WESTERN FUELS ASSOCIATION
THE NATIONAL FUEL SUPPLY COOPERATIVE

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, ID: ONRR-2017-0001

Submitted via email: armand.southall@onrr.gov.

Dear Mr. Southall:

On April 4, 2017, the Office of Natural Resources Revenue (ONRR) requested comments and suggestions from affected parties and the interested public on whether the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule that was published in the Federal Register on July 1, 2016 ("2017 Valuation Rule") should be repealed.

Western Fuels Association (WFA) is a not-for-profit cooperative that supplies coal and transportation services to consumer-owned electric utilities located in 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 the 2017 Valuation Rule, we have substantial interest in this issue.

WFA supports repeal of the 2017 Valuation Rule. As stated in our May 8, 2015 comments when the 2017 Valuation Rule was proposed, WFA identified serious and substantial issues with the 2017 Valuation Rule. Those issues were not addressed in the final 2017 Valuation Rule, and therefore remain as reasons the 2017 Valuation Rule should be repealed.

We pointed out in our May 8, 2015 comments that the proposed 2017 Valuation Rule was inconsistent with its stated goals of providing improvements that offer greater simplicity, certainty, clarity, and consistency in product valuation and reporting for mineral lessees.

There were two radical modifications approved under 2017 Valuation Rule.

The first radical modification concerns valuing coal in a NAL transaction. Instead of valuing this coal at the mine site using the benchmark method, the 2017 Valuation Rule requires that the royalty to be assessed against the gross proceeds of *electricity* generated and subsequently sold at

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arm's length. To value coal away from the mine siting using a totally different commodity i.e. electricity as the basis for valuation is a wide departure from the rules governing royalty valuations.

During the Training for the 2017 Valuation Rule, ONRR did not provide adequate direction as to how to determine value by this new method, or even where to obtain the information needed to calculate the valuation. ONRR told the producers that if not enough information was provided, the "default provision" would be imposed. This expansion of the default provision is the second radical modification prescribed in the 2017 Valuation Rule. This change vastly expanded the authority of the Secretary to unilaterally set valuations.

In our comments during the 2017 Valuation Rule proposal period, WFA pointed out serious concerns with the ability to comply with the "netback from sale of electricity" requirement. These concerns were not addressed in the final rule. The following is a summary of the concerns we identified in our May 8, 2015 comments:

1) Valuation of electricity cannot be determined if the plant uses a mix of arm's length and affiliated coal for manufacturing electricity.

2) Valuation cannot be determined when the affiliated coal goes into a stockpile and is not consumed for a significant period of time – which is a common occurrence.

3) Valuation cannot be determined when the electricity is produced from various sources of coal with widely varying coal quality characteristics which is common at power plants.

4) Valuation cannot be determined in a straightforward manner when coal transportation costs differ for multiple coal sources supplied to power plants.

5) Valuation cannot be determined when different coal qualities require different management techniques (and costs) in order to use these varying qualities of coal.

6) Valuation cannot be determined when electricity pricing changes minute by minute.

7) Valuation cannot be determined because sales of electricity are frequently both arm's length and non-arm's length.

8) Other responders pointed out that a valuation of electricity cannot be determined when electricity sales are from electricity derived from a variety of fuels (i.e. coal, gas, renewables).

9) ONRR did not address questions regarding whether the netback allowances for geothermal electrical generation were adequate for generation from coal.

The above issues needed to be resolved in order to ensure that electrical ratepayers (the ultimate payors of the royalties) were not absorbing both excessive royalty payments, as well as unnecessary regulatory compliance costs.

ONRR's original intent behind the new rule was to offer greater simplicity, certainty, clarity, and consistency in product valuation and reporting for mineral lessees. Clearly, the rule does the exact opposite.

Since the final rule did not address any of WFA's identified concerns before its issuance, WFA remains unable to comply with the 2017 Valuation Rule. As a result, if the 2017 Valuation Rule were to go into effect, WFA and its affiliates would be unable to close their books until the coal valuation is accepted or unilaterally set by ONRR which could take years.

In industry workshops, participants were concerned that ONRR could also impose civil penalties for erroneous reporting. (See 70 Fed. Reg. at 28,862. May 20, 2014). Therefore, WFA could be penalized for simply being unable to comply with the 2017 Coal Valuation Rule.

RECOMMENDATION:

WFA recommends repeal of the 2017 Valuation Rule in its entirety and requests that the status quo rules be maintained. The status quo rules prescribe use of the well accepted benchmark methodology for NAL and affiliated sales. This includes supplying all contracts (arm's length and NAL) and cost plus determinations. In fact, under the benchmark regulation method, our coal is often valued, during the audit process, as having a higher value than the comparable index value of similar quality coal. Hence, while the 2017 Valuation Rule is pending repeal, the public will continue to receive arguably more than fair value on royalties from our NAL coal sales.

SUMMARY:

For the reasons stated above and the reasons set forth in our previous comments, WFA asserts that the 2017 Valuation Rule is confusing and unworkable to the point of being arbitrary, capricious and contrary to the law. As an aside, please note that the rules in effect prior to the 2017 Valuation Rule were considered by the State of Wyoming auditors and industry to be fair and reasonable and resulted in royalty payments that are at or above fair market value. There was and is no need for the 2017 Valuation Rule. Repeal is recommended.

Repealing this rule would meet all the goals stated in the notice at 82 FR 16323-16325, namely:

a) Repeal would preserve the status quo while ONRR reconsiders whether revisions to the previously existing rule were appropriate or necessary;
b) Repeal would avoid the costs to both government and industry of converting to a controversial new royalty reporting and payment system while reconsideration takes place;
c) Repeal would eliminate the need for continued and uncertain litigation over the validity of the 2017 Valuation Rule; and

d) Repeal would enhance the lessees' ability to timely and accurately report and pay royalties because we would continue to use a well-known system that has been in place for decades.

Thank you for this opportunity to comment. Please contact me at (307) 682-8051 if you have any questions regarding these comments.

Sincerely,

E Goodnough

Beth Goodnough
Manager, Regulatory Affairs