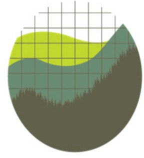

Institute *for* Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

Union of Concerned Scientists

March 15, 2021

To: Office of Natural Resources Revenue, Department of the Interior

Submitted By: Institute for Policy Integrity at New York University School of Law, Montana Environmental Information Center, Sierra Club, Union of Concerned Scientists

Subject: Comments on "ONRR 2020 Valuation Reform and Civil Penalty Rule: Delay of Effective Date; Request for Public Comment," 86 Fed. Reg. 9286 (Feb. 12, 2021)

The undersigned organizations respectfully submit the following comments to the Office of Natural Resources Revenue ("ONRR") in response to its rule, "ONRR 2020 Valuation Reform and Civil Penalty Rule: Delay of Effective Date; Request for Public Comment," 86 Fed. Reg. 9286 (Feb. 12, 2021), and the public comments requested therein.[1] In that rulemaking, ONRR delays the effective date of its previously-finalized "ONRR 2020 Valuation Reform and Civil Penalty Rule," 86 Fed. Reg. 4612 (Jan. 15, 2021) ("2020 Rule"). ONRR also seeks public comment on ten questions involving the legality and impact of the 2020 Rule, the prospects of further delaying that rule, and how Interior should consider greenhouse gas emissions in setting royalty and revenue-management policy.

These comments focus primarily on the latter issue, offering a detailed response to ONRR's fourth question: "Should the Department of the Interior … consider science on the source and impacts of climate change in setting royalty and revenue management policy?" Our answer is an emphatic yes. As explained below, changes in the royalty rate or calculation inevitably affect greenhouse gas emissions, as they alter the incentives of energy producers and thereby affect decisions about whether and how much those producers will invest in energy exploration. Both Interior's statutory mandates to steward public lands for the public interest and the Administrative Procedure Act's requirements to assess regulatory impacts and promulgate regulations that benefit society require consideration of those greenhouse gas effects.

The best method for Interior to consider and assess greenhouse gas impacts when setting royalty and revenue-management policy is to set royalty rates such that producers fully internalize the climate damages that their exploration causes. The social cost of greenhouse gases methodology, which provides a rigorous and easy-to-apply tool to assess the economic damages from an incremental unit of greenhouse gas emissions, allows Interior to do exactly that. Raising royalty rates to account for the costs of climate change will both help ensure a fair return to

[1] Our organizations may separately and independently submit other comments to this docket. This document does not purport to represent the views, if any, of New York University School of Law.

taxpayers and will result in significant social and environmental benefits by rationally shifting planet-warming fossil-fuel exploration to more eco-friendly energy sources. Thus, we urge Interior to incorporate the social cost of greenhouse gases into royalty rates as part of the comprehensive review of the federal oil and gas program called for in Executive Order 14,008.

These comments also provide brief responses to some of ONRR's other questions. As explained in those responses (and the attached regulatory comments previously submitted in response to ONRR's proposal for the 2020 Rule), ONRR did not sufficiently consider the social and environmental costs of the 2020 Rule, nor provide sufficient explanations for the policy changes adopted therein. Accordingly, we recommend that ONRR delay, suspend, and/or repeal the 2020 Rule, using procedures consistent with the Administrative Procedure Act, and institute rational royalty reforms.

I . Response to Question 4

In Question 4, ONRR seeks comment on whether "the Department of the Interior … [should] consider science on the source and impacts of climate change in setting royalty and revenue management policy."[2] Our answer is yes. Resource-management statutes and the Administrative Procedure Act both require the Department of the Interior to consider adverse environmental impacts, including climate-change effects, in setting royalty and revenue-management policy. The best way for Interior to do so is by internalizing the costs of climate change onto fossil-fuel producers by incorporating the social cost of greenhouse gases into the royalty rate.

A. Interior Is Statutorily Required to Consider Climate Costs in Setting Royalty and Revenue-Management Policy

Production of oil, gas, and coal—including prospecting, extraction, transportation, and combustion—contributes enormously to climate change. In fact, U.S. public lands would rank fifth in the world for greenhouse gas emissions if they were their own country.[3] Interior's management of public lands and waters—including whether, and on what terms, to permit fossil-fuel extraction—thus has inherent consequences for climate change and is necessarily a key component of domestic climate policy.

The setting and calculation of royalty rates is an important policy lever that affects prospectors' decisions about when to engage in energy exploration. Because corporations seek to maximize profit, they will engage in exploration and drilling only if they expect it to yield greater revenue than cost. Because the royalty burden is a cost that offsets a producer's expected revenues, it inevitably factors into this determination about whether or not to engage in drilling. A lower royalty burden (either by reducing the royalty rate or through valuation reform such as the 2020 Rule) decreases the cost of drilling and thus encourages exploration by marginally expanding the scenarios in which energy exploration is profitable—a fact that ONRR effectively acknowledged, yet failed to consider when assessing the results of, in the 2020 Rule.[4] A higher

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[2] 86 Fed. Reg. at 9288.

[3] The Wilderness Society, Federal Lands Emissions Accountability Tool, https://www.wilderness.org/articles/article/federal-lands-emissions-accountability-tool.

[4] For instance, the agency claimed that the 2020 Rule—which decreased industry's total royalty burden by a projected $28.9 million annually, 86 Fed. Reg. at 4640—would "promote domestic energy development" by "reducing regulatory burdens so that energy producers, and particularly oil, natural gas, and coal producers, are

royalty burden has the opposite effect. Accordingly, impacts on energy production—and resulting effects on climate change and other environmental and social costs—are inevitable and foreseeable consequences of any royalty or revenue-management regulation.

As detailed below, Interior must consider those impacts under the governing statutes, which require Interior to manage public lands for the public interest and to consider environmental harms in setting royalty and revenue-management policy. The Administrative Procedure Act also requires agencies to consider all regulatory costs and benefits as part of reasoned decisionmaking, further compelling Interior to consider climate impacts when setting royalty rates.

1. Federal Land-Management Statutes Require Interior to Balance Energy Production with Environmental Protection

Three primary statutes set forth the Interior's duties with respect to national energy production and federal land management: the Federal Land Policy and Management Act ("FLPMA") and the Mineral Leasing Act ("MLA") for onshore development, and the Outer Continental Shelf Lands Act ("OCSLA") for offshore development. These statutes articulate Interior's responsibility to balance orderly production of energy on federal lands with environmental preservation and other competing uses.

In accordance with this principle, FLPMA sets forth the policy that "the public lands be managed in a manner that will protect the quality of scientific, scenic, historical, ecological, environmental, air and atmospheric, water resource, and archeological values" and "that, where appropriate, will preserve and protect certain public lands in their natural condition; that will provide food and habitat for fish and wildlife and domestic animals; and that will provide for outdoor recreation and human occupancy and use."[5] FLPMA also requires the government to "receive fair market value of the use of the public lands."[6] The MLA declares it the policy of the federal government to foster the "orderly economic development of domestic mineral resources."[7] The MLA also provides that Interior may issue regulations requiring operators to prevent "undue waste" in oil and gas production.[8] And the MLA requires Interior to "[e]nsure the sale of the production of such leased lands to the United States and to the public at reasonable prices, for the protection of the interests of the United States, … and for the safeguarding of the public welfare."[9] As these statutes demonstrate, Interior must balance environmental concerns against energy production to promote public welfare and ensure a fair return to taxpayers for the use of public lands. Read together, FLPMA and the MLA instruct Interior to harmonize the need

incentivized to produce more energy," *id.* at 4615. Similar statements appear throughout the 2020 Rule. Despite these acknowledgements, however, ONRR's cost-benefit analysis for the 2020 Rule assumed static production and therefore did not evaluate the adverse social and environmental effects of increased energy production, including impacts on climate change.

[5] 43 U.S.C. § 1701(a)(8).

[6] *Id*. § 1701(a)(9).

[7] 30 U.S.C § 21(a).

[8] *Id*. § 187. The legislative history of the Mineral Leasing Act and its subsequent amendments evidences Congress's concern with the waste of oil and gas and its desire for Interior to prevent it. *See Boesche v. Udall*, 373 U.S. 472, 481 (1963) (citing H.R. Rep. No. 398, 66th Cong., 1st Sess. 12-13; H.R. Rep. No. 1138, 65th Cong., 3d Sess. 19.).

[9] 30 U.S.C § 187.

for domestic energy production with long-term environmental protection and stewardship of public lands.

The same balance is required in the context of offshore management. For instance, the congressional statement of policy in OCSLA declares that the Outer Continental Shelf is a vital natural resource held in trust by the federal government for the benefit of the American people.[10] It details Interior's dual mandate to conduct leasing while also protecting the environment and other uses of our nation's waters, including fishing and commercial shipping.[11] Moreover, the statute itself calls for Interior to promote offshore energy development in a manner that "will eliminate or minimize risk of damage to the human, marine, and coastal environments."[12] And OCSLA directs that management of the Outer Continental Shelf be "conducted in a manner which considers economic, social, and environmental values of the renewable and nonrenewable resources contained in the outer continental shelf, and the potential effect of oil and gas exploration on other resource values of the outer continental shelf and the marine, coastal, and human environments."[13] Congress further directed Interior to "select the timing and location of leasing, to the maximum extent practicable, so as to obtain a proper balance between the potential for environmental damage, the potential for the discovery of oil and gas, and the potential for adverse effects on the coastal zone."[14]

Against this statutory background, Interior is required to balance energy production with environmental protection in setting royalty and revenue-management policy. Impacts on climate change fall squarely within this mandate. When agencies exercise their rulemaking authority, as the Supreme Court has explained, they must "consider[] the relevant factors" and "rel[y] on factors which Congress has . . . intended it to consider," and a rulemaking will be struck down as arbitrary and capricious if the agency "failed to consider an important aspect of the problem."[15] For all the reasons detailed above, Interior is statutorily mandated to consider environmental impacts (including effects on climate) in managing public lands, and setting royalty policy has an inevitable and foreseeable effect on climate change. Thus, Interior is statutorily obligated to consider that impact in issuing royalty and revenue-management regulations.[16]

2. Agencies Must Consider Adverse Regulatory Impacts Under the Principles of Reasoned Decisionmaking Embodied in the Administrative Procedure Act

As detailed above, the governing resource-management statutes explicitly require that Interior consider environmental impacts in setting royalty and revenue-management policy. But even if those statutes were silent or themselves insufficient, the Administrative Procedure Act

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[10] 43 U.S.C. § 1332(3).

[11] 43 U.S.C. § 1332(2)–(3).

[12] 43 U.S.C. § 1802(3).

[13] *Id.*

[14] *Id.* § 1344(a)(3).

[15] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

[16] *See, e.g.*, *Gresham v. Azar*, 950 F.3d 93, 102 (D.C. Cir. 2020), *cert. granted* (Dec. 4, 2020) (finding regulation arbitrary and capricious when agency failed to "account for" harms that are "matter[s] of importance under the statute").

requires agencies to consider regulatory impacts and to weigh beneficial against adverse impacts when issuing regulations.

Under the Administrative Procedure Act's standards for reasoned decisionmaking, an agency must consider the costs of a regulation—that is "any disadvantage" resulting from the rule, including "harms that regulation might do to human health or the environment."[17] The purpose of such consideration is so that the agency may assess whether the benefits of a regulation outweigh the costs, another hallmark of "reasoned decisionmaking."[18] Indeed, the Supreme Court explained in *Michigan v. EPA* that "[n]o regulation is 'appropriate' if it does significantly more harm than good."[19] In doing so, the Supreme Court was interpreting a statutory term—"appropriate"—that also appears prominently in FLPMA and OCSLA, clearly indicating that these statutes too require a careful balancing of costs and benefits.[20]

Critically, this requirement to assess the impacts of a regulation extends to factors that are not explicitly outlined in the governing statute (so-called "indirect" effects). In *Michigan*, for instance, the Supreme Court required EPA to consider compliance costs that were not explicitly discussed in the relevant statutory provisions. And courts have consistently held that agencies must consider indirect effects, and have vacated rules as arbitrary and capricious that failed to sufficiently do so.[21] While these cases have normally been in the context of regulatory costs, there is no reason that agencies may treat regulatory benefits any differently.[22]

Executive guidance reflects these principles. For instance, the executive orders governing regulatory review call for agencies to accurately measure the "actual results of regulatory requirements" and explicitly require analysis of both direct and indirect costs and benefits.[23] Likewise, the Office of Management and Budget's *Circular A-4* instructs agencies to "consider any important ancillary benefits and countervailing risks," encompassing both "favorable impact[s] of the rule that [are] typically unrelated or secondary to the statutory purpose of the

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[17] *Michigan v. EPA*, 576 U.S. 743, 752 (2015).

[18] *Id.* at 750 (finding regulation arbitrary and capricious when agency "refused to consider whether the costs of its decision outweighed the benefits").

[19] *Id.* at 752.

[20] *See* 43 U.S.C. § 1701(a)(8) (requiring Interior to manage public lands "in a manner that… where appropriate, will preserve and protect certain public lands in their natural condition [and] that will provide food and habitat for fish and wildlife and domestic animals"); *id.* § 1332(5) (recognizing responsibility of government "where appropriate . . . to preserve and protect the[] marine, human, and coastal environments").

[21] *See, e.g.*, *Am. Trucking Ass'ns v. EPA*, 175 F.3d 1027, 1051–52 (D.C. Cir. 1999) (holding that EPA's consideration must include both the direct and indirect effects of pollutants, rather than only "half of a substance's health effects"), *rev'd on other grounds sub nom. Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457 (2001); *Am. Dental Ass'n v. Martin*, 984 F.2d 823, 826-27 (7th Cir. 1993) (remanding in part an Occupational Safety and Health Administration regulation for failure to consider indirect costs); *Competitive Enterprise Inst. v. Nat'l Highway Traffic Safety Admin*., 956 F.2d 321, 326–27 (D.C. Cir. 1992) (vacating rule after agency failed to consider whether benefits from more fuel-efficient cars outweighed the potential increased safety risks because smaller, more efficient cars might be less protective in a crash); *Corrosion Proof Fittings v. EPA*, 947 F.2d 1201, 1225 (5th Cir. 1991) (holding that EPA must consider the indirect safety effects of substitute options for car brakes when banning asbestos-based brakes under the Toxic Substances Control Act).

[22] *See Bus. Roundtable v. Secs. & Exch. Comm'n*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (holding that agency may not "inconsistently and opportunistically frame[] the costs and benefits of [a] rule").

[23] Exec. Order No. 13,563 § 1, 76 Fed. Reg. 3821, 3821 (Jan. 21, 2011) (affirming Exec. Order No. 12,866); accord. Exec. Order No. 12,866 § 6(a)(3)(C), 58 Fed. Reg. 51,735, 51,741 (Oct. 4, 1993).

rulemaking" and "adverse economic, health, safety, or environmental consequence[s] that occur[] due to a rule and is not already accounted for in the direct cost of the rule."[24] In an Executive Memorandum signed on his first day in office, President Biden reaffirmed his administration's commitments to those prior executive orders on regulatory impact analysis and emphasized the need for regulations to "promote the public interest."[25]

The need for ONRR to consider the environmental and social costs of increased energy extraction is especially pronounced because the agency has touted the alleged benefits of that activity in recent rulemakings. For instance, ONRR touted its belief that the 2020 Rule would promote "energy production, … economic growth, and … job creation" and "ensure[] energy security and economic vitality"[26] (even though the agency contrarily assumed static production when assessing the rule's impacts). But it is bedrock doctrine that agencies may not "inconsistently and opportunistically frame[] the costs and benefits of [a] rule."[27] Because ONRR has considered the alleged economic benefits of energy extraction in promulgating royalty and revenue-management regulations, it must therefore also consider the environmental and social costs.

Accordingly, even if the governing statutes were not explicitly concerned with environmental protection (which they are), then climate change would still be a critical factor in setting royalty and revenue-management policy. Thus, Interior must rationally consider climate-change impacts in setting royalty and revenue-management policy, and the agency should therefore reverse course and consider climate impacts as part of any future rulemaking.

B. Interior Should Increase Royalty Rates to Internalize Climate Externalities

The best way for Interior to fulfill its legal requirement to consider climate impacts in setting royalty policy is to set the royalty rate to incorporate the climate costs of energy production. While hardly the only reform that Interior should pursue to regulate environmentally harmful fossil-fuel extraction as part of its comprehensive review of the federal oil and gas program, adjusting royalty rates to account for the science and economics of climate change will internalize the climate externalities of energy production and thereby help ensure that taxpayers receive a fairer value for such use of public lands.

The climate impacts of drilling are a textbook example of a negative externality. A negative externality is a market failure that results when a cost caused by a producer is not financially borne by that producer. Because energy producers cause harm to the climate (along with other social and environmental harms from drilling) that are borne by the public rather than the producers themselves, those climate harms are a negative externality. Negative externalities are market failures because producers, lacking financial incentive to do so, do not consider the costs that they impose on third parties in making production decisions. Thus, the amount of production that maximizes producer profit exceeds the amount that is optimal from the perspective of society as a whole. Producers are over-incentivized to engage in fossil-fuel

[24] Office of Mgmt. & Budget, *Circular A-4 on Regulatory Analysis* 26 (2003).

[25] Executive Memorandum on Modernizing Regulatory Review § 1 (Jan. 20, 2021).

[26] 86 Fed. Reg. at 4614.

[27] *Bus. Roundtable*, 647 F.3d at 1148–49.

extraction because they do not bear the costs of climate change, resulting in an overreliance on fossil fuels that is causing the planet to warm at an alarming pace.[28]

The market failure of negative externalities can be corrected by "internalizing" the externality—that is, by shifting the external cost from third parties onto the producer. This realigns the producer's incentives with the public interest, since there are no longer external costs and therefore the profit-maximizing approach also maximizes net social benefit. Thus, while producers are currently incentivized to over-invest in fossil-fuel extraction because they bear few of the environmental and climate costs that their production imposes, this market failure can be corrected by internalizing those external costs of production.

Internalizing those costs is well within Interior's statutory authority, as resource-management statutes set floors for royalty rates but give the agency wide latitude to set rates above those minimums.[29] Indeed, as one member of Congress explained before the statute's enactment, the MLA gives Interior "practically unlimited authority as to the granting and the terms and conditions of leases."[30] Despite broad authority to adjust royalty rates, however, Interior has rarely deviated from the minimum statutory rates, causing federal royalty rates to fall well below those imposed by other jurisdictions.[31] Federal royalty rates are also well below the social costs of extraction, imposing an externality on the public and incentivizing producers to take insufficient environmental precaution.[32] These royalties have not been adjusted as the vast costs of climate change have come into focus; in fact, the royalty rate for oil and gas drilling has not been updated since the Woodrow Wilson administration—long before the science behind climate change became established.[33]

Adjusting royalty rates to account for climate impacts would internalize this climate externality and help provide taxpayers with fair value for the use of federal land. This can be

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[28] *See generally, e.g.*, IPCC, AR5 Synthesis Report: Climate Change (2014) (detailing "widespread impacts on human and natural systems" from climate change).

[29] *See* 30 U.S.C. § 226(b)(1)(A) (setting minimum royalty rate of 12.5 percent of onshore oil and gas revenues); *id.* § 207(a) (setting minimum royalty rate of 12.5 percent of surface coal revenues); 43 U.S.C. § 1337 (a)(1) (setting minimum royalty rate of 12.5 percent of offshore oil and gas revenues).

[30] 51 Cong. Rec. H14,954 (Sept. 10, 1914) (statement by Mr. Thomson of Illinois). The House Report for FLPMA also recognized that communities face "onerous" burdens from fossil-fuel exploration, and expressed particular concern for "severe environmental impacts." House Report No. 94-681, 94th Cong., 1975 WL 12515, at 19–20 (July 23, 1975).

[31] For instance, the federal onshore oil and gas royalty rate of 12.5 percent (the statutory minimum) is less than the royalty rate imposed by many states for production of oil and gas on state-owned land. Many states impose royalty rates ranging from 16.67 to 20 percent. CONGRESSIONAL BUDGET OFFICE, *Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands* 9 (2016), https://perma.cc/SEMb7-PNA5. Texas imposes a 25 percent royalty rate. Ctr. for W. Priorities, *Royalties and Public Revenues from Energy Development on American Lands*, http://westernpriorities.org/wp-content/uploads/2015/07/Royalties-Public-Revenues-from-Energy-Development-on-American-Lands.pdf.

[32] *See, e.g.*, Jayni Hein & Peter Howard, Inst. for Pol'y Integrity, *Illuminating the Hidden Cost of Coal* (2015), https://policyintegrity.org/files/publications/CoalCostsSummary.pdf ("Accounting for both methane and transportation externality costs would justify adding 70.1 percent to the current 12.5 percent surface-mine royalty rate . . .. This would justify a new royalty rate of 82.6 percent for federal surface-mined coal.").

[33] Nicole Gentile, Ctr. for Am. Progress, *Federal Oil and Gas Royalty and Revenue Reform* (June 19, 2015), https://cdn.americanprogress.org/wp-content/uploads/2015/06/RevenueOilGas-brief.pdf?_ga=2.139983284.669068681.1615215466-1238915144.1614951824.

accomplished using the social cost of greenhouse gases, which provides an estimate of economic damages due to the emission of an incremental amount of greenhouse gases. The federal Interagency Working on the Social Cost of Greenhouse Gases recently restored its prior valuations of the social costs of carbon dioxide, methane, and nitrous oxide—values that it acknowledges "likely underestimate societal damages from [greenhouse gas] emissions"—and plans to update these values consistent with the latest science and economics by January 2022.[34] Because these estimates represent the damages that society bears from each unit of greenhouse gas emissions, they should be incorporated into royalty rates so that producers internalize those costs and thereby reduce the damage they impose on the public.

Accordingly, in setting future royalty rates, Interior should directly consider and incorporate climate impacts. Though just one of numerous reforms that Interior can implement as part of its comprehensive review of the federal oil and gas program to restore rationality to federal resource management, updating royalty rates to reflect external climate impacts would help align producers' incentives with the public interest and better ensure that taxpayers receive a fair return.

II. Responses to Additional Questions

Below, we respond to several of the other questions that ONRR poses in this rulemaking. For further analysis of why the 2020 Rule is arbitrary and capricious, we direct you to the Institute for Policy Integrity's comments submitted to the docket for that rulemaking, which are attached as Exhibit A.

Question 1: *The 2020 Rule was premised, in part, on certain Executive Orders that are no longer in effect, including Executive Orders 13783 'Promoting Energy Independence and Economic Growth," 13795 "Implementing an America-First Offshore Energy Strategy," and 13892 "Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication." Also, new Executive Orders, including Executive Orders 13990 "Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis," 13992 "Revocation of Certain Executive Orders Concerning Federal Regulation," and 14008 "Tackling the Climate Crisis at Home and Abroad," have been issued from and after January 20, 2021. Does the repeal of prior Executive Orders and issuance of new Executive Orders demonstrate a change in policy meriting or requiring reconsideration of some or all of the 2020 Rule?*

The promulgation or rescission of an Executive Order cannot by itself justify a regulation, as the Administrative Procedure Act requires that any regulation be rational, based on consideration of the relevant factors including an assessment of regulatory costs and benefits, and within the scope of the authority delegated to the agency by statute.[35] But for the reasons discussed herein and in the attachments—including the 2020 Rule's failure to consider the social and environmental costs of its policy choices—reconsideration and repeal of the 2020 Rule can satisfy these standards and be justified as a rational exercise of agency authority.

[34] Interagency Working Group on Social Cost of Greenhouse Gases, Technical Support Document: Social Cost of Carbon, Methane, and Nitrous Oxide: Interim Estimates Under Executive Order 13990, at 4, 11 (2021).

[35] *State Farm*, 463 U.S. at 42.

Repealing the 2020 Rule would also be consistent with the recently issued Executive Orders referenced in the question. For instance, Executive Order 13,990 calls on federal agencies to reconsider regulations that conflict with federal policy to "protect our environment[,] . . . hold polluters accountable[,] . . . [and] reduce greenhouse gas emissions."[36] Executive Order 13,992 calls on federal agencies to rescind regulations that implemented Executive Orders 13,783 and 13,892 (among others)[37]—both of which ONRR identified as bases for the 2020 Rule.[38] And Executive Order 14,008 calls on Interior to "consider whether to adjust royalties associated with coal, oil, and gas resources extracted from public lands and offshore waters, or take other appropriate action, to account for corresponding climate costs."[39] For the reasons detailed herein, rescinding the 2020 Rule is consistent with these policies.

Question 2: *The 2020 Rule reinstituted an allowance for certain deepwater oil and gas gathering costs based, at least in part, on declining oil and gas production and revenues from the Gulf of Mexico, which allowance is estimated to reduce royalty due the United States by $32.9 million per year. Is this allowance consistent with the current law and policy of the United States?*

We do not believe so. As detailed above, federal royalties fail to account for the substantial climate externalities imposed by fossil-fuel extraction. Fossil-fuel extraction also imposes other environmental and social externalities, including, in the offshore context, harms to marine ecosystems and the risk of catastrophic oil spills. Accordingly, Interior should increase royalties to better internalize these externalities. Reducing royalty payments by over $30 million annually is inconsistent with that approach and incentivizes more dangerous offshore activity. Additionally, as discussed further in the attached comments, ONRR failed to provide a reasoned justification in the 2020 Rule, as required under the Administrative Procedure Act, for its change in position that the Deepwater Policy had served its purpose of incentivizing deepwater leasing and was no longer needed.[40]

Question 3: *The 2020 Rule reinstituted extraordinary processing allowances, which allowances are estimated to reduce royalty due the United States by $11.1 million per year. Are extraordinary processing allowances consistent with the current law and policy of the United States in the limited circumstances described in the 2020 Rule?*

We do not believe so. As detailed above, federal royalties fail to account for the substantial climate externalities imposed by oil and gas drilling. Accordingly, Interior should increase royalties to better internalize these externalities. Reducing royalty payments by over $11 million annually is inconsistent with that approach. Additionally, as discussed further in the attached comments, ONRR failed to provide a reasoned justification in the 2020 Rule, as

[36] Exec. Order 13,990, 86 Fed. Reg. 7037, § 1 (Jan. 20, 2021).

[37] Exec. Order 13,992, 86 Fed. Reg. 7049, §§ 2–3 (Jan. 20, 2021).

[38] 86 Fed. Reg. at 4614–15.

[39] Exec. Order 14,008 § 208 (Jan. 27, 2021).

[40] Inst. for Pol'y Integrity, Comments on Regulatory Proposal 12–14 (Nov. 30, 2020) [hereinafter "Policy Integrity Comments"] (citing Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 81 Fed. Red. 43,338, 43,340, 43,343 (July 1, 2016)).

required under the Administrative Procedure Act, for its change in position regarding the efficacy of extraordinary processing allowances.[41]

Questions 5: *The 2020 Rule extended an option given to oil and gas lessees under an ONRR 2016 rulemaking to use an index-based valuation method to value gas and natural gas liquids for royalty purposes. The option—previously only available for non-arm's-length transactions—was extended to arm's-length transactions. The economic analysis of the extension of the option to arm's-length transactions assumed as fact that one-half of eligible lessees would elect the option and that one-half would not. As a result, the rule concluded that those lessees that elect the index-based valuation option may pay an additional $26.76 million per year in royalties, though the election could save those lessees approximately $1.35 million in administrative costs. ONRR assumed as fact that a significant number of lessees will elect the index-based valuation option even though doing so would result in their paying royalties exceeding the administrative cost savings they would realize. If that assumption of fact is flawed, is the resulting conclusion still appropriate and supported by current law and policy?*

That factual assumption was groundless and counter-intuitive, and the resulting conclusion that royalties will increase by $26.76 million therefore lacked a rational basis.

Contrary to ONRR's assumption in the 2020 Rule, lessees are not equally likely to choose to apply the index-based valuation method versus not. Instead, a lessee's decision will likely rest on basic economic incentives, with each lessee selecting the option that minimizes costs. If the administrative cost savings associated with the index-based valuation method outweighs the increased cost of royalty payments under the index-based method, then the lessee will choose to value royalties using the index price. If not, the lessee will choose to value the transaction based on the first arm's-length sale. Based on these choices, ONRR will see a net increase in royalty payments only if the administrative savings outweigh the increased cost of royalty payments for lessees. If less than half of lessees choose the index-based valuation option, then ONRR underestimated the 2020 Rule's overall reduction in royalty payments.

Question 8: *OMB Memorandum M-21-14 requires agencies to consider, among other things, whether the rulemaking process was procedurally adequate and whether interested parties had a fair opportunity to present contrary facts and arguments. Do you believe procedural issues exist in the 2020 Rule's rulemaking process and, if so, what are those issues and what could ONRR do to remedy those issues?*

There are several procedural issues with the 2020 Rule. For one, as noted above, the rule failed to provide a "reasoned explanation" for rescinding key portions of ONRR's 2016 rulemaking.[42] When an agency rescinds a prior policy, it must provide "a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance."[43] Yet ONRR provided little explanation for its changes regarding the Deepwater Policy and processing allowances. Those failures are detailed further in the attached comments.

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[41] *Id*.

[42] *F.C.C. v. Fox Television Stations, Inc*., 556 U.S. 502, 514 (2009).

[43] *State Farm*, 463 U.S. at 30.

Furthermore, when agencies rely on a cost-benefit analysis as part of a rulemaking, "a serious flaw undermining that analysis can render the rule unreasonable."[44] But as detailed above, ONRR's analysis of the 2020 Rule had multiple such flaws. For one, the agency unreasonably assumed in its cost-benefit analysis that lowering royalty payments would have no effect on drilling, and therefore ignored the substantial social and environmental costs of the rule. Furthermore, ONRR unreasonably assumed that half of lessees who engage in arm's-lengths transactions would choose the index-based valuation, contrary to basic economic logic. For these reasons, the 2020 Rule is procedurally invalid and should be rescinded.

Question 9: *What would be the impact of a potential further delay of 60 to 120 days in the effective date of the 2020 Rule?*

Delaying the 2020 Rule would increase royalty revenue. While the 2020 Rule's estimates are unreliable for the various reasons discussed above, they can provide a basic ballpark figure of the expected decline in royalty revenue from that rule. According to ONRR's estimates in the 2020 Rule, that rule would result in a decrease in royalty payments from existing production of $28.9 million annually.[45] Assuming that this decrease is evenly distributed throughout the year, this means that delaying implementation of the rule for 60–120 days would increase royalty payments by roughly $4.8–$9.6 million, under ONRR's estimates.

As described above, increasing expected royalty payments alters producers' incentives and thus is likely to produce a decline in fossil-fuel exploration, with resulting economic costs and environmental and social benefits. Whether those costs and benefits would be fully realized from a short-term delay depends on how quickly producers are able to alter their production in response to economic and regulatory conditions. What is incontrovertible is that any increase in royalty payments would represent a transfer of capital from the shareholders of regulated entities (and potentially their employees and/or customers, depending on how much short-term profits or losses are passed through) to the U.S. government, state governments, and taxpayers.

The fact that the 2020 Rule did not evaluate any of these impacts, or rationally explain why that rule's benefits justified its costs, should provide ONRR with reason enough to further delay the 2020 Rule in order to better evaluate its effects. If ONRR further delays the 2020 Rule, it should attempt to model and quantify the impacts of doing so to the extent practicable. At minimum, the agency should discuss these effects qualitatively and explain why the benefits of any delay justify the costs.

Question 10: *Should the 2020 Rule be amended, rescinded, delayed pending further review by the agency, or allowed to go into effect?*

For the reasons discussed herein, ONRR should rescind and replace the 2020 Rule as quickly as practicable using lawful procedures. For advice on the best practices to follow, we attach a report from the Institute for Policy Integrity titled *A Roadmap to Regulatory Strategy in*

[44] *Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1036, 1040 (D.C. Cir. 2012).

[45] 86 Fed. Reg. at 4640. As noted above, the rule erroneously assumed no production increase despite a decrease in effective royalty rates.

an Era of Hyper-Partisanship.[46] In particular, we draw ONRR's attention to Section II.2, which discusses tools that executive agencies may use to delay, repeal, and replace regulations.

Conclusion

Interior must consider climate impacts in setting royalty and revenue-management policy. The best way to do so is to internalize climate costs by incorporating the social cost of greenhouse gases into the royalty rate. Because ONRR failed to even consider climate costs in the 2020 Rule—and due to numerous other substantive and procedural defects in that rule—the agency should rescind the 2020 Rule.

Sincerely,

Rachel Cleetus, Ph.D., Policy Director, Climate and Energy Program, Union of Concerned Scientists
Anne Hedges, Deputy Director, Montana Environmental Information Center
Max Sarinsky, Senior Attorney, Institute for Policy Integrity at NYU School of Law
Nathaniel Shoaff, Senior Attorney, Sierra Club

Attachments:

A) Institute for Policy Integrity, Comments on Regulatory Proposal, 85 Fed. Reg. 62,054; Docket No. ONRR-2020-0001 (Nov. 25, 2020)

B) Bethany Davis Noll & Natalie Jacewicz, Inst. for Pol'y Integrity, *A Roadmap to Regulatory Strategy in an Era of Hyper-Partisanship* (2020)

[46] This report is also available at https://policyintegrity.org/files/publications/A_Roadmap_to_Regulatory_Strategy_in_an_Era_of_Hyper-Partisanship.pdf.