Office of Natural Resources Revenue
c/o Luis Aguilar
Building 53, Entrance E-20
Denver Federal Center
West 6th Ave. and Kipling St.
Denver, CO 80225

May 4, 2017

Re: Comments on the Advance Notice of Proposed Rule Making and Proposed Repeal—Federal Oil & Gas and Federal & Indian Coal Valuation Rule

Docket Numbers ONRR-2017-0001 (RIN 1012—AA20) and ONRR 2017-0002 (RIN 1012—AA21)

Dear Mr. Aguilar:

Please accept these comments from The Wilderness Society on the above regulatory actions by the Office of Natural Resources Revenue (ONRR). The mission of the Wilderness Society is to protect wilderness and inspire Americans to care for our wild places.

I. Introductory Comments—No Repeal of the Valuation Rule should be Contemplated and Any Revision of the Rule Must Fully Abide by the Administrative Procedure Act.

The ONRR has issued two notices in the Federal Register, one an Advance Notice of Proposed Rulemaking (ANPR) to revise the oil and gas and coal valuation rule for royalty purposes adopted on July 1, 2016, and put into effect 180 days from the date of publication on January 1, 2017 (hereinafter the Final Valuation Rule), and the other a proposal to repeal the rule. 82 Fed. Reg. 16323 (Apr. 4, 2017); 82 Fed. Reg. 16325 (Apr. 4, 2017). If the rule was repealed it would be ONRR's intention to put in place the prior rule that had governed royalty evaluations, which was adopted in the 1980s.

Under no circumstances should the Final Valuation Rule be repealed. The basis for that view will be discussed in detail below. But fundamentally given the extensive rulemaking history for the Final Valuation Rule, which carefully demonstrated and documented its value, need, and timeliness, any repeal would be inappropriate. A new Administration which may have different views does not allow for repeal given the underlying statutory commands to ensure the American public receives fair market value for royalties from federal fossil fuels extraction. This is especially true of any essentially summary repeal, which is apparently what ONRR has in mind. 82 Fed. Reg. at 16323-325. Any such expedited effort would deprive the public of the statutorily required opportunities it has to participate in rulemaking.

While revisions of the rule can be considered, in doing so the ONRR must fully abide by the notice and comment procedures specified by the Administrative Procedure Act (APA). As will be discussed below, given the extensive prior rulemaking history that found that the Final Valuation Rule was fully justified and met current needs, modifications to the rule would require an extensive, public, rulemaking process.

II. Comments on the Advance Notice of Proposed Rulemaking and the Proposed Rule.

In the ANPR the ONRR states it is seeking comments on two scenarios: (1) comments on whether a new valuation rule should be promulgated if the Final Valuation Rule is repealed; and (2) comments on what changes should be made to the Final Valuation Rule if it is not repealed. 82 Fed. Reg. at 16326. In the repeal proposal, the ONRR is proposing to repeal the Final Valuation Rule "in its entirety," and the previously adopted rules effective prior to the January 1, 2017 would be reestablished. *Id.* at 16323. The following comments address both of these Federal Register notices.

As stated, in our view the Final Valuation Rule should not be repealed. The ONRR could, however, consider changes to the 2016 rule if it carefully follows the notice and comment procedures outlined in the APA. The regulations in place prior to January 1, 2017 were nearly 30 years old, having been put in place in the late 1980s. Reinstating these rules, as would occur with repeal, would clearly be inappropriate. They were already outdated prior to adoption of the Final Valuation Rule, and that is even more true now. They were not based on current energy markets and were not in line with modern technologies and practices in the coal, oil, and natural gas industries. And, as was amply demonstrated in the prior rulemaking, they shortchanged the American public from the full royalty benefits they deserve from development of federal fossil fuels. The Final Valuation Rule alleviated these problems, and therefore it should not be abandoned.

The prior rulemaking was a lengthy and exhaustive process that deserves acknowledgment and respect from the ONRR (as well as the Secretary of the Interior and the Administration). The prior rulemaking leading to the Final Valuation Rule extended over nearly six years. First, an ANPR was published on May 27, 2011. 76 Fed. Reg. 30878 (May 27, 2011). After that it took three and a half years before the proposed rule was published on January 6, 2015. 80 Fed. Reg. 608 (Jan. 6, 2015). During this time six public workshops were held and comments were received from over 300 commenters and 190,000 petition signatories. Thousands of pages of comments were received. The comment period on the proposed rule was extended to 120 days. The final rule was not published until a year and half after the proposed rule, on July 1, 2016, and was not effective until January 1, 2017. 81 Fed. Reg. 43338 (July 1, 2016). In putting the Final Valuation Rule in place, the ONRR stated, "[r]ecognizing lessees may have to change their systems, we set the effective date of this rule to 180 days from the date of publication." 81 Fed. Reg. at 43360. Clearly the Final Valuation Rule was put in place based on a very full and thorough public process with ample time for companies to adjust their systems to comply with it, which argues against any attempts to abandon it or modify it.

The Final Valuation Rule was developed using a careful, thoughtful, and deliberative process, as envisioned by the APA. This rule should not and cannot simply be abandoned, as the ONRR is proposing to do. Reinstating an outdated rule simply makes no sense—as fully documented in the prior rulemaking.

The ONRR recognizes that the Final Valuation Rule sought to achieve four important goals:

1. Offering greater simplicity, certainty, clarity, and consistency in product valuation;
2. Ensuring Indian mineral lessors receive maximum revenues from coal resources;
3. Decreasing lessee costs of compliance and the ONRR's cost to ensure compliance; and
4. Providing early certainty to ONRR and stakeholders.

82 Fed. Reg. at 16326. The purpose of the current ANPR is to essentially repeat what had already been accomplished with the Final Valuation Rule. *See* i*d.* (stating the purpose of the ANPR rulemaking process is to: (1) offer greater simplicity, certainty, clarity, and consistency in production valuation; (2) to be easily understood; (3) decrease industry's costs of compliance; and (4) provide early certainty to industry, ONRR, and stakeholders). Having <u>already</u> achieved these goals, there is no need to repeat a process that has already created these benefits by repealing the rule, and even a reconsideration of the rule is not appropriate if all it is doing is recreating what has already been done.

That would represent a massive waste of federal resources given what has already been invested in this rule. It also would not be in compliance with the provisions in Executive Orders 13771 and 13781 which require reducing regulation and regulatory costs and reorganization of the Executive Branch through non-wasteful practices that minimize new rulemaking.

In considering modifications to the Final Valuation Rule, the ONRR states that it has three goals. These are to:

1. Provide clear regulations that are consistent with meeting the responsibility to "ensure fair value for the public's resources."
2. To provide valuation methods that are efficient and practicable to use; and
3. To provide certainty that correct payment has been made.

82 Fed. Reg. at 16326.

We think the agency should consider (or reconsider) whether the Final Valuation Rule has <u>already</u> done all these things and achieved these goals. We urge you to review the 2015 proposed rule and the 2016 final rule and assess whether a sufficient explanation of, and adoption of, these provisions was already made when the Final Valuation Rule was adopted. We believe they were. If you disagree that the 2016 rule met these goals, you should provide a detailed explanation of why this is so before proceeding with any changes to the rule. Public comment must be allowed for before proceeding with any rule change. And again, the ONRR must ensure it is not engaging in a massive waste of previously thoughtfully invested resources, as required by Executive Orders 13771 and 13781.

As noted by former Secretary of the Interior Sally Jewell when the Final Valuation Rule was adopted:

> These improvements were long overdue and urgently needed to better align our regulatory framework with a 21st century energy market place, offering a simpler, smarter, market-oriented process. As the steward of America's oil, natural gas and coal production on public lands, Interior has an obligation—and is fully committed—to ensuring that the American taxpayer receives every dollar due for the production of these domestic energy resources. This valuation rule is important because it ensures, in part, that our federal coal program is properly structured to obtain all revenue due to taxpayers. The updated rule will increase the effectiveness and efficiency of the valuation process, and provide greater clarity and consistency for lessees and revenue recipients.

https://www.doi.gov/pressreleases/interior-department-announces-final-regulations-ensure-american-public-receives-every.

It certainly is not clear that the Final Valuation Rule had not already provided regulations that ensure fair value is received for public resources, provided for efficient and practicable valuation methods, and provided certainty that correct payments would be made, as the ONRR says are the goal of the ANPR.

Much of the impetus for the proposed repeal of the Final Valuation Rule seems to be to address the litigation that was filed on December 29, 2016 by coal and oil and gas companies challenging the rule.[1] 82 Fed. Reg. at 16323. But we would note that these legal challenges only contest "certain provisions of the Final Valuation Rule." *Id.* If the whole rule is not being challenged, there certainly is no need to dispose of the whole rule just to react to these lawsuits.

The ONRR also claims that it has "since identified several areas in the rule that warrant reconsideration to meet policy and implementation objectives." 82 Fed. Reg. at 16323. Yet it does not state what these are. Apparently the ONRR is reacting to dissatisfaction with the rule in the new Administration, but a new Administration—enlisting the support of the ONRR—cannot simply abandon lawfully adopted regulations that have gone fully in to effect. And as will be discussed elsewhere in these comments, there are a host of statutory requirements that require oil, gas, and coal valuation rules ensure the American public receives fair value for the extraction of its resources, and these statutory requirements cannot be ignored just to please a new President.

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[1] *Cloud Peak Energy, Inc. v. U.S. Dep't of the Interior,* Petition for Review of Final Agency Action, Case No. 16CV315-F (United States District Court for the District of Wyoming, Dec. 29, 2016); *American Petroleum Inst. v. U.S. Dep't of the Interior,* Petition for Review of Final Agency Action, Case No. 16CV316-F (United States District Court for the District of Wyoming, Dec. 29, 2016).

Even if some aspects of the Final Valuation Rule warrant reconsideration, that is not license to abandon the entire rule. Clearly, at most, the ONRR should be considering selected changes to the Final Valuation Rule, done carefully with full public involvement through the APA notice and comment process, not wholesale abandonment of it.

Another significant driver in the push to repeal the rule seems to be coming from certain Executive Orders (EO) that are mentioned in the Federal Register notice for the proposed repeal. 82 Fed. Reg. at 16323. EOs 12866, 13563, and 13771 are mentioned. However, the Federal Register notice indicates these EOs will be complied with, partly because they are inapplicable and thus do not govern this rule rulemaking. EO 12866 only applies to "significant rules" and this is not a significant rule; EO 13563 is applicable and directs improved regulatory procedures; and EO 13771 is inapplicable because under the circumstances presented here "it does not require the repeal of two other existing rules, and the agency is not required to offset its cost against the cost of other fiscal year 2017 rules." *Id.* at 16324. It is worth noting that the guidance for implementing EO 13771 issued by the Office of Management and Budget provides that an agency should, among other things, identify regulations that are "outdated, unnecessary, or ineffective" and "impose costs that exceed benefits." https:// www.whitehouse.gov/the-press-office/2017/04/05/memorandum-implementing-executive-order-13771-titled-reducing-regulation.

Given the newness of the Final Valuation Rule it certainly is not outdated. And the proposed and final Federal Register notices for the Final Valuation Rule made it clear the rule was necessary and effective and that its benefits exceeded its costs. If the ONRR is going to overcome these published facts arguing against repeal, it needs to develop and present for public comment any rebuttals or updates to them. We would also note that the final Federal Register notice for the Final Valuation Rule made it clear that EOs 12866 and 13563 had been complied with in developing the rule. 81 Fed. Reg. at 43367. Given the prior compliance with these EOs, there is no need to update this review, especially since the later issued EO 13771 is not applicable to this rule.

The ONRR claims in the repeal proposal that repeal would be consistent with EO 13771 (even though as mentioned it is inapplicable to this rulemaking) because:

1. It would preserve the regulatory status quo since the pre-existing regulations would be revived;
2. It would avoid costs to government and industry of converting to a new royalty reporting and payment system;
3. It would eliminate the need for the litigation; and
4. It would enhance lessees ability to timely and accurately pay royalties "because they would continue to use a well-known system that has been in place for decades."

82 Fed. Reg. at 16323. These assertions are misguided.

First, the Final Valuation Rule is the status quo. It was adopted in July, 2016, provided 180 days for companies to get their systems ready for compliance, and went fully into effect on January 1 of this year as a legally binding rule lawfully developed under the APA. Moving back to the prior rule is not the status quo; it has been fully supplanted. Making a claim that we would be returning to a status quo that does not even exist anymore is disingenuous. Moreover, in developing the Final Valuation Rule—as shown by the lengthy commentaries in both the proposed rule and the final rule—the ONRR made it clear that the new rule was: (1) prudent and economic and offered greater simplicity, certainty, clarity, and consistency in product valuation; (2) decreased both industry's and the ONRR's cost of ensuring compliance; and (3) provided early certainty to the ONRR and stakeholders. 82 Fed. Reg. at 16326. And eliminating any need for litigation is an abdication of the government's duty to defend federal laws that have been lawfully (and fully) adopted and put into place. Last, returning to an antiquated system for royalty payments that is totally out of sync with modern industry technologies and practices is just an excuse to shortchange the government (and the public) from getting full royalty payments that are lawfully owed.[2] Clearly the government's first priority in this rulemaking should be to ensure the public receives <u>full</u> royalty payments for the extraction of its minerals from the federal public lands and minerals estate, not just making it easier for industry to pay royalties. And clearly the Final Valuation Rule was already consistent with EO 13771.

ONRR's incorrect view that moving back to a rule that has been fully overturned would somehow be moving back to a "status quo" is probably driven by the February 27, 2017 "postponement" of the effectiveness of the Final Valuation Rule that the ONRR published in the Federal Register. 82 Fed. Reg. 11823 (Feb. 27, 2017). This illegal postponement has convinced the court hearing the challenges to the Final Valuation Rule to stay the litigation while ONRR seeks a repeal of the rule. *See Cloud Peak Energy, Inc. v. United States Dep't of the Interior,* Unopposed Motion for Stay, Civil Case No. 16-cv-315-F (United States District Court for the District of Wyoming, Apr. 26, 2017) and *id.* at Order Granting in Part Unopposed Motion for Stay (Apr. 27,2017). We would note that in these documents it seems clear the ONRR is pursuing a repeal—not modification—of the rule. This raises grave concerns about a "predetermined outcome" for this rulemaking. Having a predetermined outcome prior to public comment is a certain way to create legal infirmity in this rulemaking and the ONRR should avoid that. Any summary effort to repeal this rule, as the court documents indicate is happening, must be abandoned.

We would also note that the legality of the postponement has been challenged by the States of New Mexico and California. *People of the State of California v. United States Dep't of the Interior,* Complaint for Declaratory and Injunctive Relief, (United States District Court for the Northern District of California, Apr. 26, 2017); attached hereto as Exhibit 1. As the Plaintiffs in that case state,

> An agency cannot "postpone" the effective date of a rule when that effective date has already come and gone. Further, the legal basis on which the agency relied for the postponement, Section 705 of the Administrative Procedure Act ("APA"), does not apply to rules that have already gone into effect. ONRR's attempt to delay the Rule after it became effective is facially invalid, and constitutes an attempted end-run around the APA's notice-and-comment requirements.

[2] <u>See</u> 30 U.S.C. §§ 189, 207(a), 226(b), 359; 43 U.S.C. § 1334; 25 U.S.C. § 396d (all putting in place requirements or authorizations to make payments to the government for mineral extraction).

The ONRR should fully consider this case as it moves forward with this rulemaking. If this litigation is successful, it would call into question the validity of any effort to repeal the Final Valuation Rule.

When an agency seeks to amend or repeal a rule it must use the same procedure it used when it adopted the rule in the first place. *See Perez v. Mortgage Bankers Assoc.*, 135 S.Ct. 1199, 1206 (2015) (stating the APA mandates "that agencies use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance" (citation omitted)). And a rule, new or otherwise, must meet the arbitrary and capricious standard established by the APA. "Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfr. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). Here, the ONRR must ensure that any modifications to the Final Valuation rule meet these standards by ensuring it fully considers the statutory requirements to ensure a fair return to American taxpayers, ensures that the interests of the United States are met and that the public welfare is safeguarded, it fully considers the factual determinations and conclusions that were made in the prior rulemaking, and it ensures that any "difference in view" that is driving any changes is not implausible.

One of the most important aspects of the Final Valuation Rule is the elimination of non-arms-length sales with subsidiaries/affiliates as the basis for determining royalties that are owed for coal, a tactic which in the past has greatly reduced royalty assessments. Instead, the Final Valuation Rule required arms-length sales so that full and proper royalties would be paid for coal. This is an important mechanism for ensuring the government gets a fair return for the sale of its fossil fuels, and this requirement must be maintained even if changes are made to the Final Valuation Rule.

This is an issue that is brought up in the request for comments if the Final Valuation Rule is not repealed. 82 Fed. Reg. at 16326-27. The ONRR is interested in hearing comment on "[h]ow best to value non-arm's-length coal sales and/or sales between affiliates" and "[w]hether ONRR should update the valuation regulations governing non-arm's-length dispositions of Federal gas, and if so how." In our view, as demonstrated amply in prior public comments and the ONRR's assessment of the proposed rule and final rule, all non-arm's-length transactions should be prohibited in the valuation rule. Only arms-length transactions should be considered in determining the value of the minerals for royalty purposes. This is the only way to ensure the public receives fair value and a fair return for is resources.

III. Executive Order 13783 Must be Considered.

We also want to note another EO that is not mentioned in either the ANPR or the proposal to repeal the Final Valuation Rule. And that is EO 13783, "Promoting Energy Independence and Economic Growth," which was issued on March 28, just before the Federal Register notices for these actions were released. EO 13783 should certainly be considered in this rulemaking. Among other things it directs all federal agencies to review all existing regulations and policies ("agency actions") that potentially "burden" domestically produced energy resources. EO 13783 § 2(a). Based on this, agency actions could be suspended, revised, or rescinded, or a notice and comment procedure to do so could be started. *Id.* § 2(g). However, "[s]uch review shall not include agency actions that are mandated by law, necessary for the public interest, and consistent with the policy set forth in section 1 of this order." *Id.* § 2(a).

There is no doubt that the ONRR is mandated by law to put in place strong valuation rules so that appropriate royalties can be received from federal fossil fuels development. With respect to coal, the Secretary of the Interior must receive "fair market value" from the coal that is leased and at a minimum a 12.5 percent royalty must be paid based on the "value of the coal." 30 U.S.C. §§ 201(a) and 207(a). And as mentioned, oil and gas leases must also "be conditioned upon the payment of a royalty at a rate of not less than 12.5 percent in amount or value of the production removed or sold from the lease." *Id.* § 226(b). And, coal, oil, and gas leases all must be conditioned so as to protect the interests of the United States and provide for the safeguarding of the public welfare. *Id.* § 187. *See also* footnote 2, *infra*, (describing these and other statutory requirements).

There also is no doubt that the public interest would not allow for the Final Valuation Rule to be suspended or rescinded, although revision may be permissible. As just stated, protecting the public welfare is a cornerstone of the federal mineral leasing program. As shown by Secretary Jewell's comments and ONRR's commentary on the proposed and final rule, it can be said that protecting the public interest is foundational to why the Final Valuation Rule was adopted and put in place. Clearly this rule cannot be repealed only to be replaced by a rule the agency has already determined is out of date and does not meet today's needs or standards, and EO 13783 does not permit such actions that are contrary to the public interest.

And then there are the policies of section 1 of EO 13783 which must also be complied with before any suspension, revision, or recension of an agency action can be contemplated. The "clean and safe development of our Nation's vast energy resources" is national policy. As is the "prudent development of these natural resources." And even the review of agency actions mandated by the EO is not to be "beyond the degree necessary to protect the public interest or otherwise comply with the law." It is also national policy under the EO to "promote clean air and clean water for the American people." "[N]ecessary and appropriate" regulations that "achieve environmental improvements for the American people" should be developed "through transparent processes that employ the best available peer-reviewed science and economics." These are some of the policies provided for in section 1 of EO 13783 that must be complied with if any change to a regulation is contemplated.

It is clear that simply abandoning the Final Valuation Rule and reinstating a rule that is known to be insufficient for meeting 21st century needs is not permitted by the policies in EO 13783. Such a course of action would not further the "clean and safe development" of our energy resources; it would not contribute to the "prudent" development of our natural resources; as discussed, this course of action would be contrary to law and not in the public interest; it would not promote clean air and clean water; and abandonment of the rule would not achieve environmental improvements for the American people based on the best available science or economics. Repeal of the Final Valuation Rule is prohibited under the terms of EO 13783.

IV. Our Comments Submitted on the Proposed Valuation Rule should be Reconsidered.

Additionally, we would like to discuss the comments we submitted on the proposed Valuation Rule on May 8, 2015. Those comments are included herewith as Exhibit 2. We supported the proposed, and Final Valuation Rule. As we noted, the ONRR, under the valuation rule, has a responsibility to recover the full value owed to the taxpayer. We noted several of the federal laws that require the government to ensure fair value is achieved for the extraction of public minerals.[3] The proposed rule represented a "market solution to what was previously an unbalanced and distorted market place in favor of energy producers." Moreover, we noted that in addition to ensuring fair value is paid to the government and taxpayers, the valuation rule should also recognize and take account of the fact that there are opportunity costs when public lands and resources are developed for minerals at the expense of other economically valuable uses of these lands, such as recreation, wildlife habitat, scenery, ecosystem services, and various community benefits.

In our comments on the proposed valuation rule we highlighted several specific issues that needed to be addressed in the rule. These included:

1. The need for the removal of the Deep Water Gathering Policy, which had an inappropriate definition of transportation costs and allowed for improper deductions from oil and gas royalty payments. May 8, 2015 Comments at 3-4 (hereinafter Draft Rule Comments).

2. The need to remove transportation exceptions that had allowed exceptions to oil and gas royalty payments if transportation costs were greater than 50 percent in some cases, and which deprived the public of fair value for resources extracted from public land. Draft Rule Comments at 4. These transportation allowances were used to allow exceptions for pipeline losses and line fill, which subsidized losses after the royalty point, and the rule changes helped ensure a fair return to taxpayers.

3. Relative to coal, and as mentioned above, the proposed rule, and the Final Valuation Rule removed benchmarks, instead requiring use of the first arm's-length sale to determine royalties for coal, a proposal which we favored. Draft Rule Comments at 5. In addition, the proposed and final rule allowed for valuation based on gross proceeds from the arm's-length sale of electricity, instead of allowing non-arm's-length sales (such as when the coal lessee or its affiliates use the coal to generate electricity) to govern royalty payments. These were important steps in valuing coal at its fair market price.

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[3] *See*, *e.g.*, 43 U.S.C. § 1701(a)(9) (stating it is the policy of the United states that "the United States receive fair market value for the use of the public lands and their resources unless otherwise provided by statute"); 30 U.S.C. §189 (giving the Secretary of the Interior authority to "prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes" of the Mineral Leasing Act); 30 U.S.C. § 187 (requiring due diligence, skill, and care in the operation of leased properties and the prevention of undue waste, as well as other provisions that ensure production on leased lands provides for the "protection of the interests of the United States" and the "safeguarding of the public welfare"). 25 U.S.C. §§ 396 and 396d and 30 U.S.C. § 359 were also cited.

4. We also expressed concern in our comments about not enforcing washing or transportation allowance limits on coal, as was done for oil and gas. Draft Rule Comments at 5. We felt the transportation exemptions for coal provided an avenue for producers to defray costs that would be put in place by the first-arm's-length sale requirement and that this would reduce the effective royalty rate. "Therefore by not implementing a similar transportation limit to that imposed on oil and gas lessees, ONRR may in effect be undercutting any potential progress towards achieving accurate efficient revenue for the taxpayer." *Id.*

5. We also expressed support for the "default provision" that the Final Valuation Rule put in place. Draft Rule Comments at 6. The default provision was needed because of several situations where accurately determining value was not possible, or was thwarted. While concern has been expressed that this provision creates uncertainty as to the royalties owed or there is a need for definiteness in economic matters, the default provision is only used as a last resort where royalty payments grossly deviate from what was expected. "If there is uncertainty, it is likely to be the result of a failure to pay fair market value on the part of the lessee." *Id.* n.5.

In addition to these points we also noted in our comments that there is a need to reconsider the alarmingly low royalty rates paid on both coal and oil and gas (12.5 percent, with studies by Headwaters Economics showing that the effective rate for coal royalties is only 4.9 percent).[4] We also pointed out there was a need to consider climate change issues in the valuation rulemaking. The need to consider these and the numbered issues just discussed—specifically getting fair value—were brought out by the 2007 Royalty Policy Committee Report that was cited in our comments, and which should be reconsidered by ONRR.

All of these issues previously raised by The Wilderness Society should be considered in any modifications that are proposed to the Final Valuation Rule. Again, these comments are attached herewith as Exhibit 2.

V. Reports by Experts on Coal Markets should be Considered.

The APA requires agencies to give "consideration" to relevant comments. 5 U.S.C. § 553(c) ("the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented …."). Agencies must respond to comments that are material to issues raised in a rulemaking proceeding.[5] To be material, comments must be such that, "if true . . . would require a change in [the] proposed rule."[6]

[4] *See* Haggerty, Mark. "An Assessment of U.S. Federal Coal Royalties Current Royalty Structure, Effective Royalty Rates, and Reform Options". A Research Paper by Headwaters Economics. January 2015. Accessed on May 3, 2017. https://headwaterseconomics.org/wp-content/uploads/Report-Coal-Royalty-Valuation.pdf.

[5] *Portland Cement Ass'n v. Ruckelshaus,* 486 F.2d 375, 393-94 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 921 (1974).

[6] *Louisiana Federal Land Bank Ass'n, FCLA v. Farm Credit Administration,* 336 F.3d 1075, 1080 (D.C. Cir. 2003).

The following reports provide information relevant to the need for full and fair valuation of federal coal, including, at a minimum, improving valuation of coal disposed of in non-arm's-length transactions and no-sale situations.

a. *Sightline Institute, Unfair Market Value II Report, June 2016.* http://www.sightline.org/research_item/unfair-market-value-ii/

Conditions under which federal coal is exported, and volatile market conditions, make full and fair valuation of federal coal particularly important. This report by Clark Williams-Derry of Sightline Institute outlines export market conditions that affect the market valuation of coal that should be captured by federal coal owners, including through better valuation of coal disposed of in non-arm's length transitions. In the past, the U.S. coal industry took full advantage of the brief spike in the seaborne coal market, in many cases earning hefty profits by exporting coal to Asia. The industry is continuing its aggressive pursuit of coal exports and hopes to position itself to realize even greater profits should seaborne coal prices rise again. Ensuring that the federal coal owners receive full and fair value for their resources and have certainty that correct payment was made was the intent of this report.

This report, an update of Sightline's 2014 analysis of exports of federal coal, offers data and methods to review the finances and economics of federal coal exports, and how export dynamics affect the value of federal coal sold to private companies. The key findings of this report include:

> **Overheated Asian coal markets sparked a U.S. export boom.** After a 2009 spike in Chinese coal imports sent Pacific Rim coal prices skyrocketing, coal companies operating in the western United States took advantage of high prices to boost exports, particularly from mines in Montana, Utah, and Colorado.
>
> **U.S. exporters relied on federal coal.** Major West Coast coal exporters relied heavily—and in some cases almost exclusively—on coal produced from federal coal leases to supply overseas customers.
>
> **Asian coal markets have collapsed.** Declining coal imports in China and India, coupled with burgeoning coal supplies from Indonesia, Australia, and Russia, flooded seaborne coal markets with inexpensive coal. Starting in 2011, international coal prices fell for five consecutive years, forcing many US exporters to pull out of Asian markets.
>
> **U.S. coal producers still hope for an export rebound.** Despite the collapse in seaborne coal prices, US coal companies have continued to pour money and resources into export projects—suggesting that coal industry executives were making calculated gambles that export markets could re-inflate.
>
> **The potential for future exports boosts the value of federal coal.** The possibility that seaborne coal prices might someday rise gives the purchasers of federal coal leases a valuable "option" to profit from future price increases.

The federal government should consider coal exports when setting the "fair market value" of federal coal. As the Department of the Interior and the ONRR review the federal coal program royalties and valuation, they should consider the unique dynamics of coal exports—

including the “option value” of potential future coal exports— when determining the fair market value of federal coal leases. The Sightline Institute Report raises important issues related to the export market and federal coal, and its analyses and recommendations should be considered and responded to in any reconsideration of the Final Valuation Rule.

b. *Headwaters Economics. 2015. The Impact of Federal Coal Royalty Reform on Prices, Production, and State Revenue.* https://headwaterseconomics.org/energy/coal/coal-royalty-reform-impacts/

In its report, The Impact of Federal Coal Royalty Reform on Prices, Production, and State Revenue, Headwaters Economic considers ONRR’s proposal to change the method for determining the price used for valuation for non-arm’s length sales of federal coal and proposes two additional methods for how valuation could be improved. Headwaters proposes that the gross commodity value of federal coal required for royalty valuation is best revealed by the net delivered price paid by domestic power generators, coke plants, other industrial consumers, and for coal delivered free along ship at export terminals. “To understand how this policy option would work, Headwaters estimated the likely change in federal royalty revenue by comparing actual mine prices utilized for royalty valuation between 2008 and 2014 based on ONRR reported sales value, sales volume, and royalty statistics, to actual net delivered prices using data form the Energy Information Administration (EIA) and proprietary data purchased from SNL Energy.”

They found, on page 2 of this report, that “using net delivered prices for royalty valuation would have earned about $140 million in additional revenue between 2008 and 2014, a 20 percent increase over actual collections.” Their analysis showed that this change would have had a marginal increase in the cost of delivering coal to consumers (1.6% increase in the net delivered price) and a very small change in demand for coal (a 0.2% decrease in production).

Using the Net Delivered Price provides greater transparency for coal owners. Though ONRR’s use of the first arm’s length transaction for royalty assessment may be the simplest way to improve ease of compliance, “this reform would do little, if anything, to improve transparency or ensure a fair return. Due to data limitations, we could not assess the likely revenue outcomes of this proposed reform . . . . By comparison, a regulation that utilizes net delivered prices of federal coal for royalty valuation offers significant improvements in transparency and is also the most effective and fair way to ensure a fair return to the federal landowner for coal sold in through non-arm’s length transactions at the mine.”

The proposal put forth by Headwaters should be considered if the ONRR wants to know “[h]ow best to value non-arm’s-length sales and/or sales between affiliates” or “[w]hether ONRR should update the valuation regulations governing non-arm’s-length disposition of Federal gas,” as it states in the Federal Register notice.

VI. Transparency

In response to requests from commenters asking for more transparency to the public for coal valuation about royalty payments from sales of publicly-owned oil, gas and coal, the Final Valuation Rule notes on page 43339 that “The U.S. Department of the Interior (Department) created a data portal as part of the Extractive Industries Transparency Initiative—a global, voluntary partnership to strengthen the accountability of natural resource revenue reporting and build public trust for the governance of these vital activities. You can access the data portal at https://useiti.doi.gov.” We were pleased to read that "The (U.S. Interior) Department remains committed to the principles and goals of EITI including transparency and good governance of the extractive sectors...," and hope that ONRR and the Department of the Interior will continue to provide information on the royalty payments made by U.S. oil, gas, and coal lessees through the USEITI portal and the information provided will continue to improve.

VII. Conclusion.

Thank you for considering these comments. We look forward to remaining engaged in any rulemaking related to the Valuation Rule as this process moves forward.

Sincerely,

Bruce Pendery