRENT ROYALTY STRUCTURE, EFFECTIVE ROYALTY RATES, AND REFORM OPTIONS ("hereinafter Headwaters Report") 1 (2015), http://headwaterseconomics.org/wphw/wp-content/uploads/Report-Coal-Royalty-Valuation.pdf. The FCLAA specifically provides that surface mine leases will be charged a minimum royalty of 12.5% and that the secretary of the interior sets by regulation the royalty rate for underground mine leases. "A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12 1/2 per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations." 30 U.S.C. § 207(a).

[5] Patrick Rucker, *Asia Coal Export Boom Brings No Bonus for U.S. Taxpayers*, REUTERS, (Dec. 4, 2012), *available at* http://www.reuters.com/article/2012/12/04/us-usa-coal-royalty-idUSBRE8B30IL20121204.

A Reuters investigation estimated that this practice resulted in companies escaping $40 million in royalty payments on coal exports from Wyoming and Montana alone in 2011.[6] In fact, according to the U.S. Energy Information Administration, 42% of all coal produced in Wyoming was sold through a captive transaction (from one company to an affiliated company), up from 4% in 2004.[7] This practice amounts to an effective subsidy for coal production that deprives taxpayers of royalty payments needed to protect public and tribal lands. It also means that coal companies are escaping costs that are eventually borne by the public.

ONRR's rulemaking presents a unique opportunity to reform the federal coal royalty system, cut subsidies, and close loopholes. Ending such subsidies to the coal industry enjoys broad, bi-partisan support with nearly two-thirds of Americans opposing providing federal subsidies to companies that mine coal on America's public lands.[8]

ONRR's proposed rule would require that non-arm's-length transactions be valued at the first arm's-length transaction for assessing royalties.[9] This is a step in the right direction, but does not go far enough to ensure adequate royalties are paid. We instead recommend that the rule be revised to base royalties on the final delivered price of coal. Currently, coal lessees can deduct unlimited transportation and washing costs from the total sale price upon which royalties are due.[10] This needs to be changed. We suggest that companies be allowed to deduct only up to 50% of their transportation costs, consistent with other industries like oil and gas. Finally, we recommend that coal washing deductions not be allowed because washing is a cost of marketing coal that should be borne by industry, not the public.[11]

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[6] Rucker, 2012.
[7] ENERGY INFORMATION ADMINISTRATION, COAL DISPOSITION BY STATE (2012), http://www.eia.gov/coal/annual/pdf/table8.pdf; ENERGY INFORMATION ADMINISTRATION, ANNUAL COAL REPORT: 2004 (2005), http://www.eia.gov/coal/annual/archive/05842004.pdf.
[8] Poll Conducted by Hart Research Associates, Public Opinion on Coal Mining on Public Lands (January 16-19, 2015).
[9] 80 Fed. Reg. at 609.
[10] 30 C.F.R. § 1206.257; 30 C.F.R. § 1206.261.
[11] The Mineral Leasing Act has been interpreted as obligating lessees to place mineral resources they extract in "marketable condition" at no cost to the federal lessor (or government). *Devon Energy Corp. v. Norton*, 2007 U.S. Dist. LEXIS 61709 (D.D.C. 2007) (citing to *California Co. v. Udall*, 296 F.2d 384, 387-88 (D.C. Cir. 1961) (upholding marketable condition requirement)). "Marketable condition" under ONRR's regulations means "coal that is sufficiently free from impurities and otherwise in a condition that it will be accepted by a purchaser under a sales contract typical for that area." 30 C.F.R. § 1206.251. Coal

Impacts to Wildlife from Coal Mining

Wildlife is affected by coal mining in many ways. Mining and related activities cause direct wildlife mortalities and disturb and displace wildlife. Reptiles, amphibians and small mammals are generally not mobile enough to avoid mining equipment and are often directly killed during mining. Birds die when they collide with electrical transmission lines and other mine support structures. Fish and other aquatic wildlife are killed when streams are re-routed, and from construction and mining activities that occur near stream channels.[12]

Coal mining fragments habitat and causes extreme disturbances that displace larger, more mobile wildlife. Displaced wildlife are placed at risk because, among other impacts like road crossings, they must move to locations already occupied by other wildlife and will experience greater competition for resources they need to survive.

Wildlife in habitat near mines like pronghorn and raptors are often forced to move given the intense noise and destructive activity associated with mining. For example, it has been shown that energy development taking place within 3 km or less of greater sage grouse leks – areas where male sage grouse perform in front of females as part of the birds' mating ritual – can cause an increase in the distance females travel to nesting sites and result in lower rates of nest initiation.[13], [14]

Coal mining also harms wildlife by polluting nearby water and air. Mining equipment emits sulfur dioxide, nitrous oxide, and toxic trace metals such as lead in areas that oftentimes would otherwise be relatively free of these pollutants. In areas near access

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washing is a process used to remove impurities of the coal. As a result, washing costs are costs associated with making federal coal marketable, which is an obligation the lessee bears.

[12] U.S. Forest Service General Technical Report INT-126, "Wildlife: User guide for mining and reclamation," (July 1982), *available at* http://babel.hathitrust.org/cgi/pt?id=umn.31951d03009787s.

[13] Lyon, A.G. and S.H. Anderson, "Potential gas development impacts on sage grouse nest initiation and movement," *Wildlife Society Bulletin* 31(2)486-491 (2003), *available at* http://www.jstor.org/stable/3784329.

[14] U.S. Department of Interior, Bureau of Land Management Instruction Memorandum No. 2014-100, "Gunnison Sage-grouse Habitat Management Policy on Bureau of Land Management-Administered Lands in Colorado and Utah," (May 30, 2014), *available at* http://www.blm.gov/wo/st/en/info/regulations/Instruction_Memos_and_Bulletins/national_instruction/2014/IM_2014-100.html.

roads and other locations with heavy traffic, "increased levels of lead in vegetation and wildlife have been observed."[15]

Over time, increased exposure of wildlife to trace elements through dust from various mining activities can cause animals to "suffer from disorders of the mucous membranes and pulmonary complication."[16] Surface water contamination from increased sediment loads and the leaching of toxic elements from exposed ores and rocks can cause decreases in aquatic oxygen content and light penetration, reducing the growth of aquatic plants and resulting in fish mortality as well as habitat degradation and destruction in streams.[17]

Carbon pollution from coal combustion and other sources further presents profound impacts to wildlife. We are already experiencing record-breaking and destructive storms and floods, unprecedented severe droughts, earlier, more frequent and more intense wild fires, decreased snow pack, ocean acidification, and other troubling impacts.[18] This warming is projected to get more intense.[19]

With a warming world comes shifting habitats and changes in suitable wildlife ranges. As a result, many wildlife species are finding or will find themselves without a home. Plant and animal species are moving their entire ranges in search of colder locales, in many cases two-to-three times faster than scientists anticipated.[20] If carbon pollution continues at the current rate, scientists predict that higher temperatures will lead to extinctions of 50% of species around the globe.[21]

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[15] U.S. Forest Service General Technical Report INT-126, "Wildlife: User guide for mining and reclamation," (July, 1982), *available at* http://babel.hathitrust.org/cgi/pt?id=umn.31951d03009787s.
[16] *Id*.
[17] *Id*.
[18] U.S. Global Change Research Program, *2014 National Climate Assessment* (2014), *available at* http://nca2014.globalchange.gov/report/our-changing-climate/observed-change.
[19] *Id*.
[20] National Wildlife Federation, *Wildlife in a Warming World* (Jan. 2013), *available at* www.nwf.org/climatecrisis.
[21] Intergovernmental Panel on Climate Change, *Climate Change 2007: Synthesis Report.* Contribution of Working Groups I, II, and III to the Fourth Assessment Report of the IPCC (2007), Geneva, Switzerland, *available at* http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr_full_report.pdf.

Recommended Valuation Change for Assessing Royalty Rates

For purposes of assessing a royalty on federal coal, the proposed rule reaffirms that the value of coal produced from federal leases will be determined at or near the lease.[22] In essence, the proposed rule would allow royalties to be assessed on the price that a middle-man would pay, not on the actual market rate. However, in a competitive marketplace, a product's value is the price that maximizes profit based on what a buyer is willing to pay.[23] For federal coal mined for combustion in power plants, the market price is the final delivered price away from the lease. For example, the price a power plant would pay. Using the market price to set the royalty rate would make a tremendous difference in the amount of royalties collected. For instance, the average mine-mouth price of coal mined in the Powder River Basin is $11.55 per ton, but the market price is about $37 per ton.[24]

The benefits to the public of making this change would be substantial. If the point of valuation for coal were based on the market price when coal is delivered, transportation deductions were capped at 50% of the value of coal mined, and washing cost deductions were not allowed, the proposed reforms would result in an average increase of $0.85 per ton in royalty payments.[25] Based on royalty collections between 2008 and 2012, these reforms would have generated an additional $2.8 billion in revenue over a five-year period, or $560 million annually – for a total of $7.6 billion in royalty collections during this time.[26]

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[22] 80 Fed. Reg. at 609.
[23] N. GREGORY MANKIW, PRINCIPLES OF MICROECONOMICS 67 (7th ed. 2014), http://www.cengage.com/economics/mankiw/samplechapter/Mankiw6e_Econ_Ch04.pdf.
[24] Energy Information Administration, *Coal News and Markets, Week ending December 12, 2014*. Average Midwest market price is based on authors' analysis of data obtained from Energy Information Administration, "Form EIA-923 detailed data."
[25] Headwaters Report at 25. The $2.94/ton estimate is based on the average royalty price under a net price scenario of $2.09/ton. *See id.* at 2.
[26] Author's calculations are based on the assumption that the current royalty system in place generated $4.8 billion in revenue from 2008 to 2012. *Id.* at 3.

Royalties are also an important part of state budgets, especially for Wyoming and Montana, where coal-rich Powder River Basin lies.[27] Royalty payments to states provide a significant source of funding for schools and statewide infrastructure projects.

Conclusion

ONRR's proposed rule offers an important opportunity to ensure that coal leasing on federal and tribal land is no longer inappropriately subsidized at the public's expense and that coal companies are required to pay the full and fair cost to the public for their leasing. Coal mining has severe impacts to wildlife, and the current rules enable destructive coal mining to occur by allowing companies to mine public and tribal lands at little cost. Instead, coal companies should pay fair and adequate royalties on the market price of coal to ensure that the public and affected states receive adequate payments for the coal leased on their land.

Sincerely,

Jim Murphy
Senior Counsel
National Wildlife Federation

[27] The royalties received by the federal government from coal production are split roughly equally between the U.S. Treasury Department and coal-originating states. 30 U.S.C §§ 191, 191a, 355.