



**STATE OF WYOMING**  
**DEPARTMENT OF AUDIT**

**Matthew H. Mead**  
Governor

**Michael Geesey**  
Director

(307) 777-6605  
Fax (307) 777-5341  
Email:  
michael.geesey@wyo.gov

**DIRECTOR'S OFFICE**

July 26, 2011

Hyla Hurst  
Regulatory Specialist  
Office of Natural Resources Revenue  
P.O. Box 25165, MS 610C  
Denver, Colorado 80225

Re: Regulation Identifier Number 1012-AA00 Federal and Indian Coal Valuation

Dear Hyla Hurst:

Thank you for the opportunity to comment on the Office of Natural Resources Revenue's (ONRR) advanced notice of proposed rulemaking before proposing change to the existing regulations governing the valuation of coal produced from Federal and Indian leases, for royalty purposes. Please find listed below our comments on each issue.

**Comments and recommendations on**

**A. Alternative Valuation Methods**

**What alternative to gross proceeds would you recommend?**

Wyoming recommends not changing the regulations when it comes to valuing coal under an arms-length transaction. We take issue with the ONRR position that it is burdensome to analyze sales, transportation, and processing transactions each month. With the use of electronic media, it is actually becoming easier to obtain, analyze, and draw conclusions from this information.

The only way to ensure revenue neutrality in any of these scenarios is by analyzing sales, transportation, and processing transactions each month and making the comparison.

**Would a dollars-per-energy content unit (e.g., dollars-per-million British thermal units(\$/MMBtu)) or dollars-per-weight unit (e.g., \$/ton) valuation method be reasonable? If so, how should such a value be established?**

No, to ensure fair value would require adjustments based on the markets. So why not just continue to use market value or gross proceeds, as reflected in the arm's length contract prices.

**Should such “fixed” royalty values be revised from time to time? If so, on what basis, and at what time or on what occasions?**

Wyoming would like to make it clear that royalty values should be revised **if** the current method for valuing coal is changed to the use of ‘fixed’ royalty values, then definitely, there should be, at minimum, monthly adjustments. Without these adjustments there is no way revenue neutrality could be ensured.

For example in a declining price market environment the producers will be upset that the “fixed” royalty value over reflects the value of the coal, due to the market value of the coal becoming less while the “fixed” value that producers pay royalty on remains unchanged and does not reflect the decrease in price or royalty value of the coal, at least without adjustments. Then in a rising-price market environment the “fixed” royalty value would not be in the public’s best interest. Because it would under reflect royalty value as prices for the coal increases, while royalties would continue to be paid on the lower “fixed” price and not the new higher prices. In the long run, prices are more likely to rise than fall and thus more likely to be detrimental to the public’s interest, if this method is used without adjustments.

Again, these adjustments will be based on market prices, so why not just use market prices.

**Are there published index prices that accurately reflect the actual market value of coal? If so, what are those index prices and to what areas of the country or to what types of coal do they apply?**

Yes, in the Powder River Basin index prices, in conjunction with quality adjustments, do appear to reflect the market value of the coal. Recently, it is not uncommon for producers to be using index prices in their contracts. These index prices are geographically sensitive, for example the Powder River Basin index prices do not reflect market value for southwest Wyoming, which typically sells for a lot higher prices.

The *Argus Coal Daily* does appear to reflect the market value for the Powder River Basin. However, there is no index price that would reflect fair value for coal produced in the southwest Wyoming area of the country.

**Does the concentration of Federal or Indian production in some areas of the country create any potential problems with relying on index prices in those areas, now or in the future?**

Yes, there are not always index prices that are reflective of certain geographical areas of the country. In some areas there is not as much competition, so prices are higher. In some areas such as southwest Wyoming the price of the coal is based on other indices or factors other than price, such as labor, resulting again in higher prices. Therefore using an index price will result in using a price that is significantly less than the price the producer is receiving for the coal.

## **B. Non-Arm's-Length or No-Contract Situations**

### **Should the current non-arm's-length benchmarks and their current sequential priority be retained? If not, what other methodologies might ONRR use to determine the royalty value of coal not sold at arm's length?**

No, ONRR should not retain the current non-arm's-length benchmarks and their current sequential priority. When it comes to non-arm's-length or no-contract coal sales situations, Wyoming would very much like the regulations to be changed. Some of the current benchmarks are unworkable:

- Benchmark one: Currently, gross proceeds will be accepted as value if the proceeds are comparable to arm's-length sales. The major problem here is that it is extremely difficult to obtain proprietary information on comparable arm's-length sales in the area. Other coal companies and purchasers of coal are under no obligation to provide any such information.
- Benchmark two: Here value is based on prices reported to a public utility commission. Prices that are self-reported are always suspect for their accuracy.
- Benchmark three: Value is based on prices reported to the Energy Information Administration of the Department of Energy. Again, prices that are self-reported are always suspect for their accuracy.
- Benchmark four: Value is based on "other relevant matters"; this includes published spot market prices. This benchmark is too broad to be effectively used with any consistency.
- Benchmark five: A net-back method is used if none of the proceeding benchmarks can be used. Benchmark five should be utilized with input from the states and tribes.

You should not use the same valuation methodology for a **captive mine** as for sales to marketing affiliates. Captive mines' production should be valued on a case-by-case method determined through the valuation determination process with input from the states and tribes.

**Affiliated sales** should be based on the higher of the affiliate resale, or gross proceeds. The regulations should not allow coal producers to create affiliates to reduce the royalties paid.

### **Should factors for determining the comparability of arm's-length contracts to non-arm's-length contracts, at 30 CFR 1206.257(c)(2)(i), be amended, clarified, or removed?**

There is no way a coal producer can follow this regulation, because it requires confidential information from other coal producers in order to attain the factors. The factors are good, but the regulation is not workable.

**Should the royalty value of coal initially sold under non-arms-length conditions be based on the gross proceeds received from the first arm's-length sale of that coal in situations where there is a subsequent arm's-length sale?**

Yes, Wyoming supports changing the definition of the term "lessee" to include the lessee and its affiliates, partners, marketing agents, and trade and export associations, and establish royalty value based on the first sale to a buyer who is not included in the definition of "lessee" and is a bona fide arms-length transaction.

**Should the royalty value of the coal sold under non-arm's-length conditions be based on a published index price? If so, which index and why?**

Considering non-arm's-length transactions are highly susceptible to manipulation, value should be based on the higher of the resale price or index price, if the index price is appropriate. For non-arm's length sales other than a captive mine, an index price, as a floor, would only be appropriate in Wyoming in the Powder River Basin for non-international sales.

Again, the *Argus Coal Daily* does appear to reflect the market value for the Powder River Basin. However, there is no index price that would reflect fair value for coal produced in southwest Wyoming.

We would like to emphasize that index prices should not be applied to a captive mine situation. We also, do not believe arms-length sales should be used to value a captive mine's production. The appropriate methodology should be determined through valuation determination on a case-by-case method with consultation and involvement with the State and tribes.

**Should the royalty value be determined by calculating the cost to produce the coal plus a return on capital investment, if the particular coal is never sold at arm's length, or if sold by a coal cooperative of which the lessee is a member? If so, how should the return of capital investment be calculated?**

Yes for both coal cooperatives and captive mines. Based on the value enhancement of coal, the return of capital investment should be calculated as two times the Standard and Poor's BBB bond rate to approximate a market-based cost of capital. In comments to the Federal oil valuation proposed rule, Federal Register, volume 68, number 161 on page 50094, ONRR's own experts recommended rate higher than just the BBB rate for a market-based cost of capital. In 2003 industry presented studies to support the premise that the BBB bond rate under reflected true costs of capital and that market-based cost of capital should be much higher.

**Are there any other appropriate methods for determining the royalty value of coal consumed without sale or without an arm's-length sale?**

In instances other than a captive mine or cooperatives, we could use the weighted average arm's-length price of the entire mine in question for a 12 month period, when the majority of the sales are arm's-length sales.

## **C. Transportation and Washing Allowances**

### **Can the process of determining appropriate transportation and washing deductions or allowances be simplified? If so, how?**

Just use reasonable actual costs incurred, where appropriate. We do not see a reason to change any of the regulations involving transportation.

The only way to ensure revenue neutrality in any of these scenarios is by looking at actual cost. In order to protect the public's best interest actual cost will need to be looked to ensure revenue neutrality.

### **Should ONRR allow bundled charges for coal transportation or washing?**

No this makes auditing more difficult and producers soon lose the ability to unbundle.

### **Should ONRR set standard cents per ton allowances amounts for washing and transportation in lieu calculating actual costs? If so, how should such fixed allowances be determined; and when, and under what circumstances, should they be changed?**

No, it should be based on reasonable actual costs, where appropriate.

### **Is coal washing an operation necessary to put coal into marketable condition for which no allowance should be permitted?**

Yes, washing is tantamount to treating the coal necessary to remove impurities from the coal.

### **Should transportation allowances be based on yearly averages from one region to another?**

No, just use reasonable actual costs incurred, where appropriate. We do not see a reason to change any of the regulations involving transportation.

The only way to ensure revenue neutrality in any of these scenarios is by looking at actual cost. In order to protect the public's best interest actual cost will need to be looked to ensure revenue neutrality.

### **Should the coal transportation and washing allowances be limited to a maximum percentage in a manner similar to gas transportation and processing allowances?**

Definitely, it should be the same as oil and gas.

## **D. Coal Cooperatives**

**Should the royalty value of coal sold by these cooperatives be determined based on a different method than is used for coal not sold by or through cooperatives due to the unique aspects of these cooperatives? If so, what method(s) would you propose?**

Yes, the royalty value of coal sold by these cooperatives should be determined based on a different method. A valuation determination should be used on a case-by-case basis in consultation and involvement with the State and tribes. The valuation determination may need to consider production costs and return of investment for determining the royalty value of coal sold by these cooperatives.

The only way to ensure revenue neutrality in any of these scenarios is by looking at actual cost. In order to protect the public's best interest actual cost will need to be looked to ensure revenue neutrality.

**Please comment on the use of production costs and return on investment as a possible valuation method.**

We like the use of production costs and return of investment as determined through a valuation determination on a case-by-case method with consultation and involvement with the State and tribes.

## **E. Other Issues**

**Are there general valuation methods that would be appropriate for most or all in situ or surface gasification or liquefaction operations? If so, please describe them.**

The appropriate methodology should be determined through valuation determination on a case-by-case method with consultation and involvement with the State and tribes.

**What other new production methods is industry developing that are likely to be economically viable and used in the near- to medium – term future?**

Coal-to-liquid plants are likely to be taking place here in Wyoming in the future, as well as clean coal technology development.

**Are there any new marketing methods for coal of which ONRR should be aware?**

In the Powder River Basin affiliate sales that are in turn sold on international markets, for example Asian markets. Due to the lack of capacity for transportation to Asian markets, the prices would be higher than the Powder River Basin index price. Transportation constraints in terms of port capacity generates higher than index prices for the Powder River Basin, due to the economic constraints of supply and demand overseas.

**Should the Federal and Indian regulations be combined?**

No Comment.

**Should the Indian coal valuation regulations be modified to eliminate the approval and form-filing requirements for washing and transportation allowances in the current regulations at 30 CFR 1206.458(a) and 1206.461(a)?**

No comment.

**ONRR is also interested in receiving comments on any other alternative coal valuation methodologies.**

No comment.

In conclusion, we appreciate the opportunity to comment on the Office of Natural Resources Revenue's advanced notice of proposed rulemaking governing the valuation of coal produced from Federal and Indian leases.

Sincerely,

\_\_\_\_\_/s/\_\_\_\_\_  
Michael Geesey, Director  
Wyoming Department of Audit

\_\_\_\_\_/s/\_\_\_\_\_  
Steve Dilsaver, Administrator  
Wyoming Department of Audit  
Mineral Audit Division