WESTERN FUELS ASSOCIATION
THE NATIONAL FUEL SUPPLY COOPERATIVE

May 4, 2017

Luis Aguilar
Regulatory Specialist
Office of Natural Resources Revenue
P.O. Box 25165
MS 61030A
Denver, Colorado 80225

Attn: Regulation Identifier Number (RIN) 1012-AA21

Re: Comments on Office of Natural Resources Revenue (ONRR) Proposed Rule to Amend Federal and Indian Coal Valuation Regulations, 82 FR 16325, ONRR-2017-0002

Submitted via email to: Luis.Aguilar@onrr.gov

Dear Mr. Aguilar:

Western Fuels Association (WFA) is a not-for-profit cooperative that supplies coal and transportation services to consumer-owned electric utilities located in the the Great Plains, Rocky Mountain and Southwest regions. WFA services assist with the generation of an estimated 4,400 megawatts of electricity. This is enough to supply the electric needs of approximately 3 million households. The sales of coal from our related entities are primarily to related, rural cooperative owned utilities. Since WFA operations are directly impacted by changes to the coal valuation rules, we have substantial interest in this issue.

On April 4, 2017, the Office of Natural Resources Revenue (ONRR) requested comments on two possible scenarios pending the outcome of the proposed rule to repeal the 2017 Valuation Rule.

1. **If the 2017 Valuation Rule is repealed, ONRR requests comments whether a new rulemaking would be beneficial or is necessary. If so, then identify whether revisions to the regulations governing the valuation are needed and, if so, what specific revisions should be considered.**

WFA Recommendation under Scenario 1

WFA does not feel that it would be beneficial or necessary for new rulemaking. We believe the pre-2017 regulations generally meet the stated goals of ONRR. The pre-2017 regulations are clear, understandable and consistent with fulfilling the Secretary's responsibility to ensure fair value for the public's resources, provide

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valuation methods that are as efficient as practicable for lessees to use, and provide early certainty that correct payment has been made.

WFA additionally agrees with ONRR that gross proceeds from arm's length contracts are and should continue to be the best indication of market value. Consistent with pre-2017 regulations (for ad valorem leases) at 30 C.F.R. §§ 1206.257(b) and 1206.457(b), when a coal lessee engages in an arm's length sale with its customer for production, that should establish the value of the coal for royalty purposes.

In the case of the non-arm's length (NAL) sales WFA also agrees that the benchmark methodology is appropriate. The benchmark method identifies which type of NAL sale has occurred and makes sure that gross proceeds is satisfied. WFA has generally found the current benchmarks applicable to NAL situations to be workable, consistently applied, and reasonably simple for the lessee and ONRR to implement. Contrary to unsubstantiated statements and misleading data contained in some opponents of federal coal leasing reports, the current benchmark system has proven to be well substantiated during audits conducted by the Wyoming Department of Audit. The current process is not cumbersome, nor is it costly to administer, and finally, it contains no loopholes that can be exploited to limit royalty liability since the regulations dictate that under no circumstances can the value for royalty purposes be less than gross proceeds accruing to the lessee from the sale of coal. In addition, once a contract has been identified as NAL, and continues into a future audit period, there should not be as much work needed to verify if gross proceeds were met in that audit since the best benchmark has already been chosen in a previous audit.

Consistent with existing regulations §1206.20 for coal, the definition of gross proceeds is the total monies and other consideration accruing for the disposition of any of the following including, but not limited to:

a) Payments for services such as crushing, sizing, screening, storing, mixing, loading, treatment with substances including chemicals or oil, and other preparation of the coal that the lessee must perform at no cost to the Federal Government or Indian lessor

b) Reimbursements for royalties, fees, and any other reimbursements

c) Tax reimbursements even though the Federal or Indian royalty interest may be exempt from taxation

d) Monies and all other consideration to which a seller is contractually or legally entitled, but does not seek to collect through reasonable efforts

Therefore, WFA supports repeal of the 2017 Valuation Rule in its entirety and recommends reinstating the current benchmark methodology for NAL sales. This includes supplying all contracts (arm's length and NAL) and cost plus determinations.

2. **If the 2017 Valuation Rule is not repealed, ONRR requests comments regarding whether potential changes are needed. If the 2017 Valuation Rule is not**

repealed, ONRR requests comments regarding whether potential changes to the 2017 Valuation Rule are needed. Possible topics include, but are not limited to:

- **Whether ONRR should have one rule addressing Federal oil and gas and Federal and Indian coal valuation, or separate rulemakings.**
- **How best to value non-arm's-length coal sales and/or sales between affiliates.**
- **Whether ONRR should update the valuation regulations governing non-arm's-length dispositions of Federal gas, and if so, how.**
- **Whether ONRR should address marketable condition and/or unbundling, and if so, how.**
- **Whether ONRR should have a default provision clarifying how ONRR will exercise Secretarial authority to determine value for royalty purposes in cases where there is misconduct, breach of duty to market, or ONRR cannot otherwise verify value. Other potential valuation methods or necessary changes to ONRR valuation regulations.**

The 2017 Valuation Rule is inconsistent with its stated goals of providing improvements that offer greater simplicity, certainty, clarity, and consistency in product valuation and reporting for mineral lessees. Instead, for affiliated sale situations, the 2017 Valuation Rules requires implementation of the illogical and indefinite net-back royalty valuation methodology. The net-back method is well known to be the least logical, most complicated, and option of last resort for establishing mineral valuations. In fact, ONRR bypassed its own rules and gave itself the unilateral power to set coal royalty valuation whenever it chooses and at whatever level it chooses for affiliated sales.

The 2017 Valuation Rule also ignores that the applicable mineral leasing laws and lease terms entitle the lessor to a prescribed percentage of the value of coal at the lease. For affiliated sale dispositions, the 2017 Valuation Rule overlooked that the prescribed royalty rate in the lease contract was agreed to only value coal, not to value another commodity (i.e. electricity) generated by consuming the coal and the price for which is affected by a variety of regulatory and market factors inapplicable to coal. The required valuation concept of valuing the net-back from sale of electricity rather than the intended valuation of coal at the lease is rife with insurmountable issues. The issues are so overwhelming, in fact, that the proposed net-back valuation method in the 2017 Valuation Rule is impossible for producers, ONRR and the State Departments of Audit to determine valuations. This subjects producer's valuations to

the onerous default provision, which is ubiquitous with uncertainty, lacks simplicity and clarity, and will result in inconsistent and unsubstantiated determinations.

WFA Recommendation under Scenario 2

If the 2017 Valuation Rule is not repealed, WFA recommends the following changes be implemented:

a) Remove the "net-back from sale of electricity" provision. The 2017 Valuation Rule required royalty valuations to be determined based on the gross proceeds of *electricity* generated and sold at arm's length by the coal lessee or its affiliate. WFA and others have repeatedly identified significant and substantial issues with the net-back from electricity concept (see our May 8, 2015 comments on the proposed Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule, the comments received from the National Mining Association and Wyoming Mining Association, as well as our May 4, 2017 comments regarding RIN 1012-AA20 Repeal of Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule, ID: ONRR-2017-0001). Since the 2017 Valuation Rule did not address these identified concerns before its issuance, WFA and similar producers remain unable to comply with the 2017 Valuation Rule. Therefore, we recommend the 2017 Valuation Rule eliminate the concept of netting back from the sale price of electricity.

b) Remove the "default provision". Removing the "default provision" would eliminate the misconduct penalty provision for not providing required documentation. This requirement is troublesome under the "net-back from sale of electricity" valuation method contained in the 2017 Valuation Rule. As has been well documented in our above described prior comments, determining valuation from the net-back of electricity will be impossible for the coal producer and the electricity producer, which then could trigger the default provision and the misconduct provisions.

c) Remove the "Coal Cooperative" definition. This does not add any significance to the regulations, but only duplicates the "Affiliate" definition.

d) For affiliate sales, reinstate Benchmark 4 from the pre-2017 valuation rules. Benchmark 4 determines valuations including "other relevant matters" which include circumstances unique to the mine. Use of Benchmark 4 eliminates the uncertainty contained in the net-back method proposed in the 2017 valuation rule, and instead requires affiliated coal valuations be determined by the cost-plus methodology. The cost-plus methodology is a well-accepted accounting method that can be measured against a market value and recognized by both the payor and ONRR while under audit. Hence it meets the stated goals in the April 4, 2017 ANPR.

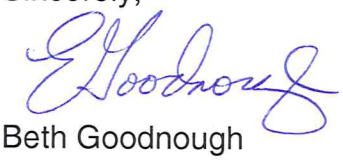
e) Provide verification tools upon request. During the Federal & Indian Coal Valuation Rule Training for the 2017 Valuation Rule, the majority of the producers were unable to obtain the Standard & Poor's Average Monthly 15 year BBB Corporate

Bond Yield Index. Therefore, consideration must be made to provide these and other required verification tools to producers in a timely manner upon request.

Secretary Zinke recently announced the reestablishment of the Royalty Policy Committee. This Committee will be a reasonable forum to review and discuss appropriate changes to royalty regulations. WFA supports using this process to provide input on proposed changes to federal mineral royalty valuation methods.

Thank you for your consideration of these comments.

Sincerely,



Beth Goodnough
Manager, Regulatory Affairs