Institute *for*
Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

October 6, 2017

Mr. Vincent Devito, Chairman
Royalty Policy Committee and
Royalty Policy Committee Members
1849 C Street NW MS 5134
Washington, D.C. 20240

Via Electronic Submission: rpc@ios.doi.gov

Dear Chairman Devito and Members of the Royalty Policy Committee:

On behalf of the Institute for Policy Integrity ("Policy Integrity") at New York University School of Law,[1] thank you for the opportunity to provide information and public comment on federal royalty policies, including how to uphold the requirement to "earn fair market value" for the use of public lands and resources. This letter reiterates the comments that I made at the Royalty Policy Committee meeting on October 4, 2017.

The Department of the Interior ("Interior") is required, by statute, to earn "fair market value" for taxpayers for the use and development of federal resources.[2] It must also harmonize resource production with environmental preservation and other values, pursuant to the "multiple use" mandate set out in the Federal Land Policy and Management Act.[3]

How royalties are set and assessed is critical to ensuring receipt of fair market value for taxpayers. Policy Integrity has four main recommendations for your work:

1. Interior should increase federal fossil fuel royalty rates, as multiple studies show that higher royalty rates would increase total revenue for the public;
2. Interior should also consider adjusting royalty rates upward for coal, oil, and natural gas leases to recoup some of the environmental and social costs of production;
3. Interior should reinstate the Coal Valuation Reform Rule, which was projected to deliver up to $78 million in annual net benefits to the public; and

[1] The Institute for Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy. This document does not purport to present New York University School of Law's views, if any.

[2] 43 U.S.C. § 1701(a)(9).

[3] 43 U.S.C. § 1344(a)(3)-(4).

4. Interior should eliminate royalty rate reductions that contribute to inefficiently high levels of production and hinder receipt of fair market value.

In addition, we ask that you continue to engage the public in these important discussions around public lands and resources, and seek broad perspectives, in particular those not represented on the committee.

1. **Interior should increase federal fossil fuel royalty rates, as multiple studies show that higher rates would increase total revenue for the public.**

First, multiple studies show that increasing federal fossil fuel royalty rates would increase revenue for the public. A report by the U.S. Government Accountability Office ("GAO"), published in June 2017, found that, "Raising federal royalty rates—a percentage of the value of production paid to the federal government—for onshore oil, gas, and coal resources could decrease oil, gas, and coal production on federal lands but *increase overall federal revenue*…"[4]

One of the studies that GAO reviewed estimated that raising the federal royalty rate for oil and gas to 16.67 percent, 18.75 percent, or 22.5 percent could increase net federal revenue by $125 million to $939 million over 25 years.[5] And for federal coal, the studies that GAO reviewed suggested that raising the royalty rate to 17 percent or 29 percent could increase federal revenue by up to $365 million per year after 2025.[6]

In fact, the White House Council for Economic Advisors ("CEA"), found that maximizing federal revenue from federal coal leasing would require royalty rates of 304 percent (equal to approximately a $30 per short ton royalty charge on Powder River Basin coal), which

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[4] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, OIL, GAS AND COAL ROYALTIES: RAISING FEDERAL RATES COULD DECREASE PRODUCTION ON FEDERAL LANDS BUT INCREASE FEDERAL REVENUE, GAO-17-540 (Jun 20, 2017), https://www.gao.gov/products/GAO-17-540 [hereinafter, "GAO, OIL, GAS AND COAL ROYALTIES"] (emphasis added).

[5] *Id*. at 22-23. Net federal revenue is the revenue retained by the federal government after approximately half of revenues are returned to the states in which the resources were produced, and after any other disbursements. The oil and gas royalty rate studies that GAO reviewed were: CONGRESSIONAL BUDGET OFFICE, OPTIONS FOR INCREASING FEDERAL INCOME FROM CRUDE OIL AND NATURAL GAS ON FEDERAL LANDS (Washington, D.C.: April 2016), https://www.cbo.gov/publication/51421; ENEGIS, LLC, BENEFIT-COST AND ECONOMIC IMPACT ANALYSIS OF RAISING THE ONSHORE ROYALTY RATES ASSOCIATED WITH NEW FEDERAL OIL AND GAS LEASING (Washington, D.C.: April 2011).

[6] GAO, OIL, GAS AND COAL ROYALTIES, *supra* note 4. The coal royalty rate studies that GAO reviewed were: EXECUTIVE OFFICE OF THE PRESIDENT OF THE UNITED STATES, COUNCIL OF ECONOMIC ADVISERS, THE ECONOMICS OF COAL LEASING ON FEDERAL LANDS: ENSURING A FAIR RETURN TO TAXPAYERS (Washington, D.C.: June 2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160622_cea_coal_leasing.pdf%22%22 [hereinafter, "CEA, ECONOMICS OF COAL LEASING"]; Haggerty, Lawson, and Pearcy, Steam COAL AT AN ARM'S LENGTH: AN EVALUATION OF PROPOSED REFORM OPTIONS FOR U.S. COAL USED IN POWER GENERATION (Working paper, October 2016), https://www.eenews.net/assets/2017/06/21/document_gw_07.pdf.

would curtail some future federal coal production while increasing revenue by $2.7 to $3.1 billion when fully phased-in by 2025.[7]

And independent analysis by the Institute for Policy Integrity at NYU School of Law found that increasing the federal royalty rate to 18.7% for Powder River Basin coal would have earned up to $1.2 billion in additional royalty revenue over five years.[8]

In short, higher royalty rates can lead to more revenue for schools, infrastructure, municipal budgets, and environmental mitigation.

2. **Interior should adjust royalty rates upward for coal, oil, and natural gas leases to recoup some of the environmental and social costs of production.**

Second, Interior should adjust royalty rates upward for coal, oil, and natural gas leases to recoup some of the environmental and social costs of production. Fossil fuel leasing is not all upside. There are real costs—including climate change costs—that should be taken into consideration in managing these programs to earn fair market value and protect environmental values.[9]

Interior, states, and tribes bear many of these costs directly, through fighting wildfires on public lands and dealing with the effects of reduced snowpack that threaten water resources. As just one example, climate change has led to fire seasons that are now on average 78 days longer than in 1970, and an increasing portion of the U.S. Forest Service budget is directed to fighting wildfires on public lands.[10]

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[7] CEA, ECONOMICS OF COAL LEASING, *supra* note 6 at 3, 4, 25. This study also found that the increase in royalty revenues would be "vastly larger than the loss in bonus bid revenue." *Id*. at 25.

[8] Jayni Foley Hein and Peter Howard, *Illuminating the Hidden Costs of Coal*, Institute for Policy Integrity, NYU School of Law at 2 (Dec. 2015), http://policyintegrity.org/files/publications/Hidden_Costs_of_Coal.pdf.

[9] *See id*.; *see also* Spencer Reeder and James H. Stock, FEDERAL COAL LEASING REFORM OPTIONS: EFFECTS ON CO2 EMISSIONS AND ENERGY MARKETS: EXECUTIVE SUMMARY, VULCAN PHILANTHROPIES (Feb. 2016), http://www.vulcan.com/MediaLibraries/Vulcan/Documents/FedCoalLeaseModelResults_ExecutiveSummary_Vulcan_FINAL_16Feb2016.pdf; Jayni Foley Hein, PRIORITIES FOR FEDERAL COAL REFORM, Institute for Policy Integrity, NYU School of Law (June 2016), http://policyintegrity.org/files/publications/Priorities_for_Coal_Reform.pdf; Jayni Foley Hein and Peter Howard, RECONSIDERING COAL'S FAIR MARKET VALUE THE SOCIAL COSTS OF COAL PRODUCTION AND THE NEED FOR FISCAL REFORM, Institute for Policy Integrity, NYU School of Law (Oct. 2015), http://policyintegrity.org/files/publications/Coal_fair_market_value.pdf.

[10] U.S. DEP'T OF AGRICULTURE, THE RISING COST OF WILDFIRE OPERATIONS: EFFECTS ON THE FOREST SERVICE'S NON-FIRE WORK (2015), https://www.fs.fed.us/sites/default/files/2015-Fire-Budget-Report.pdf.

3. **Interior should reinstate the Coal Valuation Reform Rule, which was projected to deliver up to $78 million in annual net benefits to the public.**

Third, Interior should reinstate the Coal Valuation Reform Rule, which was projected to deliver up to $78 million in annual net benefits to the public.[11] This rule was designed to increase transparency, simplify procedures, and ensure that royalties are fairly assessed by using arm's length transaction prices.

The Coal Valuation Reform Rule was the result of five years of study and public participation and was designed "to offer greater simplicity, certainty, clarity, and consistency in product valuation and reporting for mineral lessees."[12]

The Rule sought to accomplish its purpose through two major reforms: first, by closing a loophole that allowed lessees to pay royalties based on the value of the minerals as sold through captive (instead of arm's length) transactions,[13] and second, by allowing for the audit and identification of transportation cost allowances.[14] As we explained in our comments on the proposed repeal, there is no valid basis to repeal the rule; it should therefore be reinstated.[15]

4. **Interior should eliminate royalty rate reductions that contribute to inefficiently high levels of production and hinder receipt of fair market value.**

Fourth, Interior should eliminate royalty rate reductions that contribute to inefficiently high levels of production and hinder receipt of fair market value. Interior should not be in the business of subsidizing uneconomical mining or drilling.

President Trump has indicated his intention to run the United States more like a business, but a well-run business would not give away its assets for a fraction of their true value or allow outside actors to impose uncompensated costs on its bottom line. Public resources belong to all taxpayers, not to private developers. And public lands must be managed for the benefit of current and future generations.

Sincerely,

Jayni Foley Hein
Policy Director, Institute for Policy Integrity, NYU School of Law

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[11] Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform; Final Rule, 81 Fed. Reg. 43338, 43338 (July 1, 2016).

[12] *Id.*

[13] *See, e.g.*, 81 Fed. Reg. at 43346 (gas), 43354-55 (coal).

[14] 81 Fed. Reg. at 43352-53 (oil); *id.* at 43344-445 (gas).

[15] INSTITUTE FOR POLICY INTEGRITY, NYU SCHOOL OF LAW, Comment Letter on Proposed Repeal (May 4, 2017), http://policyintegrity.org/documents/Policy_Integrity_Comments_on_Coal_Oil_Gas_Valuation_ANPR.pdf.