TRAPPER MINING INC.

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Via Email to: Luis.Aguilar@onrr.gov
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Office of Natural Resources Revenue, Building 53, Entrance E-20
Denver Federal Center
West 6th Ave. and Kipling St.
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Re: Federal Oil and Gas and Federal and Indian Coal Valuation (ONRR-2017-0002)
Regulation Identifier Number (RIN) 1012-AA21.

Dear Mr. Aguilar:

These comments are submitted on behalf of Trapper Mining Inc. ("TMI"). TMI has operated the Trapper Mine ("Trapper") near Craig, Colorado since 1983. Trapper is located adjacent to the Craig Station Power Plant ("Craig Station") and was designed to serve as a dedicated mine-mouth fuel supply for the plant in the early 1970s. During its operation, Trapper has produced coal from four different federal coal leases as well as from other non-federally owned coal properties. Substantially all the coal produced from Trapper was historically sold to the owners of the Craig Station under the Craig Station Fuel Agreement (established on March 1, 1973, and expired on June 30, 2014). More recently, the coal produced at Trapper is sold to the owners of TMI for use at the Craig Station under the terms of the Craig Station Long-Term Coal Supply Agreement established January 1, 2010, and extending through December 31, 2020.

Trapper Mine and Craig Station ownership structure

There is substantial overlap between the TMI and Craig Station ownership structures. Trapper and the Craig Station are operated as separate and distinct businesses and the percentage of controlling ownership divided amongst the owners varies between the two entities. The four owners of Trapper are also part-owners of the Craig Station where the coal produced at the Trapper Mine is consumed. The four owners consist of an investor-owned utility, a wholesale generation and transmission utility, and two power supply entities that are political subdivisions of states. Their ownership interests in Trapper correspond to their obligations to purchase coal under the Craig Station Long-Term Coal Supply Agreement dated January 1, 2010, and their interests in the electricity produced by Craig Station's units 1 and 2.

Trapper Mining Inc. reorganized corporate structure

In 1998, TMI reorganized its corporate structure and made the decision to henceforth conduct business as a cooperative. TMI notified the Minerals Management Service ("MMS") (predecessor to ONRR) of this change and proposed certain revisions in its coal valuation methodology approach for royalty calculation purposes. MMS responded on August 12, 1998, acknowledging the change in TMI's corporate organization and accepting the proposed revisions in the coal valuation approach formula with certain specified changes ("MMS Approval Letter"). Approval was given at that time to value Federal coal production consumed under non-arm's-length conditions using a cost of production plus a return on investment component for mine investment. This cost based non-arm's-length valuation procedure reasonably approximates the fuel costs reported by all of the participants (both investor-owned and cooperative electric utilities) to either the public utility commission or their member boards. TMI has abided by these approved valuation formulas since they were established in cooperation with MMS in 1998.

Trapper Mining Inc. supports the repeal of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rules and does not support promulgation of a new set of valuation rules to replace them

One of the ONRR's justifications for reforming the coal royalty valuation rules was that the federal coal "industry and marketplace have changed dramatically." For TMI and the Craig Station, this is not the case. As the 40-year history of the Trapper Mine and coal sales to the owners of the Craig Station demonstrate, no significant change in the market for Trapper Mine's coal, or the terms of its sale to the owners of the Craig Station for electric generation, or the ownership of Trapper itself, has occurred and no change is anticipated. While changes in federal coal sales markets may have occurred elsewhere (i.e. particularly with respect to federal coal sales to non-mine mouth power generators), those changes have not taken place at Trapper nor are they likely to. Trapper has had a long-term and stable relationship with its buyers (who are also its owners), and helped develop the non-arm's-length rules that have historically been applied to its federal coal sales. Trapper has followed those rules regarding non-arm's-length sales and reported coal valuations and royalties due accordingly.

The existing valuation methodology well reflects and accounts for the historical and current circumstances at Trapper whereas the new regulations will be difficult if not impossible to apply in any logical, consistent and accountable fashion. The most significant concern in the reformed rules is incorporating the new concept of valuing coal for royalty purposes, not as coal, but as electricity. For example, the reformed rules stretch coal royalty valuation calculations far beyond the transactions they were originally intended to address. They raise the need for extremely complex calculations by the coal buyer/electric generator and its affiliated electricity purchasers who have nothing to do with mining federal coal. In addition, they attempt to adapt concepts developed for an entirely different industry, the geothermal industry, by incorporating reference to 30 CFR Subpart H as the means to determine generation and transmission deductions from the gross value of electricity sales.

It could be very difficult, if not impossible, to calculate the value of coal produced by Trapper based on associated sales of electricity because those sales, which may be arm's-length and non-arm's length, do not occur until the electricity generated from Craig Station is ultimately sold to the final end-user consumers of Trapper's buyers. In Trapper's situation, the new regulations would require it to potentially work back through numerous chains of electricity transactions (daily, weekly, monthly, spot, and long-term contract) and transmission systems (interstate and intrastate) to determine the gross proceeds of the electricity sales, less all allowable deductions. Such complex calculations would require investments by Trapper and its coal purchasers in new personnel and data collection, recordkeeping, and accounting systems. However, the reformed rules do not clearly set forth guidance on how to properly make those calculations in Trapper's situation. Indeed, when representatives of Trapper attended an ONRR training seminar in October of 2016 seeking guidance on how to comply with the reformed rules, ONRR's own representatives were generally at a loss as to how Trapper's coal would ultimately be valued for royalty purposes, given its unique relationships with its coal purchasers, and stated that Trapper's situation would be a "groundbreaking" for the new regulations. The resulting additional costs and regulatory burdens associated with the reformed rules will be simply too onerous for Trapper's and its coal purchasers' respective businesses and will needlessly eliminate a coal royalty valuation system that has worked effectively for nearly two decades.

Lastly, whatever marginal royalty income the reformed regulations may generate for the ONRR, it will be far more than offset by the costs to comply with them. Even ONRR's analysis shows that the marginal revenue would be minimal if not negative. The Cost Analysis at 80 F.R. 633 states that ONRR expects the changes to federal coal royalty valuations to change royalty revenue by plus or minus $1.06 million. The median value is zero. The Cost Analysis at 80 F.R. 639 states that royalties paid on federal coal from coal cooperatives constitute 1-2% of federal coal royalties paid. So, the expected effect of the reformed coal royalty valuation rules is no change in 1-2% of federal coal royalties.

The Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rules must be repealed. The reformed rules proposed by ONRR will create additional costs and undue regulatory burdens for federal coal producers and their affiliated buyers while producing no marginal revenue for ONRR. In addition, ONRR should not promulgate new valuation rules following the repeal. Instead, the coal valuation methodologies in existence prior to the promulgation of the reformed rules should continue in full force and effect because they have worked successfully for years, providing regulatory certainty for coal producers and their purchasers and a reliable royalty income from federal coal production.

Yours sincerely,

Michael Morriss
President & General Manager

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