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Re: Comments to Proposed Rule, Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, Docket No. ONRR-2012-0004

This letter provides comments on behalf of the Western Organization of Resource Councils, Natural Resources Defense Council, Northern Plains Resource Council, Powder River Basin Resource Council and Western Colorado Congress on the rule proposed by the Department of the Interior's (DOI) Office of Natural Resource Revenue (ONRR) to reform federal coal valuation.

The Western Organization of Resource Councils (WORC) is a regional network of eight grassroots community organizations with 12,200 members and 39 local chapters and affiliates in seven states, including Colorado, Idaho, Montana, North Dakota, Oregon, South Dakota and Wyoming. Our members farm and ranch on lands overlying and neighboring federal, state and privately owned coal deposits, and experience numerous impacts due to coal mining, transport and processing. WORC and its member groups have a longstanding interest in federal coal leasing, mining and royalty policy, and for over 35 years have actively engaged in advocacy in this area.

The Natural Resources Defense Council is the nation's most effective environmental action group, combining the grassroots power of more than 2 million members and online activists with the courtroom clout and expertise of nearly 500 lawyers, scientists and other professionals.

Northern Plains Resource Council is a grassroots conservation and family agriculture non-profit organization based in Billings, Montana. Northern Plains organizes Montana citizens to protect our water quality, family farms and ranches, and unique quality of life. Northern Plains is dedicated to providing the information and tools necessary to give citizens an effective voice in decisions that affect their lives. Northern Plains formed in 1972 over the issue of coal strip mining and its impacts on private surface owners who own the land over federal and state mineral reserves as well as the environmental and social impacts of mining and transporting coal. Our members care deeply about Montana, its future, and the issues surrounding coal. Many of our members' livelihoods as ranchers and farmers depend entirely on clean air and water, native soils and vegetation, and lands that remain intact. The strip mining of coal affects them directly. Many more of our members will be affected by the transportation of the coal stripped from the ground at Otter Creek and shipped through our state.

The Powder River Basin Resource Council has a long history of involvement working for responsible coal leasing and mining in the Powder River Basin. Powder River was formed in 1973 by ranchers and concerned citizens of Wyoming to address the impacts of strip mining on rural people and communities. Today, we work for the preservation and enrichment of our agricultural heritage and rural lifestyle; the conservation of our unique land, mineral, water, and clean air resources, consistent with the responsible use of those resources to sustain the livelihood of present and future generations; and the education and empowerment of our citizens to raise a coherent voice in the decisions that will impact their environment and lifestyle. Our members live, raise families, ranch, work, and travel throughout the Powder River Basin near the various coal mines of the area.

Western Colorado Congress is a grassroots, democratic organization that has addressed critical issues facing western Colorado for more than three decades. Our mission is to organize people to challenge injustice and to increase their power over decisions that affect their lives. With nearly 2,200 members in five affiliated community groups, WCC has a unique capability to articulate local priorities and mobilize our members on critical issues.

We welcome the opportunity to comment on the Office of Natural Resource Revenue's (ONRR) proposed rule regarding coal valuation reform. We commend the Royalty Policy Committee for, in 2007, identifying the need to update ONRR's current rules, particularly with regard to non-arm's-length transactions. With so much coal held by vertically integrated energy companies or cooperatives that do not operate at arm's length, updates are needed to ensure the mechanisms in place to price the public's coal truly reflect its full value when assessing royalties.

This is particularly true given the aggressive efforts of many of coal companies to expand exports to foreign markets, which are generally more lucrative. Although exports today appear unlikely to rise as high as some in the industry had hoped and planned, exports, including those of federal coal, have risen and are expected to continue to increase. The coal industry is changing and adapting to new conditions and so must the federal regulations governing the industry change and adapt to best protect the American public. We urge ONRR to finalize its proposed rule as quickly as possible to ensure that both federal and state taxpayers receive their full, legal share of the revenue derived from these sales.

I. Federal Coal Royalty Program

Royalties are not a tax, despite recent efforts by some in the coal industry to portray them as such. The royalty has *always* represented a standard part of any lease agreement to provide payment to the mineral owner for the current market value of the resource at the time of production.[1] Selling coal is a proprietary function of the federal government, not a sovereign act, and the fact that the mineral owner and seller is the U.S. government does not make the royalty payment a tax.

In the case of coal, the Secretary of the Interior is required by the Mineral Leasing Act to obtain a royalty of not less than 12.5 percent for surface mined coal.[2] Royalties have yielded $800 million per year in recent years, which is nearly 70% of total revenue from federal coal leasing, representing an important source of revenue for the federal treasury, and especially for individual state treasuries, which share in the revenue collected by the federal government.[3]

II. The Need for Coal Royalty Valuation Reform

ONRR's current coal royalty valuation rules have been in effect since 1989. Since this time, the coal industry and coal markets have changed drastically in a variety of ways, including:

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[1] As opposed to the bonus bid and rental, which compensate the mineral owner for the grant of exclusive access and right to produce the mineral.
[2] 30 U.S.C. § 207(a).
[3] Office of Natural Resource Revenue. Statistical Information. Accessed May 8, 2015. Accessible at: http://statistics.onrr.gov/ReportTool.aspx.

- In 1990, coal accounted for 55 percent of U.S. power generation. By 2014, coal's contribution had shrunk to 39 percent.[4]

- In 1990, U.S. coal mines produced 1.03 billion tons of coal. Production rose, peaking at 1.17 billion tons in 2008, then declined to 984 tons in 2013.[5]

- Since 1990, federal coal production has risen, displacing non-federal coal production. Of particular note is the Powder River Basin in Wyoming and Montana, which now produces 40 percent of the coal mined in the U.S., as compared to 22 percent in 1990.[6] The Powder River Basin holds nearly 60 percent of federal coal reserves and accounted for 86 percent of federal coal production in 2013.[7]

- Coal companies are aggressively working to expand exports to foreign markets. Exports have increased from 39.6 million short tons in 2002 to 117.7 million short tons per year in 2013.[8] Export terminal proposals in Washington and Oregon contemplate 100 million tons of new export capacity for Western coal.[9]

- From 2006-2012 more than 86 million tons of coal from Colorado, Montana, Utah and Wyoming were exported, with annual exports generally increasing over this period.[10] The majority of the coal produced in each of these states is federal coal.[11]

- Over the past decade, coal companies have built extensive networks of subsidiaries and affiliates through which they sell and distribute coal domestically, as well as to export markets. Non-arms length sales of Wyoming coal to companies related to mine owners – an insignificant factor in 1989 when royalty evaluation rules were

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[4] U.S. Energy Information Administration. "Frequently Asked Questions." Accessed May 8, 2015. Accessible at: http://www.eia.gov/tools/faqs/faq.cfm?id=427&t=3.
[5] U.S. Energy Information Administration. "Monthly Energy Review." April 27, 2015. Accessible at: http://www.eia.gov/coal/data.cfm#summary.
[6] U.S. Energy Information Administration. "Historical detailed coal production data (1983-2013)." Accessible at: http://www.eia.gov/coal/data.cfm#production.
[7] U.S. Energy Information Administration. "Sales of Fossil Fuels Produced from Federal and Indian Lands, FY 2003 – FY 2013." Accessible at: http://www.eia.gov/analysis/requests/federallands/pdf/eia-federallandsales.pdf.
[8] U.S. Energy Information Administration. Coal Data Browser, Quantity & price of coal imports & exports dataset. Accessed May 7, 2015. Accessible at: http://www.eia.gov/beta/coal/data/browser/.
[9] De Place, Eric. "Northwest Fossil Fuel Export." *Sightline Institute* September 2014.
[10] U.S. Energy Information Administration. "Annual Coal Distribution Report." December 19, 2013. Accessible at: http://www.eia.gov/coal/distribution/annual/archive.cfm.
[11] [11] U.S. Energy Information Administration. "Sales of Fossil Fuels Produced from Federal and Indian Lands, FY 2003 – FY 2013." Accessible at: http://www.eia.gov/analysis/requests/federallands/pdf/eia-federallandsales.pdf.

enacted – have risen rapidly from four percent in 2004 to 42 percent in 2014.[12] One hundred percent of coal exported from Montana in 2013, or 12.1 million tons, was sold via a broker or trader intermediary.[13]

III. Support for ONRR's proposed rule

ONRR's current rules require companies to follow benchmarks when selling to an affiliated company. The benchmarks allow royalties to be based on factors such as comparable arm's-length sales, prices reported to public utility commissions and the Federal Energy Regulatory Commission, and a netback calculation.

Using these benchmarks, coal companies have been able to take advantage of the segmented nature of the global coal market to minimize royalties by always paying a royalty based on the benchmark mine mouth price of coal, typically $10-12 in the Powder River Basin, even for coal that is sold to an affiliated company and subsequently resold on the international market for several times this price.

The changes in markets and industry structure since 1989 demand updates to ONRR's rules because, as currently written, ONRR's regulations provide mechanisms by which companies may minimize royalty payments on non-arm's length sales to subsidiaries and affiliates.

In the case of coal that is mined for export, any undervaluation means that the American taxpayer is subsidizing the sale of coal to foreign competitors, which we cannot support. According to a 2012 Reuters report[14], payment of royalties based on the full value of exported coal would have yielded $40 million more in 2011 alone, and losses could be billions of dollars per year if coal companies ship 150 million tons of coal per year out of the Pacific Northwest as then proposed.

The proposed rules would address this gaping loophole and simplify the system, requiring coal companies to calculate royalties based on the first true arm's length transaction. They would also allow ONRR to substitute its own valuation method if it is dissatisfied with a coal company's valuation.

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[12] Lee-Ashley, Matt and Thakar, Nidhi. "Cutting Subsidies and Closing Loopholes in the U.S. Department of the Interior's Coal Program." Center for American Progress. January 6, 2015.

[13] Rucker, Patrick. "U.S. coal leans on brokers for export sales, data shows." *Reuters*. April, 16 2015. Accessible at: http://www.reuters.com/article/2015/04/16/usa-coal-exports-idUSL2N0XD1CD20150416.

[14] Rucker, Patrick, "Asian coal export boom brings no bonus for U.S. taxpayers." *Reuters*. December 4, 2012.

ONRR's proposal will result in royalty payments on non-arm's length sales being based on market value and eliminate the loophole that allows coal companies to minimize royalty payments, particularly for exported coal. It is important to have mechanisms in place to fully share in the rising value of coal if export markets continue to grow. We strongly support these changes and urge ONRR to finalize its proposal as quickly as possible.

Headwaters Economics found that, had coal valuation been based on net market prices as ONRR proposes, royalty collections from 2008 – 2012 would have been $850 million higher, an average of $170 million per year.[15]

ONRR also proposed to base deductions for transportation costs on a reasonableness standard. We support this proposed change as well. Under current rules, coal companies can deduct unlimited transportation and washing costs from the sale price before calculating royalties. Because virtually all federal coal is currently sold or valued at the mine mouth, transportation deductions are seldom claimed.[16]

Once ONRR's proposed rule is implemented and coal companies are required to calculate royalty payments based on the non-arm's-length sale, a sale which likely occurs off-lease, companies are certain to begin taking transportation deductions. It is important that this deduction be clearly defined and limited in order to prevent it from becoming a new loophole, particularly for coal companies with transportation and export affiliates.

We urge ONRR to ensure that transportation deductions are based on arm's-length market prices for transportation and port activities. Under no circumstances should deductions be allowed for expenses related to the speculative aspects of export transactions, including take-or-pay contract penalties or liquidated damages.

We further urge ONRR to eliminate washing and beneficiation deductions. Similar to blasting, dragging, and hauling to the tipple, washing is a cost of producing and marketing the coal and a part of market value. These costs belong in the business plans of mining companies, coal hauling railroads and the ultimate end users of the coal. Such deductions appear to be minimal in practice[17], and only add to the complexity and administrative expense of the current rules. To the extent that such deductions are significant, they effectively absorb and conceal the true value of the commodity at the public's expense.

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[15] Haggerty, Mark and Haggerty, Julia. "An Assessment of U.S. Federal Coal Royalties." Headwaters Economics. January 2015.
[16] *Ibid.*
[17] *Ibid.*

IV. Need for Greater Transparency

The public has the right to know the sale price of publicly owned resources, how those values are established including any deductions, and the amounts of royalties and other payments being collected on their behalf. The current lack of transparency has eroded public trust and increased criticism of the program.

In closing, we urge ONRR to use this rulemaking process as an opportunity to require additional reporting from companies and to maximize disclosure to the public. We believe this can be done without interfering with legitimate proprietary interests.

President Obama has committed to increased transparency through his Memorandum on Transparency and Open Government, issued on his first day in office,[18] and by joining the global Extractive Industries Transparency Initiative "so that taxpayers receive every dollar they're due from the extraction of natural resources."[19]

We urge ONRR to regularly publish a public report that details for each coal lease the market value of the coal, the method by which the value was determined, the amount of transportation deduction allowed, the amount of the royalty payments and the applicable royalty rate including any royalty rate reductions. This information will go a long way toward the transparency that is needed to allay growing public concerns about the program, and to help expose any additional areas where reforms are needed.

Thank you for the opportunity to comment.

Sincerely,

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Western Organization of Resource Councils, Chair

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[18] Accessible at: https://www.whitehouse.gov/the_press_office/TransparencyandOpenGovernment/.
[19] More information at: http://www.doi.gov/eiti/index.cfm.

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