STATEMENT OF
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UNITED STATES DEPARTMENT OF THE INTERIOR
BEFORE THE
COMMITTEE ON NATURAL RESOURCES
SUBCOMMTTEE ON ENERGY AND MINERAL RESOURCES
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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the Department's Proposed Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Regulation and unbundling of transportation and processing costs.

Within the Department, the Office of Natural Resources Revenue (ONRR) is charged with the collection, verification, and disbursement of revenues associated with energy and mineral leasing on Federal and American Indian lands and the Outer Continental Shelf. ONRR is entrusted with an important role to collect, account for, analyze, audit, and disburse on average $10 billion in annual revenues owed for the utilization of public natural resources and serves as a custodial trustee of the royalty assets from Indian trust properties and as an advocate for the interests of Indian mineral owners.

ONRR's revenue management effort is one of the Federal government's greatest sources of non-tax revenues. In Fiscal Year 2015, ONRR disbursed $9.8 billion in annual revenues to states, tribes, individual Indian mineral owners, the Federal Treasury, and special use accounts. Every American benefits from the revenues we collect, directly through payments to tribes and individual Indian mineral owners or indirectly through disbursements to states and the U.S. Treasury.

When the Secretary of the Interior established ONRR, it provided an opportunity for a top to bottom review to improve the management and oversight of revenue collection and disbursement activities. Centralized placement in the Department positioned ONRR to leverage its revenue collection expertise to serve a leadership role in agency-wide collaboration and implementation of key Administration initiatives and reforms. As an organization, ONRR continues to adapt to change and we have successfully made improvements to become more operationally efficient and ensure we are collecting every dollar due on behalf of the American public, tribes, and individual Indian mineral owners. ONRR's core business principles of continuous improvement, leadership, and collaboration are central components of the consolidated valuation regulations and the unbundling of transportation and processing fees.

Consolidated Valuation Regulations

ONRR began its regulatory reform efforts by engaging in a deliberate and careful approach to solicit stakeholder input. Consultation with Tribes in accordance with Departmental policy and public engagement started in May 2011, when ONRR published two Advanced Notice of

Proposed Rulemakings in the *Federal Register* to obtain input from the public and the regulated industry. Additionally, in September and October 2011, ONRR hosted six public workshops to gain feedback and input on specific aspects of regulatory reform.

After considering the information gained from these initiatives, the Department published the Proposed Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform Rule in the *Federal Register* on January 6, 2015. The current valuation regulations have been in place for natural gas and coal since the late 1980s and the federal oil valuation regulations are over a decade old. In the years since the current regulations became effective, the Department's responsibilities have not changed, but the industry and the marketplace have changed dramatically. Regulatory changes are long overdue and urgently needed to better align our regulatory framework with a 21st century energy marketplace and business practices.

The valuation rule was originally published with a 60-day public comment period, but after receiving a significant number of requests to extend the public comment period, the Department published a notice in the *Federal Register* on February 13, 2015, extending the comment period by 60 days to May 8, 2015. Coupled with the early stakeholder engagement, the extended public comment period allowed for a careful review of the many complexities contained in the proposed rule.

The proposed rule clarifies and reforms valuation criteria that have not kept pace with the significant changes that have occurred in the domestic energy markets. The recommended changes offer greater clarity and consistency in product valuation, reduce industry-reporting costs, and provide early certainty that companies have paid and that the Department has collected every dollar due for the use of our Nation's valuable natural resources. The recommended regulatory changes do not alter the underlying principles of the current royalty valuation regulations. In fact, in the proposed rule, the Department reaffirmed that the value, for royalty purposes, is best determined at or near the lease and that gross proceeds from arm's-length contracts are the best indication of market value.

The proposed rule focuses on simplifying and clarifying the determination of value in non-arm's-length and no-sale situations. To do so, the proposed rule eliminates the current benchmarks, a series of indicators used to derive market value, and replaces them with a valuation method that uses the first arm's-length-sale to value production for royalty purposes. While these changes seem significant, they affect only a small percentage of lessees because the overwhelming majority of sales are treated as arm's length under existing regulations. As an example, more than 90 percent of all coal sales are considered arm's length and not subject to the current benchmarks. Nevertheless, by removing the administratively burdensome benchmarks, the government and companies would be able to determine the royalty value more efficiently.

Another proposed change is adding a "default provision" to make explicit the Secretary's existing discretion to addresses valuation situations where circumstances result in the inability of the Secretary to reasonably determine the value of production. Under the existing mineral leasing statutes, lease documents, and regulations, the Secretary may enforce her authority and exercise considerable discretion to use a variety of factors and other appropriate information to establish the reasonable value of production. The proposed "default provision" demarcates the

Secretary's authority and adds transparency to the parameters under which the Secretary would exercise this discretion that has always been authorized by statute.

In response to the proposed valuation regulations, the Department received more than 1,000 pages of comments from over 300 commenters and over 190,000 petition signatories from states, tribes, industry trade associations, public interest groups, companies, and private citizens. The comments reflect the diverse positions of the regulation's stakeholders. The goal is to produce a final rule that offers greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees and mineral revenue recipients – a rule that provides early certainty that companies have paid and ONRR has collected every dollar due.

Unbundling Transportation and Processing Fees

In 2007, the Royalty Policy Committee (RPC) Subcommittee on Royalty Management issued a report titled "*Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf,*" which contained recommendations to enhance compliance coverage for gas plants and transportation systems. The recommendations in the report pointed to improving the availability and accuracy of gas plant and pipeline information, which is critical in determining expected volumes and values for royalty compliance purposes. Gathering additional information on transportation systems and processing plants has allowed ONRR to expand audit and compliance coverage and better ensure the collection of every dollar due.

Natural gas transportation and processing service providers frequently charge a single bundled fee for their service. The bundled fee often includes allowable and non-allowable costs for gathering, compression, dehydration, sweetening, or boosting natural gas. Producers that enter into arm's-length service contracts with bundled fees for multiple services are required to determine what percentage, if any, of the bundled fee is allowable under the regulations.

ONRR's unbundling team works collaboratively with auditors, states, tribes, and industry to evaluate and determine effective methods of unbundling transportation and processing fees. By reviewing engineering drawings, equipment specifications, and processes, ONRR can provide accurate Unbundling Cost Allocations (UCAs) to producers. It is important to understand that it is the producer's responsibility under the law to unbundle their transportation and processing fees and that producers are expected to perform their own marketable condition and unbundling analyses, which they can submit to ONRR for review and guidance. ONRR's unbundling effort and the publication of UCAs is a value-added opportunity for companies. Producers can apply the UCAs to the bundled fees to determine allowable transportation and processing fees under the marketable condition regulations.

To date, ONRR has posted UCAs for over 40 percent of the Federal gas volume on its website to assist industry in proper royalty valuation and payment. To ensure future success, ONRR is evaluating the current unbundling work effort to refine and institute best practices and to be more effective and collaborative with stakeholders.

Conclusion

The consolidated valuation regulations and the unbundling of transportation and processing fees support the Department's goal of improving the management and oversight of natural resource revenue collection activities. The Proposed Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform Rule provides greater certainty and predictability to the industry and strengthens the Department's management of natural resources on public lands. The collaborative unbundling effort offers greater clarity and consistency in the determination of allowable transportation and processing fees. By applying our core business principles of continuous improvement, leadership, and collaboration to all of these efforts, ONRR is working diligently to ensure we are collecting every dollar due on behalf of the American public. Mr. Chairman and Members of the Subcommittee, this concludes my written statement.