

Western Organization of Resource Councils

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May 4, 2017

Delivered via regulations.gov
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Re: Comments to Repeal of Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, Docket No. ONRR-2017-0001 and Comments to ANPRM Federal Oil & Gas and Federal & Indian Coal Valuation Reform, Docket No. ONRR-2017-0002

Dear Mr. Southall:

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 proposed rule (hereafter “repeal”) proposed by the Department of the Interior’s (DOI) Office of Natural Resource Revenue (ONRR) to repeal a previous rule (hereafter “valuation rule”) that reformed federal coal royalty valuation, and on the Advanced Notice of Proposed Rulemaking (hereafter “ANPRM”) for reforms to federal oil & gas and federal and Indian coal valuation rules.

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 one of 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.

We thank ONRR for the opportunity to comment on the repeal of the 2017 Valuation Rule and the ANPRM. Prior to the reforms made last summer, ONRR's rules had not been updated since ... We commend the Royalty Policy Committee for identifying the need to update ONRR's current rules back in 2007 during the Bush Administration, 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.

ONRR's reforms approved last summer were the result of a multi-year rulemaking process and, as discussed below, were based on strong technical grounds, an exhaustive evaluation of industry concerns, and hundreds of thousands of public comments supportive of the rule.

We believe that the proposed repeal of the valuation rule and the ANPRM are unwarranted actions. If it is ONRR's goal to provide a fair return to taxpayers for the use of

federal coal, then ONRR should implement the reforms laid out in the valuation rule, not repeal them. Disallowing royalty valuation on non-arm's length sales will ensure that ONRR is collecting royalties on the full market price of federal coal, realizing the true value for states, tribes, and taxpayers who are entitled to a fair return. This is particularly true and particularly relevant as coal companies seek to expand exports to foreign markets, which are generally more lucrative than the domestic coal market.

I. Problems with ONRR's Repeal and ANPRM Actions

We do not support ONRR's proposed action to repeal the valuation rule and initiate a new rulemaking to address federal mineral royalty reform. The valuation rule was written to address problems with the federal mineral royalty collection system, including but not limited to royalty calculation on non-arm's length transactions preceding more lucrative export sales. By repealing the valuation rule, ONRR fails to address those problems and fails to secure a fair return for federal coal development.

We are concerned that ONRR has initiated these actions with a predetermined outcome. While we thank ONRR for the opportunity to comment on the agency's intent to repeal the rule, we are skeptical that the agency is open to considering any alternative action as a result of public input. This concern is underscored by ONRR's rush to initiate a short comment period with no warning and no outreach to stakeholders. The valuation rule was written after years of consideration and cooperation and its draft received over 200,000 supportive comments. In contrast, ONRR rushed to announce an impromptu 30-day comment period on the repeal, with apparent unwillingness to extend the comment periods for either proposed action, despite requests for extension from non-profit organizations, the American Petroleum Institute and Council of Petroleum Accountants Societies, Senate Energy and Natural Resources Ranking Member Maria Cantwell, and the Independent Petroleum Association of America.

As the original rule became effective January 1, 2017,¹ to repeal it, ONRR must fully comply with the APA's rulemaking requirements. To comply with the APA's requirements, ONRR must enter into this comment period with an open mind and adequately respond to all comments offered.

II. 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.² Selling coal is a proprietary function of the federal government, not a sovereign act,

¹ We also have concerns about the agency's action to "stay" the effectiveness of the rule and agree with the legal claims raised by California and New Mexico that ONRR's actions post January 1st have been unlawful.

² 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.

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.³ 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.⁴

State budgets in Wyoming, Montana, and other Western states are shrinking and it is critical that ONRR's rules work in a way to achieve the desired objective of obtaining the full royalty for all federal coal leased, mined, and sold.

III. The Need for Coal Royalty Valuation Reform

Prior to publication of the valuation rule in July 2016, ONRR's coal royalty valuation rules had been in effect since 1989. Since this time, the coal industry and coal markets have changed drastically in a variety of ways, including:

- In 1990, coal accounted for 55 percent of U.S. power generation. By 2016, coal's contribution had shrunk to 30.4 percent.⁵
- 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 728 million tons in 2013.⁶
- 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 1990.⁷ The Powder River Basin holds nearly 60 percent of federal coal reserves and accounted for 86 percent of federal coal production in 2013.⁸
- 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

³ 30 U.S.C. § 207(a).

⁴ Office of Natural Resource Revenue. Statistical Information. Accessed May 8, 2015. Accessible at: <http://statistics.onrr.gov/ReportTool.aspx>.

⁵ U.S. Energy Information Administration. "Frequently Asked Questions." Accessed May 2, 2017. Accessible at: <https://www.eia.gov/tools/faqs/faq.php?id=427&t=3>.

⁶ U.S. Energy Information Administration. "Monthly Energy Review." April 25, 2017. Accessible at: https://www.eia.gov/totalenergy/data/monthly/pdf/sec6_3.pdf.

⁷ U.S. Energy Information Administration. "Historical detailed coal production data (1983-2013)." Accessible at: <http://www.eia.gov/coal/data.cfm#production>.

⁸ 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>.

in 2013.⁹ A proposed export terminal in Washington contemplates 44 million tons of new export capacity annually for Western coal.¹⁰

- 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.¹¹ The majority of the coal produced in each of these states is federal coal.¹²

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-arm's length sales of Wyoming coal to companies related to mine owners – an insignificant factor in 1989 when royalty evaluation rules were enacted – have risen rapidly from four percent in 2004 to 42 percent in 2014.¹³ One hundred percent of coal exported from Montana in 2013, or 12.1 million tons, was sold via a broker or trader intermediary.¹⁴

IV. Federal Coal Exports are Increasing

Today, U.S. thermal coal exports seem unlikely to increase to levels that some in the industry had hoped and planned for. However, exports remain a significant element of the market for federal coal, and tend to account for an outsized portion of federal coal's value. Exports have increased recently, and are expected by some in the industry to increase further. According to Axios, Cloud Peak Energy CEO Colin Marshall is "hoping to do a record amount of coal exports" this year, and projected that Cloud Peak would export up to 5 million tons of coal from the Powder River Basin in 2017.¹⁵ Other coal producers, such as Bowie, export federal coal and have plans to increase exports.

Clark Williams-Derry of the Sightline Institute points out in his 2014 report *Unfair Market Value* that Interior's continued ignorance of increasing exports of federal coal is costing American taxpayers millions of dollars each year. Williams-Derry writes:

The evidence is irrefutable. Coal companies operating in the western United States ship significant volumes of federally owned coal to overseas customers. Exporting coal to customers in Asia and Europe can often yield higher profits than coal companies can realize from selling the same coal in domestic markets. And in many cases, coal

⁹ 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/>.

¹⁰ Washington Department of Ecology. "Millennium Bulk Terminals Longview (MBTL) proposal." Accessed May 2, 2017. <http://www.ecy.wa.gov/geographic/millennium/index.html>

¹¹ U.S. Energy Information Administration. "Annual Coal Distribution Report." December 19, 2013. Accessible at: <http://www.eia.gov/coal/distribution/annual/archive.cfm>.

¹² 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>.

¹³ 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.

¹⁴ 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>.

¹⁵ Harder, Amy. "Coal CEO Eyes Record Exports." Axios. April 14, 2017. Accessed May 2, 2017. <https://www.axios.com/coal-ceo-eyes-record-exports-2359673063.html>

companies have clearly stated that are pursuing specific federal coal leases as part of a detailed strategy to boost overseas coal sales.¹⁶

Despite this evidence, both the Bureau of Land Management and the Office of Natural Resources Revenue continue to ignore the export market and, in so doing, fail to achieve a fair market value from federal coal. An easy first step in remedying this problem is for ONRR to retain the 2017 valuation rule, which ensures that federal coal royalties are collected based on the true profits of federal coal, not based on a deflated non-arm's length transaction.

While some coal producers are not betting their businesses on exports, the reality is that coal exports are a non-negligible portion of the market for federal coal and have outsized influence for some producers, and federal coal royalty policy should be structured to realize the true value that coal exports represent. By repealing the valuation rule and returning to the status quo pre-existing regulations, ONRR is knowingly failing to realize this value.

V. ONRR's 2017 Valuation Rule is Necessary

The *Federal Register* notice for this docket states, "Repeal of the 2017 Valuation Rule would maintain the current regulatory status quo by keeping the longstanding pre-existing regulations in effect." The 2017 Valuation Rule was written and published because pre-existing regulations failed to sufficiently capture the value of federal mineral royalties. By repealing the valuation rule and reinstating the status quo, ONRR is knowingly returning to a set of rules that fail to accomplish the agency's objective -- to provide a fair return to the public.

Prior to publishing the 2017 valuation rule, ONRR's rules required companies to follow benchmarks when selling to an affiliated company. The benchmarks allowed royalties to be calculated 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 royalty payments 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.

¹⁶ Williams-Derry, Clark. *Unfair Market Value: by Ignoring Exports, BLM Underprices Federal Coal*. Sightline Institute. July 2014. Accessible at: http://www.sightline.org/research_item/unfair-market-value/.

According to a 2012 Reuters report,¹⁷ payment of royalties based on the full value of exported coal would have yielded \$40 million more in 2011 alone; losses would have been billions of dollars per year if coal companies shipped 150 million tons of coal per year out of the Pacific Northwest, as was then proposed. The Reuters report led to a bipartisan investigation from the Senate Energy Committee and additional information from the Department of Interior's Office of Inspector General that shed light on the scope of the problem.

The 2017 valuation rule addressed this gaping loophole and simplified the royalty valuation system, requiring coal companies to calculate royalties based on the first true arm's length transaction. The valuation rule also would have allowed ONRR to substitute its own valuation method if it was dissatisfied with a coal company's valuation.

If allowed to be implemented, the 2017 valuation rule will result in royalty payments on non-arm's length sales that are based on market value and will eliminate the loophole that allows coal companies to use non-arm's length sales to minimize royalty payments, particularly for exported coal. It is important to have mechanisms in place to fully compensate the public for the rising value of publicly-owned coal if export markets continue to grow. We strongly support the 2017 valuation rule and urge ONRR to immediately abandon its proposal to repeal the rule.

Headwaters Economics found that royalty collections from 2008 – 2012 would have been \$850 million higher, an average of \$170 million per year, had coal royalty valuation been based on net market prices as ONRR intended in the 2017 valuation rule.¹⁸ This increase in royalty revenue comes from fair and accurate calculation of the profits that coal companies receive from mining and selling a nonrenewable public resource. Repealing the valuation rule and returning to the status quo would amount to a coal industry subsidy worth billions of dollars over time. We urge ONRR not to repeal this important rule.

VI. Recommendations for the ANPRM for Federal Oil and Gas and Federal and Indian Coal Valuation, Docket No. ONRR-2017-0002

In addition to its intention to repeal the Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation rule, ONRR issued an Advanced Notice of Proposed Rulemaking (ANPRM) for revisions to how ONRR calculates royalty payments for federal oil and gas and federal and Indian coal. Our recommendations include the following:

1. *Instead of repealing, implement the 2017 Valuation Rule.* The 2017 valuation rule created a clear and simple process by which companies that profit from federal minerals can report their profits and accurately pay what they owe in federal royalties.
2. *Base all federal coal royalty calculations on non-arm's length transactions.* ONRR should ensure that royalties are calculated on profits earned from the true market price of coal, not

¹⁷ Rucker, Patrick, "Asian coal export boom brings no bonus for U.S. taxpayers." Reuters. December 4, 2012.

¹⁸ Haggerty, Mark and Haggerty, Julia. "An Assessment of U.S. Federal Coal Royalties." Headwaters Economics. January 2015.

from sales to affiliated companies. The simplest way to do this is to calculate royalties on the first non-arm's length transaction after mining federal coal.

3. *In the absence of non-arm's length transactions, base royalty calculations on an index of comparable arm's length sales.* The index and comparisons should account for similarities or differences in market price of electricity, heat content, and coal quality.
4. *Clearly define and limit transportation deductions.* Because virtually all federal coal is currently sold or valued at the mine mouth, transportation deductions are seldom claimed.¹⁹ If ONRR requires royalty valuation at non-arm's length transactions, more valuations sales are likely to take place off-lease, more companies will claim transportation deductions. ONRR should take steps to ensure accountable reporting of transportation costs and limit transportation deductions in order to prevent them from becoming an entirely new royalty payment loophole.
5. *Base transportation deductions on a reasonableness standard.* Under the status quo pre-existing regulations, coal companies can deduct unlimited transportation and washing costs from the sale price before calculating royalties.
6. *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.
7. *Eliminate washing and beneficiation deductions.* Similar to blasting, dragging, and hauling to the tipple, washing is a cost of producing and marketing coal and a part of its 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,²⁰ 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.

VII. 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 ask 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.

¹⁹ Ibid.

²⁰ Ibid.

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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