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

August 10, 2021

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

Re: Comments on "ONRR 2020 Valuation Reform and Civil Penalty Rule: Notification of Proposed Withdrawal," 86 Fed. Reg. 31,196 (proposed June 11, 2021), Docket No. ONRR-2020-0001

The Institute for Policy Integrity at New York University School of Law ("Policy Integrity")[1] respectfully submits the following comments in response to the Office of Natural Resources Revenue's ("ONRR") proposal ("Proposed Rule") to rescind the 2020 Valuation Reform and Civil Penalty Rule ("2020 Rule").[2] Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decision-making through advocacy and scholarship in the fields of administrative law, economics, and public policy.

Policy Integrity supports ONRR's proposal to fully rescind the 2020 Rule, and submitted comments to ONRR in November 2020 opposing that rulemaking (which are attached hereto).[3] We write now to encourage ONRR to further elaborate upon its reasons for fully withdrawing the 2020 Rule, in contrast to other alternatives. In particular, several provisions of the 2020 Rule receive limited attention in the Proposed Rule, and ONRR can expand upon its justification for rescinding these provisions.

1. ONRR should further consider how rescinding the 2020 Rule may be beneficial for penalty proceedings.
2. ONRR should further elaborate on how the 2020 Rule's provisions regarding coal cooperatives were substantively and procedurally flawed.
3. ONRR should further justify withdrawing the 2020 Rule with respect to the default provisions.
4. ONRR should offer additional justifications for withdrawing the 2020 Rule's provisions regarding administrative law judges.
5. ONRR should provide additional justification regarding its treatment of coal valuation, including responding to the concerns raised by the U.S. District Court for the District of Wyoming in *Cloud Peak Energy, Inc. v Department of the Interior*.[4]

---

[1] This document does not purport to present the views, if any, of New York University School of Law.
[2] ONRR 2020 Valuation Reform and Civil Penalty Rule: Notification of Proposed Withdrawal, 86 Fed. Reg. 31,196 (proposed June 11, 2021) (proposing to withdraw ONRR 2020 Valuation Reform and Civil Penalty Rule, 86 Fed. Reg. 4612 (Jan. 15, 2021)).
[3] Institute for Policy Integrity, Comments on the ONRR 2020 Valuation Reform and Civil Penalty Rule 25, https://policyintegrity.org/documents/Valuation_Comment_Letter_Institute_For_Policy_Integrity_Final.pdf [hereinafter "Policy Integrity 2020 Comments"].
[4] *Cloud Peak Energy, Inc., v. U.S. Dep't of the Interior,* 415 F. Supp. 3d 1034, 1051 (D. Wy. 2019).

Background

In 2007, the Government Accountability Office ("GAO") called on the Department of the Interior to evaluate and update royalty procedures after finding that the royalties paid for oil, gas, and coal mined on federal lands were among the lowest in the world.[5] In particular, it was difficult for ONRR to ensure that lessees paid royalties based on the fair market value of the minerals sold, rather than on artificially low prices received in related-party transactions.[6] Over the next several years, the GAO continued to call on Interior to reform royalty procedures.[7] In 2013, Interior's Office of the Inspector General similarly identified weaknesses in the payment system, which put Interior at risk of not receiving the fair market value of its leases.[8] Also in 2013, a bipartisan group of senators called for an investigation and reform of any regulations that were "inadequate to ensure that full royalty value is returned."[9]

In response to these calls for reform, Interior in 2013 began a process to review and consider improvements that "could dramatically improve compliance and reduce administrative costs for industry and the Government."[10] Three years later, after holding several public workshops, providing a lengthy comment period, and reviewing thousands of pages of public comments, ONRR issued a rule to reform valuation methodologies ("2016 Rule").[11] In that rule, ONRR sought to provide "greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees and mineral revenue recipients," decrease "industry's cost of compliance," and ensure that "companies have paid every dollar due" to federal and state taxpayers.[12] By simplifying procedures and updating valuation methodologies (including requiring valuation based on arm's-length transactions, or alternative valuation methodologies when no arm's-length transaction existed), the 2016 Rule was projected to decrease private administrative costs[13] and increase royalty revenue paid to federal and state governments.[14] Additionally, the 2016 Rule sought to ensure that the royalties paid reflect the revenues generated from federal mineral and gas resources.[15]

---

[5] U.S. Gov't Accountability Office, *Oil and Gas Revenues*, GAO-07-676R (2007).
[6] *See* 80 Fed. Reg. at 608, 616–17, 628.
[7] *See* U.S. Gov't Accountability Office, GAO-15-39, Oil and Gas Resources: Interior's Production Verification Efforts and Royalty Data Have Improved, but Further Actions Needed (2015); U.S. Gov't Accountability Office, GAO-14-50, Actions Needed for Interior to Better Ensure A Fair Return (2013); U.S. Gov't Accountability Office, GAO-08-691, The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment at 7-10 (2008).
[8] U.S. Dep't of the Interior, Office of the Inspector General, Evaluation: Coal Management Program at 1 (June 2013) (describing weaknesses in the coal valuation procedures).
[9] Letter to Ken Salazar from Senators Lisa Murkowski and Ron Wyden (Jan. 2, 2013).
[10] Letter to Chairman Wyden from Ken Salazar, Secretary of the Interior (Feb. 7, 2013).
[11] ONRR 2016 Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 81 Fed. Reg. 43,338 (Jul. 1, 2016) [hereinafter "2016 Rule"].
[12] *Id.* at 43,338.
[13] *Id*. at 43,359–60.
[14] *Id*. at 43,367.
[15] *Id.* at 43,342 (explaining that 2016 Rule was intended to "ensure that [royalties paid] reflect the total consideration actually transferred, either directly or indirectly, from the buyer to the seller").

Beginning in 2017, under the Trump administration, ONRR took numerous steps to undo the 2016 Rule. ONRR first issued an indefinite suspension of the 2016 Rule, and then attempted to fully repeal the 2016 Rule, but both of those actions were vacated for violating the Administrative Procedure Act ("APA").[16] In January 2021, with less than a week remaining in the President Trump's term, ONRR finalized the 2020 Rule, which rescinded key provisions of the 2016 Rule. In the Proposed Rule, ONRR now identifies several APA defects that go to the entirety of the 2020 Rule, including the inadequacy of the comment period, lack of consideration of alternatives, lack of reasoned explanation, and failure to adequately justify changes from the 2016 Rule.[17]

In a separate challenge to the 2016 Rule, coal company Cloud Peak Energy sought a preliminary injunction in the U.S. District Court for the District of Wyoming. In October 2019, the court denied the injunction, except with respect to the provision of the 2016 Rule on utilizing electricity sale prices to value coal when no arm's-length sale for that coal occurred.[18] That litigation remains ongoing.

Currently, ONRR is seeking public comment on its proposal to withdraw the 2020 Rule. ONRR is also asking the public to consider alternatively withdrawing only specific provisions of the 2020 Rule, such as the deepwater gathering allowance, extraordinary processing allowance, or index-based valuation provisions. As a whole, the 2020 Rule forwent many of the advantages of the 2016 Rule, including provisions projected to increase royalty revenue and expected to better align royalties with the fair market value of the resources extracted.

Accordingly, ONRR should fully rescind the 2020 Rule. In doing so, however, the agency should consider providing several additional rationales in addition to those already offered in the Proposed Rule.

ONRR Should Further Elaborate Upon Its Reasons for Fully Withdrawing the 2020 Rule, in Contrast to Other Alternatives, Particularly with Regard to Several Regulatory Provisions that Receive Little Attention in the Proposed Rule

Policy Integrity agrees with ONRR's finding that parts of the 2020 Rule were internally inconsistent, and therefore arbitrary and capricious, in particular the justification of the 2020 Rule as simultaneously seeking to increase production and not impacting production.[19] ONRR also recognizes various legal issues with specific portions of the 2020 Rule.[20] Many of these issues focus on the five "revenue-impacting provisions" of the rule, specifically 1) deepwater gathering allowances; 2) extraordinary processing allowances; 3) index-based valuation for

[16] *Becerra v. U.S. Dep't of the Interior,* 276 F. Supp. 3d 953 (N.D. Cal. 2017); *California v. U.S. Dep't of the Interior*, 381 F. Supp. 3d 1153 (N.D. Cal. 2019).
[17] *See* Proposed Rule, 86 Fed. Reg. at 31,199–200 (discussing APA defects that go to the 2020 Rule as a whole).
[18] *Cloud Peak Energy, Inc., v. U.S. Dep't of the Interior*, 415 F. Supp. 3d 1034, 1051 (D. Wyo. 2019).
[19] Proposed Rule, 86 Fed. Reg. at 31,203 (describing how the 2020 Rule contradicted itself in arguing simultaneously that ONRR sought to increase production and that production would be unaffected by the 2020 Rule).
[20] *See id*. 31,199-31,200 (listing procedural defects for the 2020 Rule as a whole, as well as for portions of the 2020 Rule).

arm's-length sales; 4) modification of the index price used in index-based valuation; and 5) increasing the index price used in index-based valuation to account for transportation expenses.[21]

Notably, however, ONRR does not identify legal issues specific to certain provisions of 2020 Rule. Although the Proposed Rule is relatively silent about these specific provisions of the 2020 Rule, Policy Integrity has previously identified legal concerns with those provisions. While it is not necessary that ONRR identify specific concerns with every provision of the 2020 Rule if it fully rescinds that rule, additional legal justifications would better support a full rescission rather than a partial repeal.

1. ONRR should further consider how withdrawing the 2020 Rule may be beneficial for penalty proceedings

ONRR notes that "the 2020 Rule did not discuss alternatives to the repeal of the definition of misconduct or the requirement of signed contracts," thus making the rule procedurally deficient.[22] As Policy Integrity described in our previous comments, while some industry actors raised concerns about the definition of "misconduct" for being potentially overbroad, ONRR explained in the 2016 Rule that its definition was based on Black's Law Dictionary, and therefore removing the definition of "misconduct" entirely will create unnecessary uncertainty while failing to provide regulatory benefit.[23] If the 2020 Rule is fully withdrawn, including the provision striking the definition of "misconduct" from 30 C.F.R. § 1206.20, this withdrawal would restore the previous definition and thereby facilitate regulatory certainty while realigning ONRR's regulations with the standard legal definition of "misconduct." ONRR should expand upon its justification for restoring the definition of "misconduct" should it decide to fully withdraw the 2020 Rule.

2. ONRR should further justify withdrawing the 2020 Rule with respect to the default provision.

The Proposed Rule also offers little specific justification for reinstating the default provision that ONRR rescinded in the 2020 Rule. The default provision, which was promulgated as part of the 2016 Rule, enables ONRR to value production in cases where the valuation has been called into question due to misconduct or other issues that compromise the correct valuation.[24] While there are several specific reasons to reinstate the default provision that Policy Integrity has previously identified, the Proposed Rule does not describe this provision or its reasons for reinstating it in detail.

As ONRR explained in the 2016 Rule, the default provision was instituted to inform lessees when and how the Secretary will use his discretion, thus providing certainty and clarity surrounding the application of that rule.[25] The 2020 Rule's removal of this provision thus threatens to reintroduce uncertainty by leaving lessees unsure when the Secretary will exercise

[21] *Id*. at 31,200.
[22] *Id.* at 31,199.
[23] Policy Integrity 2020 Comments at 25.
[24] 2016 Rule, 81 Fed. Reg. at 43,341.
[25] *See id.* at 43,355–56.

this discretion. Additionally, the default provision offered lessees with the right to appeal any order from the Secretary regarding royalty valuation, which created an important check on the Secretary's power. Additionally, ONRR's removal of the default provision in the 2020 Rule was largely justified by Executive Orders that have subsequently been withdrawn.[26] And finally, removal of the default provision in the 2020 Rule appeared to rely on industry "perception" more than concrete analysis.[27] In light of these various bases for reinstating the default provision, ONRR should provide further justification if it finalizes the reinstatement of that provision.

3. ONRR should further justify withdrawing the 2020 Rule's provisions regarding coal cooperatives.

Although the Proposed Rule seeks to undo the 2020 Rule's provisions regarding coal cooperatives—which removed the 2016 Rule's definition of "coal cooperative" and method to value sales between coal cooperative members—ONRR does not offer a specific justification for this proposal. Should ONRR finalize this proposal with respect to coal cooperatives, it should offer further justification for that determination.

ONRR can look to the 2016 Rule for such a justification. "Coal cooperative" was included in the 2016 Rule to describe formal or informal organizations of companies that are not operating at arm's length from one another.[28] In the 2016 Rule, ONRR explained that defining the concept of a "coal cooperative" was "imperative" in order to ensure that royalties were not set artificially low, as the unique vertical integration within the coal industry complicates the fair market valuation of coal.[29] Further, ONRR can highlight the fact that the agency offered little justification for rescinding this definition in the 2020 Rule, which alluded vaguely to "concerns with the meaning and effect of the coal cooperative amendments" with little explication.[30]

4. ONRR should further justify withdrawing the 2020 Rule's provisions regarding administrative law judges.

The Proposed Rule also offers little specific justification for rescinding the 2020 Rule's provision with respect to the powers of administrative law judges ("ALJs"). Under the 2020 Rule, ONRR rescinded a provision of its regulations that empowered ALJs to forfeit the benefit of a stay of penalty accrual on the determination that the defense to the penalty assessment was frivolous. Although ONRR offers no specific justification for reinstating that provision in the Proposed Rule, it previously explained in litigation that this provision "serves to warn and deter against [regulated parties] bringing baseless claims [against ONRR] and identifies the penalty or consequence for a failure to heed that warning," and is thus similar to "warnings sometimes

---

[26] Policy Integrity 2020 Comments at 23–24 (referring to Executive Orders 13783 and 13795, which concerned the previous administration's efforts to decrease regulatory burdens and increase domestic energy production).
[27] *Id.*
[28] 2016 Rule, 81 Fed. Reg. at 43,339.
[29] *Id.* at 43,355 ("We disagree with the comment that the definition of coal cooperatives is 'unnecessary.' In fact, given the unique institutional nature of cooperatives in the coal industry—corporate relations among mine producers, logistics operations, electric generation, and overseas sales—that is not commonly found in markets for oil and gas, we deemed it imperative to define coal cooperatives for royalty purposes.").
[30] 2020 Rule, 86 Fed. Reg. at 4636.

given in judicial proceedings that sanctions will be imposed for bringing frivolous suits."[31] ONRR should expand upon these justification if it reinstates this provision.

Expanding upon this justification is particularly useful in light of the District of Wyoming's 2018 opinion concluding that the ALJ provision was arbitrary and capricious for lacking any "basis in the record."[32] Although that District of Wyoming decision was subsequently vacated by the U.S. Court of Appeals for the Tenth Circuit on standing grounds,[33] opponents of this provision may still invoke the District of Wyoming's limited reasoning in arguing that reinstating the ALJ provision is similarly arbitrary and capricious. Providing additional justification for this provision that responds to the District of Wyoming's concerns would minimize the possibility of a court vacating this provision once again.

5. ONRR should further justify withdrawing the 2020 Rule's provisions regarding coal valuation.

Although ONRR seeks to rescind the 2020 Rule's provisions regarding coal valuation—namely, that rule's removal of the provision enabling ONRR to value coal based on the sales price of electricity when the coal is not sold through an arm's-length transaction that would reflect its market rate—it offers little specific justification for that proposal. As previously noted, valuing coal based on electricity sales was enjoined by a federal district court in 2019, and returning to coal valuation based on electricity sales could risk further legal challenge, particularly if ONRR does not provide additional justification for such a determination.[34] If ONRR proceeds with rescinding the 2020 Rule's provisions regarding coal valuation, it should therefore offer additional justification that addresses the court's concerns.

In particular, the District of Wyoming stated in *Cloud Peak* that "[t]rying to value coal based on the sale of electricity is akin to valuing wheat based on the sale of a cake," claiming that this method tended to oversimplify energy markets.[35] ONRR should directly address this argument if it finalizes the reinstatement of the 2016 Rule's provisions regarding coal valuation. Notably, the court in *Cloud Peak* also stated that ONRR "offered no response to the contention that it ignored and oversimplified the complexities of electric markets," implying that a more detailed analysis that addressed these issues might be upheld.[36] ONRR could thus benefit from including a more detailed analysis of coal valuation based on electricity sales. In previous comments to ONRR, Policy Integrity has offered arguments opposing *Cloud Peak*'s rationale and supporting the 2016 Rule's provision on coal valuation.[37]

If ONRR engages in such an analysis, there are several key points that it could make. For one, while the District of Wyoming's wheat analogy hinged on its claim that there are "several

---

[31] Respondents' Brief in Opposition to Petitioners' Petition for Review of Final Agency Action at 34, *Am. Petroleum Inst. v. United States Dep't of the Interior*, 366 F. Supp. 3d 1292 (D. Wyo. 2018).
[32] *Am. Petroleum Inst. v. United States Dep't of the Interior*, 366 F. Supp. 3d 1292, 1310 (D. Wyo. 2018). *vacated and remanded Am. Petroleum Inst. v. United States Dep't of Interior*, 823 F. App'x 583 (10th Cir. 2020).
[33] *Am. Petroleum Inst. v. United States Dep't of Interior*, 823 F. App'x 583 (10th Cir. 2020).
[34] *Cloud Peak Energy,* 415 F. Supp. 3d at 1051.
[35] *Id.* at 1052
[36] *Id.*
[37] Policy Integrity 2020 Comments at 18–23.

other factors [that] potentially play a much larger role in determining the sales price of the end product," this does not aptly describe the role of coal in electricity sales since coal and electricity are so closed connected.[38] ONRR could further explain that netting back has been previously used for federal coal valuation,[39] and offers the best method for valuing coal when no arm's-length transaction occurred.

Conclusion

For the reasons discussed herein and in the attached November 2020 comment letter, Policy Integrity supports the full rescission of the 2020 Rule. If ONRR finalizes that proposal, it should provide additional justification for rescinding several provisions of that rule that receive little attention in the Proposed Rule.

Sincerely,

Robin Happel, Clinical Fellow
Max Sarinsky, Senior Attorney

Attachment: Institute for Policy Integrity, Comments on Regulatory Proposal, 85 Fed. Reg. 62,054 (Nov. 25, 2020)

[38] Approximately 92% of all coal consumed in the United States is used to generate electricity. U.S. Energy Information Administration (last updated Oct. 9, 2020), https://www.eia.gov/energyexplained/coal/prices-and-outlook.php.
[39] 2016 Rule, 81 Fed. Reg. at 43,354.