



KATIE SWEENEY
General Counsel

May 4, 2017

Armand Southall
Office of Natural Resources Revenue
Building 53, Entrance E-20 Denver Federal Center
West 6th Ave and Kipling Street
Denver, CO 80225

Dear Mr. Southall:

RE: RIN 1012-AA20 Repeal of Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule

On April 4, 2017, the Office of Natural Resources Revenue (ONRR) proposed to repeal the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule that was published on July 1, 2016. 82 Fed. Reg. 16323. The National Mining Association (NMA) appreciates the opportunity to provide these comments in support of the rescission of the 2016 valuation rule that the association challenged in federal court due to its dubious legality as well as compliance and implementation hurdles. NMA's members are producers of most of America's coal, metals, industrial and agricultural minerals; manufacturers of mining and mineral processing machinery and supplies; transporters; financial and engineering firms; and other businesses related to mining. NMA's members include companies that lease federal or Indian coal and therefore have a significant interest in the proposal to rescind the 2016 rule.

Rescission of the Final Valuation Rule is Merited by its Significant Fundamental Flaws

NMA has participated in each stage of this rulemaking including preliminary comments in 2011 on the advanced notice of proposed rulemaking that was specific to federal and Indian coal valuation and more extensive comments on the broader 2015 proposed rule. NMA's comments on the proposal detailed the significant legal deficiencies with the rule. As no changes were made to address NMA's concerns when the rule was

finalized, these 2015 comments are offered in support of the rescission and incorporated by reference. NMA also incorporates by reference the petition for review of the final rule that was filed on Dec. 29, 2016 in the U.S. District Court for the District of Wyoming. The fundamental problems with the rule as detailed in NMA's comments and legal filings are summarized below:

- A new "default" valuation provision whereby ONRR may unilaterally establish royalty value in the first instance under numerous, broadly defined circumstances, undermining the certainty of even a lessee's arm's-length sales prices as value, and creating the risk that ONRR may impose a higher royalty value many years after production and initial payment;
- Mandatory valuation of coal production via an inherently unreliable "netback" method that courts and the Department have historically used only as a "last resort" if no other methodology, such as comparable sales, is available to establish a reasonable value at or near the mine;
- Inadequately defined transportation allowances particularly for coal sold for ultimate delivery at distant locations;
- Requirement that coal cooperatives and vertically integrated lessees use a novel and untested method to value coal based on the sales price of electricity generated by the coal, an entirely different commodity, and apply generation and transmission allowances summarily imported from geothermal resource valuation with no analysis of their applicability to coal-fired electric generation. This ignores the value added by all activities converting coal to electricity between the mine and the end use customer's switch, the multiple resale tiers prior to end use, the variety of retail prices paid by end use customers, and the fact that the fuel component of a retail electricity price includes non-coal energy sources from the February 17, 2017 royalty payors' complete portfolios of natural gas, hydro, wind and solar, effectively making the Final Rule's required valuation impossible to calculate;
- For all coal not sold by the lessee at arm's length, failure to provide any index or other option to use reliable alternative valuation methods established near the lease like those available for oil and gas valuation;
- Unsupported singling out of coal cooperatives for special treatment, including royalty valuation calculations that are impossible to perform, and disregard of well-established legal principles governing "affiliated" entities; and
- Refusal to recognize for valuation purposes any contract for the sale of oil, gas, or coal that is legally enforceable yet may be unwritten or unsigned by all parties.

In stark contrast to the final valuation rule, the proposed rescission acknowledges the final rule raised serious questions concerning the validity or prudence of certain provisions including the expansion of the default provision, the use of the sales price of electricity to value coal, and how to value coal production in certain non-arm's length transactions. It also acknowledges, as highlighted in public workshops on the rule, even ONRR staff were not sure how certain provisions could be implemented. Given the

seriousness of these concerns, ONRR has correctly determined that a rescission of the final rule is appropriate.

Finally, the proposed rescission properly notes that the rescission is consistent with Executive Order 13771 on “Reducing Regulation and Controlling Regulatory Costs.” NMA agrees with that conclusion but notes that the rescission is also consistent with Executive Order 13783 on “Promoting Energy Independence and Economic Growth.” That order requires review of regulations that potentially burden the development or use of domestically produced energy resources and appropriately rescind those that burden the development of domestic energy resources. Clearly, the final valuation rule, with its many legal infirmities and implementation issues would burden the development of federal coal.

Adequacy of Regulations That Predate the Final Valuation Rule

The alleged purpose of the 2016 valuation rule was to address dramatic changes in the industry and the marketplace as well as to provide “greater simplicity, certainty, clarity and consistency in product valuation.” Yet, ONRR failed to provide evidence of any significant changes in the domestic coal market over the last 28 years that merit a wholesale rewrite of the valuation regulations. Nor has ONRR demonstrated the need for greater consistency or clarity. While there have been some controversies over royalty payments since the establishment of the 1989 coal regulations, the controversies have largely declined over the years as the agency and lessees became more familiar with the coal valuation regulations. Most of the controversies today relate to line item adjustments for transportation and processing as opposed to disputes regarding valuation methodologies.

In fact, the 1989 regulations have become very well understood. The comprehensive 1989 rulemaking that established the coal valuation regulations was the result of several years of consideration and efforts to develop an appropriate set of rules for the determination of value of coal for royalty purposes. The rulemaking represented a compromise on all sides; few stakeholders were completely satisfied but there appeared general recognition that the final regulations represented the best compromise that could be developed.

Such a deliberative process should not be undone without significant evidence that the existing rules are inadequate. Complexity of rules in and of itself does not justify wholesale changes, especially when the existing rules provide certainty for both regulators and the regulated community. The 2016 rule, if not rescinded would upend the established and well-known methods for coal valuation and instead insert arbitrariness and uncertainty. NMA is pleased that ONRR recognized in the proposed rescission that the existing rules “enhance the lessees’ ability to timely and accurately report and pay royalties because they would continue to use a well-known system that has been in place for decades.”

Important Role of the Royalty Policy Committee

Just days before the proposed rescission was published, Secretary of the Interior Zinke announced he was reconstituting the Royalty Policy Committee (RPC). The RPC was originally established in 1995 to provide expert advice to the Secretary on the management of the nation's federal and Indian minerals revenue program. The open dialogue created by the RPC over the years has provided the Secretary with valuable insights that have been applied to improve implementation of existing regulations and policies and to assist in determining whether changes to regulations and policies are needed.

Despite the critical role of the RPC, however, its charter was allowed to expire in 2014. Per the new charter, the role of the RPC will be to advise the Secretary on issues related to the determination of fair market value and the collection of revenue from energy and mineral resources on federal and Indian lands as well as the potential impacts of proposed policies and regulations related to revenue collection from energy development. Given the expertise and the stakeholder representation (states, tribes, industry, academia, and public interest groups), NMA believes the RPC is the right venue to begin discussions about whether any revisions are needed, including revisions advocated by the mining industry in the past such as allowing the use of comparable arm's-length sales from the producer's own mine in the first benchmark.

Conclusion

The final rule did not support ONRR's goal of simplifying the regulations and rather would have served to only frustrate that objective and result in burdens and regulatory uncertainty that outweigh any purported benefits to industry ONRR or the public. NMA appreciates the opportunity to comment in support of the proposed rescission of the final valuation rule. Given the legal infirmities and implementation hurdles, ONRR appropriately is pursuing their rescission.

Sincerely,

A handwritten signature in cursive script that reads "Katie Sweeney". The signature is written in black ink on a white background.

Katie Sweeney