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May 8, 2015

Armand Southall
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SUBJECT: Comments on Proposed Rulemaking: Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform; 30 CFR Parts 1202 and 1206; Regulation Identifier Number 1012-AA13; Docket Number ONRR-2012-0004

Mr. Southall:

Salt River Project Agricultural Improvement and Power District (SRP) appreciates the opportunity to comment on the proposed rulemaking titled "Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform."[1] As a not-for-profit public power utility, SRP serves more than one million electric customers within the Phoenix metropolitan area. As part of a diversified portfolio of assets, SRP owns, among other assets, 29% of Craig Generating Station Units 1 and 2 located near Craig, CO and 32.1% of Trapper Mining Inc., a coal cooperative owned by 4 of the 5 owners of the Craig Generating Station ("Trapper"). Trapper has operated the Trapper Mine near Craig, Colorado since 1983. In general, SRP supports the comments submitted by Trapper to the proposed rulemaking, a copy of which is attached hereto.

In its proposed rulemaking, the Office of Natural Resources Revenue ("ONRR") has proposed to revise the royalty valuations for coal mined on Federal and Indian lands with the primary stated purpose to "simplify processes and provide early clarity regarding royalties owed" and "reduce industry's cost of compliance."[2] To accomplish this, ONRR has proposed to alter the basis of valuation for those coal sales from affiliated organizations and coal cooperatives using the gross proceeds from the first arm's-length sale of either the coal or the gross energy sales associated with the coal.

[1] Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 80 Fed. Reg. 609, Jan 6, 2015
[2] 80 Fed. Reg., No. 3, Pg. 608

The proposed valuation methodology is fundamentally flawed and introduces significant additional complexity regarding valuation of coal royalties. Jointly-owned electric generating stations, such as Craig Generating Station,[3] often serve the energy needs of multiple regions and markets. Because gross proceeds for each utility will vary substantially, the proposed rulemaking would likely result in significantly different prices for the exact same coal. Such a result would unfairly burden the customers of those utilities who are penalized by resulting higher fuel prices. Further, to determine gross realizations based on energy sales would be virtually impossible. Energy fed into the grid from a specific generating unit does not necessarily get utilized within a given utility's market. Rather, through a series of exchange, trade, and transmission capacity agreements, utilities receive comparable volumes of energy from a regional trading hub. As such, gross realizations based on energy sales from a specific source would be impossible to determine.

Market pricing at the regional trading hub may serve as a viable proxy to specific gross realizations based on energy sales, but regional hub pricing carries market risk – with transactions just as likely to result in a loss or a gain. Such market risk would put royalty valuations at risk, resulting in a negative valuation (ie a credit or check back from ONRR) of royalties. To require royalty valuation on the basis of gross electric proceeds will introduce significant additional steps in the process for determining which facility to dispatch as part of its overall grid operations, increase both the mining and energy industry's compliance costs, and delay the timeframe for royalty valuation rather than providing the early clarity and reduced cost of compliance stated as the objective of this proposed rulemaking.

Under the current requirements for valuation of coal royalties, each mine is required to submit audited financials to validate the reported gross proceeds on which the royalties are based. This process provides ONRR the assurance that the gross proceeds for the coal are appropriate and fully accounted for. ONRR's proposal would require similar provisions for audited financials,[4] but such audit provisions would be meaningless without requiring potentially significant revisions to existing contracts. In most cases (specifically pertaining to jointly-owned generating assets), the entity responsible for payment of royalties would not necessarily have access to audited financials from energy sales that would pertain to the same time period in which royalties would be incurred, thereby adding uncertainty and unnecessary delay to the coal royalty valuation process.[5] Indeed as ONRR stated in this proposed rule, coal royalty valuation will continue to be complex,[6] but ONRR's proposed revisions to both Federal and Indian coal royalty valuations unnecessarily complicates further an already complex process.

Variable revenues associated with energy sales and the expected difficulty for mining

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[3] Craig Generating Station is owned by Tri-State Generation & Transmission, SRP, Xcel Energy, PacifiCorp, and Platte River Power Authority

[4] 80 Fed. Reg., No. 3, Pg. 621, 1206.143

[5] For example, SRP's Fiscal Year runs May 1 through April 30 of the following year. Its financials are audited on a fiscal year basis. Trapper's Fiscal Year runs January 1 through December 31 of the same year. Audited financials from SRP would not correspond and would require significant effort to correlate multiple years of audited financials from SRP.

[6] 80 Fed. Reg., No. 3, Pg. 609

companies to try to determine the appropriate revenues for valuation, combined with the inability for mining companies to meet the audited financial requirements add significant complexity to the process of determining royalties and fail to provide clarity throughout the process. As such, this proposal fails to meet the most significant of ONRR's intended purposes for reforming its coal royalty valuations and ONRR should review other less complex options to value non-arm's length sales. One such method would be to codify the method currently employed at Trapper Mine, wherein an assumed rate of return (previously agreed to by ONRR) is applied on top of the gross realizations to approximate the "market value" of the coal.

As part of its proposed rulemaking, ONRR failed to adequately assess the financial impacts to either the ONRR through royalty revenues or to the mine through substantially increased administrative costs. ONRR has assumed that costs would be effectively zero for this proposed change in coal valuations, but provides no real basis for assuming this cost.[7] If there is no financial benefit to ONRR, then there is little basis or need for revising the methodology used to determine royalties. The same holds true for Indian Coal Royalty valuations – if there is no financial benefit associated with revising the methodology, ONRR should not promulgate such changes.

With respect to creating standardized schedules for transportation and processing allowances,[8] SRP believes that transportation and processing allowances vary widely from site to site. Use of such standard schedules may not appropriately allow for adequate deductions for transportation and/or processing. Often times, transportation opportunities are limited and as such, application of a standard schedule to address such transportation costs may unnecessarily penalize lessees who have no alternatives to otherwise reduce costs associated with transportation of coal.

In addition to the above concerns, SRP does not believe setting a default option for valuing non-arm's length sales of Federal and Indian coal in lieu of electricity sales would be appropriate either. In general, such a default provision would grant the Secretary too much discretion regarding coal valuation. ONRR states it would use such a default provision minimally and always use a "reasonable value of production using market-based transaction data."[9] If the provision would have little to no use, promulgation of such a default value would be premature.

Finally, transactions involving non-arm's length sales often occur where the miner and generator have little to no access to broader markets for coal. The existing transactions for coal without access to the broader coal market would, in most cases, represent the entire market for such coal use. To grant the Secretary of the Interior ("Secretary") the discretion to apply "market-based transaction data" to such transactions ignores the fact that, under similar market-based conditions, such transactions would potentially be unlikely to occur in the first place. Further, giving the Secretary considerable discretion to apply default provisions based on "discretionary

[7] 80 Fed. Reg., No. 3, Pg. 639
[8] 80 Fed. Reg., No. 3, Pg. 609
[9] 80 Fed. Reg., No.3, Pg. 640

factors and any other information" the Secretary, in his/her sole discretion, deems relevant,[10] would introduce significant and unacceptable uncertainty to the valuation of royalties long after the transaction was completed, especially since ONRR clarifies within this proposed rulemaking that any guidance provided by ONRR regarding royalty valuations will be non-binding.[11] Finally, SRP supports ONRR's determination not to change the valuation methodology for arm's length contract sales.

If you have any questions regarding these comments, please contact me at Bobby.Olsen@srpnet.com or by phone at (602) 236-2305.

Thank you,

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Attachments: Trapper Mining Comments RE: Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform

[10] 80 Fed. Reg., No. 3, Pg. 640
[11] 80 Fed. Reg., No. 3, Pg. 649

TRAPPER MINING INC.

May 7, 2015

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(Submitted electronically: http://www.regulations.gov on May 7, 2015)

RE: Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform (ONRR-2012-0004)

Subject: Regulation Identifier Number 1012-AA13.

Dear Mr. Southall:

These comments are submitted on behalf of Trapper Mining Inc. ("TMI"). TMI has operated the Trapper Mine ("Trapper") near Craig, Colorado since 1983. Trapper is located adjacent to the Craig Station Power Plant ("Craig Station") and was designed to serve as a mine-mouth fuel supply for the plant in the early 1970s. During its operation, Trapper has produced coal from four different federal coal leases as well as from other non-federally owned coal properties. Substantially all the coal produced from Trapper was historically sold to the owners of the Craig Station under the Craig Station Fuel Agreement (established on March 1, 1973, and expired on June 30, 2014). More recently, the coal produced at Trapper is sold to the owners of TMI for use at the Craig Station under the terms of the Craig Station Long-Term Coal Supply Agreement established January 1, 2010, and extending through December 31, 2020.

Trapper Mine and Craig Station ownership structure:
There is substantial overlap between the TMI and Craig Station ownership structures. Trapper and the Craig Station are operated as separate and distinct businesses and the percentage of controlling ownership divided amongst the owners varies between the two entities. The four owners of Trapper are also part-owners of the Craig Station where the coal produced at the Trapper Mine is consumed. The four owners consist of an investor-owned utility, a wholesale generation and transmission utility, and two power supply entities that are political subdivisions of states. Their ownership interests in Trapper correspond to their obligations to purchase coal under the Craig Station Long-Term Coal Supply Agreement dated January 1, 2010, and their interests in the electricity produced by Craig Station's units 1 and 2.

Trapper Mining Inc. reorganized corporate structure:
In 1998, TMI reorganized its corporate structure and made the decision to henceforth conduct business as a cooperative. TMI notified the Minerals Management Service ("MMS") (predecessor to ONRR) of this change and proposed certain revisions in its coal valuation methodology approach for royalty calculation purposes. MMS responded on August 12, 1998, acknowledging the change in TMI's corporate organization and accepting the proposed revisions in the coal valuation approach formula with certain specified changes ("MMS Approval Letter"). Approval was given at that time to value Federal coal production consumed under non-arm's-length conditions using a cost of production plus a return on investment component for mine investment. This cost based non-arm's-length valuation procedure reasonably approximates the fuel costs reported by all of the participants (both investor-owned and cooperative electric utilities) to either the public utility commission or their member boards. TMI has abided by these approved valuation formulas since they were established in cooperation with MMS. An audit of TMI's 2011-13 royalty reports and payments by the Colorado Tax Auditing and Compliance Division, dated October 17, 2014, confirms that TMI has been following the approved regulations for reporting and paying federal coal royalties.

Trapper Mining Inc.'s issues with ONRR's proposed royalty valuation:
One of the ONRR's justifications for proposing new Coal Royalty Valuation Rules is that the federal coal "industry and marketplace have changed dramatically." For TMI and the Craig Station, this is not the case. As the 40-year history of the Trapper Mine and coal sales to the owners of the Craig Station demonstrate, no significant change in the market for Trapper Mine's coal, or the terms of its sale to the owners of the Craig Station for electric generation, or the ownership of Trapper itself, has occurred and no change is anticipated. While changes in federal coal sales markets may have occurred elsewhere (i.e. particularly with respect to federal coal sales to non-mine mouth power generators), those changes have not taken place at Trapper nor are they likely to.

TMI recommends that the proposed regulations acknowledge stable market arrangements such as Trapper enjoys and then either grandfather or exempt such arrangements from the strict application of the new regulations in favor of using proven and existing formulas like those found in the MMS Approval Letter. Such grandfathering or exempting clause would most likely fit in proposed rule 1206.258 as a binding, pre-effective date valuation determination.

Throughout the entirety of its operational history all of the coal produced by TMI from Trapper has been delivered by truck to the Craig Station. Following delivery, the coal is fed through a primary crusher and then further processed at Craig Station to produce electricity. None of the coal mined at the Trapper Mine is sold to other buyers. There are no facilities at either Trapper or at the Craig Station to accommodate coal deliveries from Trapper to other power plants or buyers.

Trapper calls attention to its long-term and stable relationship with its buyers (who are also its owners), and the collaborative development of the non-arm's-length rules that have historically been applied to its federal coal sales. Trapper has followed the appropriate rules regarding non-arm's-length sales and reported coal valuations and royalties due accordingly. Those rules also encompass reporting the cost of primary crushing performed at the Craig Station after the coal is delivered.

TMI encourages ONRR to carefully consider the historical context and reasoned development of the existing valuation regulations and to refrain from revising valuation methodologies that have proven to be effective, reliable and logical in their application. The existing methodologies well reflect and account for the historical and current circumstances at Trapper while the newly proposed regulations will be difficult if not impossible to apply in any logical, consistent and accountable fashion.

The most significant concern in the proposed rules is incorporating the new concept of valuing coal for royalty purposes, not as coal, but as electricity. For example, proposed regulations 1206.252(b) and (c) stretch coal royalty valuation calculations far beyond the transactions they were originally intended to address. They attempt to adapt concepts developed for an entirely different industry, the geothermal industry, by incorporating reference to 30 CFR Subpart H as the means to determine generation and transmission deductions from the gross value of electricity sales. They raise the need for extremely complex calculations by the coal buyer/electric generator and its affiliated electricity purchasers who have nothing to do with mining federal coal.

It also appears that an underlying assumption is that these arrangements artificially reduce the price for Trapper coal. During the past several years, TMI has received solicitations to bid on providing coal to the fifth owner of Craig. The fact that TMI did not receive the contract implies that Trapper's price is not the lowest delivered price fuel for the Craig Station. A non-arm's length agreement does not automatically ensure the fuel supply is the cheapest one available.

Whatever marginal royalty income this regulation may generate for the ONRR, it will be far more than offset by the cost of accounting to comply with it. Even ONRR's analysis shows that the marginal revenue would be minimal if not negative. The Cost Analysis at 80 F.R. 633 states that ONRR expects the changes to federal coal royalty valuations to change royalty revenue by plus or minus $1.06 million. The median value is zero. The Cost Analysis at 80 F.R. 639 states that royalties paid on federal coal from coal cooperatives constitute 1-2% of federal coal royalties paid. So, the expected effect of 1206.252(b) and (c) is no change in 1-2% of federal coal royalties.

Rules 1206.252(b) and (c) should not be adopted. They will create additional costs for federal coal producers and their affiliated buyers while producing no marginal revenue for ONRR.

Yours sincerely,

JMattern

James Mattern
President and General Manager