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**Submitted via [www.regulations.gov](http://www.regulations.gov)**

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Denver, Colorado 80225

**RE: Comments on Proposed ONRR Rule: Repeal of Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 82 Fed. Reg. 16,323  
Regulation Identifier Number: 1012-AA20**

Dear Mr. Southall:

The People of California, by and through Attorney General Xavier Becerra,<sup>1</sup> and the State of New Mexico, by and through Attorney General Hector Balderas, submit these comments opposing the Office of Natural Resource Revenue's (ONRR's) proposed "Repeal of Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform," 82 Fed. Reg. 16,323 (Apr. 4, 2017).<sup>2</sup> The Valuation Rule provides a reasonable and much needed update to outdated regulations, and serves the interests of our states by ensuring a fair return on royalties from public resources. Repealing the Rule as proposed is without legal justification under long-standing legal precedent. ONRR has failed to generate any data or other reasoned analysis supporting the proposed repeal, and the proposed action is improper on that basis alone. Further, ONRR's proposed action is erroneously based on the false premise that repeal of the Rule would maintain the status quo.

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<sup>1</sup> The California Attorney General submits these comments pursuant to his independent power and duty to protect the environment and natural resources of the State. See Cal. Const., art. V, § 13; Gov. Code, §§ 12511, 12600-12612; *D'Amico. v. Bd. of Medical Examiners* (1974) 11 Cal.3d 1, 1415.

<sup>2</sup> The rule proposed to be repealed will be referred to in this letter as the Valuation Rule.

### The Valuation Rule is Supported by an Extensive Rule-Making Record

The Valuation Rule reforms ONRR's badly outdated and extensively criticized procedure for calculating royalties on oil, gas, and coal extracted from federal lands. 81 Fed. Reg. 43,338 (July 1, 2016). Specifically, the Rule was adopted to address the Department of Interior's (DOI's) Royalty Policy Committee's 2007 recommendation that ONRR clarify and revise its regulations governing calculation of royalties, with particular attention to non-arm's-length transactions. 80 Fed. Reg. 608 (Jan. 6, 2015). In addition, in 2012, a Reuters investigation uncovered a loophole in the preexisting regulations that allowed coal companies to deprive taxpayers of royalty payments by calculating the value of coal on the domestic market and then selling it on the export market for a much higher price.<sup>3</sup> Soon after, two ranking members of the Senate Energy and Natural Resources Committee wrote to DOI expressing Congress' concern that "taxpayers [were] missing out on millions of dollars in royalties."<sup>4</sup> In response, DOI instructed ONRR to conduct an internal audit, while acknowledging that "[t]he issues surrounding Federal coal export sales underscore why royalty valuation reform is necessary and presents an opportunity for the Department to pursue broader royalty reforms."<sup>5</sup>

These various investigations revealed that the preexisting regulations governing the valuation of federally-owned natural resources, largely dating back to the 1980s, failed to account for dramatic changes that have occurred in the industry and marketplace for these minerals. 80 Fed. Reg. at 608. As a result, taxpayers have received inadequate returns from the extraction of domestic energy resources. *Id.* In addition, the preexisting rules inflated profits of coal producers by enabling them to sell coal to affiliated companies at artificially low prices, thus minimizing the amount owed in royalties. 81 Fed. Reg. at 43,339. Exploitation of this loophole caused the volume of coal sold from producers to their affiliates to increase substantially over the past decade.<sup>6</sup>

The Valuation Rule updated ONRR's valuation methodology by replacing a complicated and opaque benchmark system with a calculation based on the price of the first arm's-length transaction sale (meaning the first sale that is not to an affiliated company). 81 Fed. Reg. at 43,339. The DOI stated that the proposed changes would "ensure proper royalty valuation by

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<sup>3</sup> Patrick Rucker, *Asia Coal Export Boom Brings No Bonus for U.S. Taxpayers*, Reuters (Dec. 4, 2012).

<sup>4</sup> Senators Ron Wyden and Lisa A. Murkowski, Letter to Ken Salazar, Former Secretary, Department of the Interior (Jan. 3, 2013).

<sup>5</sup> Ken Salazar, Former Secretary, Department of the Interior, Letter to Senator Ron Wyden (Feb. 7, 2013) ("DOI Response Letter").

<sup>6</sup> The amount of coal used by producing companies or sold to affiliated or parent companies grew from 102,377 to 234,299 thousand short tons between 2004 and 2015. Compare Energy Information Administration, *Annual Coal Report: 2015* at 14 (2016) with Energy Information Administration, *Annual Coal Report: 2004* at 21 (2005).

creating a more transparent royalty calculation method that is more market oriented and less burdensome to both industry and the Government.”<sup>7</sup>

Before adopting the Rule, ONRR engaged in a five-year rulemaking process which included stakeholder outreach in the form of six public workshops and an extended 120-day comment period. 81 Fed. Reg. at 43,338. During that period, more than 300 individuals and organizations submitted over 1,000 pages of written comments.<sup>8</sup> *Id.*

### The Proposed Repeal is Not Legally Justified

In contrast to the detailed rulemaking procedure undertaken to adopt the carefully-crafted Valuation Rule, ONRR now proposes to completely undo it after only a one-month comment period. 82 Fed. Reg. at 16,323. ONRR has provided no basis for such a drastic change of course, however. ONRR’s notice claims only that the proposed repeal is justified because the Rule has been challenged by industry.<sup>9</sup> *Id.* Yet, ONRR admits that all of the industry criticisms of the Rule were brought to its attention “in workshops during the public comment period that preceded the 2017 Valuation Rule’s promulgation,” and does not identify any new information or data that was not available to it when the Rule was finalized. *Id.* Further, ONRR’s claim that the proposed repeal was developed consistent with the requirements in Executive Orders 12866 and 13563 (regarding the use of the best available science and the necessity of a rulemaking process allowing for public participation and an open exchange of ideas) has no merit because ONRR has not cited any new scientific or technical information in support of repeal or identified any deficiencies in the lengthy public process that led to the adoption of the Rule. *Id.* at 16,234. Accordingly, because ONRR has failed to identify a reasoned basis to repeal the Rule, its change of course is arbitrary and capricious under well-established legal precedent. *See Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983).

Further, ONRR is incorrect when it states that repealing the Valuation Rule would “maintain the current regulatory status quo.” 82 Fed. Reg. at 16,323. ONRR finalized the Valuation Rule on July 1, 2016, and after allowing lessees sufficient lead time to update their accounting systems, it went into effect on January 1, 2017. 81 Fed. Reg. at 43,338, 43,360, note 2. Thus, the Rule was final and in effect on February 27, 2017 when ONRR “postponed” it

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<sup>7</sup> DOI Response Letter, *supra* note 5, at 1.

<sup>8</sup> The California State Controller’s Office submitted comments acknowledging “the impact of ONRR’s proposals for gas valuation on California’s revenue interests” and “applaud[ing] its effort to pursue some long-overdue reforms.” Lee Ellen Helfrich, Counsel to California State Controller’s Office, Letter to Armand Southall Re: 80 Fed. Reg. 608 at 1 (May 5, 2015).

<sup>9</sup> In December 2016, industry groups filed three separate petitions challenging the Valuation Rule in the United States District Court for the District of Wyoming, alleging that certain provisions of the Rule are arbitrary, capricious, and contrary to the law. *Id.* The validity of these contentions, however, remains untested, as the all three court challenges were stayed prior to briefing on the merits.

without notice and comment. 82 Fed. Reg. 11,823 (Feb. 27, 2017) (Postponement of Effectiveness of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform 2017 Valuation Rule). Although ONRR cited section 705 of the Administrative Procedure Act (APA) as legal justification for the “postponement,” section 705—which allows an agency to “postpone the effective date of action” pending judicial review—does not apply to rules that have already gone into effect. *Safety-Kleen Corp. v. Environmental Protection Agency*, 1996 U.S. App. LEXIS 2324 (D.C. Cir. 1996). Contrary to ONRR’s assertions, the “current regulatory status quo” requires federal oil, gas, and coal lessees to calculate and report royalties according to the new Valuation Rule.

### The Proposed Repeal Harms States’ Interests

Repealing the Valuation Rule would cause economic harm to California and New Mexico, as well as other states, by eliminating an estimated \$18 million in additional annual royalties that states would gain as a result of the Rule. 81 Fed. Reg. at 43,367. Since 2008, California has received an average of \$82.5 million annually in royalties from federal mineral extraction within the state. New Mexico has received an annual average of \$470 million in royalties during the same time period. California and New Mexico receive roughly four percent and 27 percent, respectively, of the royalties that go to the states. Reverting back to the old, flawed system would deprive taxpayers in California and New Mexico of much needed revenue that is largely spent to support the states’ schools.

Over the past decade, federal coal leases have produced over 4 billion tons of coal from 306 leases encompassing over 475,000 acres in 10 states.<sup>10</sup> Perpetuating rules that undervalue this natural resource enriches the coal industry at the expense of the American public. In addition, coal is a fossil fuel that contributes heavily to climate change that threatens the health and well-being of California’s and New Mexico’s citizens. *See Massachusetts v. EPA*, 549 U.S. 497, 521 (2007). Rules that skew the value of coal create an unlevel playing field that undermines efforts to curb harmful greenhouse gas emissions and delays the necessary transition to a clean fuel economy. As the “statutory guardian of the public interest,” the Secretary of the Interior has a responsibility to ensure that these federal resources are not undervalued in a manner that harms the American people. *California Co. v. Udall*, 296 F.2d 384, 388 (D.C. Cir. 1961).

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<sup>10</sup> BLM, Federal Coal Program: Programmatic Environmental Impact Statement, Scoping Report at ES-1 (Jan. 2017) *available at* [https://eplanning.blm.gov/epl-front-office/projects/nepa/65353/95106/115023/CoalPEIS\\_RptsScoping\\_Vol1\\_508.pdf](https://eplanning.blm.gov/epl-front-office/projects/nepa/65353/95106/115023/CoalPEIS_RptsScoping_Vol1_508.pdf).

For all of these reasons, the California and New Mexico Attorneys General strongly oppose the repeal of the Valuation Rule. Thank you for your consideration of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Mary S. Tharin", enclosed in a thin black rectangular border.

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