February 17, 2017

VIA EMAIL AND FEDEX

Gregory Gould, Director
Office of Natural Resources Revenue
Bldg 53, Entrance E-20
Denver Federal Center
Sixth Ave. and Kipling St.
Denver, CO 80225

Re: Request to Postpone Implementation of ONRR Oil, Gas, and Coal Valuation Rule

Dear Director Gould:

Pursuant to 5 U.S.C. § 705, the National Mining Association, the Wyoming Mining Association, and the American Petroleum Institute, each on behalf of their respective members, and Cloud Peak Energy Inc., Black Hills Corporation, Tri-State Generation and Transmission Association, Inc., Basin Electric Power Cooperative, and Western Fuels-Wyoming, Inc. (collectively, "Petitioners") respectfully request that the U.S. Department of the Interior, Office of Natural Resources Revenue ("ONRR"), postpone implementation of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Final Rule, 81 Fed. Reg. 43,338 (July 1, 2016) (the "Final Rule"). The Petitioners have sought judicial review of the Final Rule through multiple Petitions filed in the United States District Court for the District of Wyoming.[1] The Final Rule is first effective as to royalty reporting due February 28, 2017 for oil, gas, and coal production in January 2017. For the reasons set forth below and in the Petitioners' court filings and submitted comments on ONRR's proposed rule, which mirrors the Final Rule, postponement of the Final Rule's implementation is necessary in the interests of justice.

Petitioners initiated the challenge to the Final Rule because it adopts new royalty reporting and payment requirements that are impracticable, and in some cases impossible, for Petitioners and many other federal and Indian lessees to comply with by the February 28, 2017 royalty reporting due date. A federal or Indian lessee's failure to properly report and pay its royalties exposes the lessee to potential knowing or willful civil penalties. In contrast, by its own analysis in the Final Rule, ONRR's delayed implementation of the Final Rule would have no significant revenue impact to the lessors, and in the interim would continue regulations that have functioned adequately for more than 25 years.

Under the Administrative Procedure Act ("APA"), "[w]hen an agency finds that justice so requires, it may postpone the effective date of an action taken by it, pending judicial review." This provision gives federal agencies broad discretion to postpone the effect of agency action

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[1] *Cloud Peak Energy Inc., et al. v. USDOI*, Case No. 16-cv-315 (filed Dec. 29, 2016); *American Petroleum Institute v. USDOI*, Case No. 16-cv-316 (filed Dec. 29, 2016); *Tri-State Generation and Transmission Ass'n, Inc., et al. v. USDOI*, Case No. 16-cv-319 (filed Dec. 29, 2016).

while litigation is ongoing. This temporary postponement under 5 U.S.C. § 705 to preserve the status quo will afford ONRR sufficient time and opportunity to determine how to proceed regarding the Final Rule. At the same time, it would avoid the expenditure of further resources of the Petitioners and ONRR on implementing a rule under which compliance is infeasible or impossible, and which may be declared invalid by the Court or modified by ONRR.

The Final Rule features a number of fundamental problems that gave rise to the regulated community's detailed rulemaking comments and currently pending litigation. The three Petitions filed against the Final Rule, as well as the detailed sets of comments submitted on the nearly identical proposed rule (available on the rulemaking docket at regulations.gov), are incorporated by reference in this letter. As more fully explained therein, the Final Rule in its current form is unlikely to survive judicial review because it exceeds ONRR's authority under applicable statutes, including the Mineral Leasing Act of 1920, the Federal Coal Leasing Amendments Act of 1976, and the Outer Continental Shelf Lands Act, and applicable lease terms, and is arbitrary and capricious under the APA. Some Final Rule provisions demand the impossible from lessees; others manufacture arbitrary and unconstrained "discretion" by ONRR. The problematic provisions in the Final Rule include, but are not limited to:

- A new "default" valuation provision whereby ONRR may unilaterally establish royalty value in the first instance under numerous, broadly defined circumstances, undermining the certainty of even a lessee's arm's-length sales prices as value, and creating the risk that ONRR may impose a higher royalty value many years after production and initial payment;

- Mandatory valuation of coal production via an inherently unreliable "netback" method that courts and the Department have historically used only as a "last resort" if no other methodology, such as comparable sales, is available to establish a reasonable value at or near the mine;

- Inadequately defined transportation allowances particularly for coal sold for ultimate delivery at distant locations;

- Requirement that coal cooperatives and vertically integrated lessees use a novel and untested method to value coal based on the sales price of electricity generated by the coal, an entirely different commodity, and apply generation and transmission allowances summarily imported from geothermal resource valuation with no analysis of their applicability to coal-fired electric generation. This ignores the value added by all activities converting coal to electricity between the mine and the end use customer's switch, the multiple resale tiers prior to end use, the variety of retail prices paid by end use customers, and the fact that the fuel component of a retail electricity price includes non-coal energy sources from the

royalty payors' complete portfolios of natural gas, hydro, wind and solar, effectively making the Final Rule's required valuation impossible to calculate;

- For all coal not sold by the lessee at arm's length, failure to provide any index or other option to use reliable alternative valuation methods established near the lease like those available for oil and gas valuation;

- Blanket denial, artificial limitation, and termination of allowances to which lessees are legally entitled, undermining ONRR's longstanding recognition of valuation at or near the lease;

- Unsupported singling out of coal cooperatives for special treatment, including royalty valuation calculations that are impossible to perform, and disregard of well-established legal principles governing "affiliated" entities;

- Sudden reversal of longstanding subsea transportation allowances for offshore oil and gas;

- Refusal to recognize for valuation purposes any contract for the sale of oil, gas, or coal that is legally enforceable yet may be unwritten or unsigned by all parties; and

- Requirement to pay royalty on unattainable index prices for federal gas.

The Final Rule proffered no evidence or compelling justification for promulgating the wholesale changes to ONRR's well-established royalty valuation regulations. Rather, ONRR ignored the many comments pointing out the multiple shortcomings in the rule ONRR proposed and then finalized the rule essentially unchanged. Moreover, ONRR failed to sufficiently analyze and disclose the overall negative economic impacts of its Final Rule.

Federal and Indian coal lessees and federal oil and gas lessees face significant hardship and uncertainty in the face of their upcoming first reporting deadline under the Final Rule. As noted above and previously, many lessees simply cannot conform to the terms of the Final Rule, which requires calculations that are infeasible to perform and information that is impossible to obtain. Industry efforts to obtain adequate guidance from ONRR thus far have been unsuccessful, as the agency has provided no substantive responses to several inquiries over multiple months. Exacerbating the harms to lessees is their exposure to enforcement actions, including significant knowing or willful civil penalties, if they are unable to report and pay their royalties in accordance with the Final Rule's stated requirements. The Final Rule also allows ONRR to impermissibly recoup more financial consideration from federal and Indian lessees than ONRR is entitled to receive. Yet, if the Final Rule challenge is successful, ONRR has no authority to compensate lessees for their substantial costs of compliance (including their creation

and implementation of new accounting systems) or with interest on any royalty overpayments. This reality defeats ONRR's purported goal in the Final Rule to provide "greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees."

Postponement of the Final Rule's implementation pending judicial review, consequently with no risk of retroactive application, would avoid the above harms, and also serve the public interest. The regulated community stands to suffer the most harm absent a postponement, while postponement and continued application of regulations that have been in effect for over 25 years would not harm ONRR or any member of the public. Postponement also serves the public interest by obviating costly and time-consuming individual enforcement and corresponding appeals simultaneous with the present litigation against the Final Rule. Finally, the public interest is served by proper application of regulations consistent with ONRR's statutory authority, in contrast to the present Final Rule.

Sincerely,

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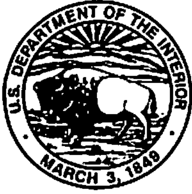

United States Department of the Interior

OFFICE OF NATURAL RESOURCES REVENUE

Washington, DC 20240

FEB 22 2017

Peter J. Schaumberg
James M. Auslander
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130 I Street, NW, Suite 700
Washington, D.C. 20005-3311

Dear Mr. Schaumberg and Mr. Auslander:

Thank you for your letter dated February 17, 2017, requesting that the Office of Natural Resources Revenue (ONRR) postpone implementation of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Rule (Rule) under Section 705 of the Administrative Procedure Act (APA). As you know, the Rule was published in the Federal Register on July 1, 2016 and took effect on January 1, 2017. The first reports under the Rule are due by February 28, 2017.

While we do not agree with all legal conclusions in your letter, in light of the pending litigation and for the following reasons, ONRR will postpone the effective date of the Rule until the issues raised in the judicial actions challenging it have been definitively resolved.

First, while ONRR believes that the Rule was properly promulgated, we agree that you have raised serious questions concerning the validity of certain provisions in the Rule. Given this legal uncertainty, we believe that it is critical to maintain the status quo until the litigation is resolved.

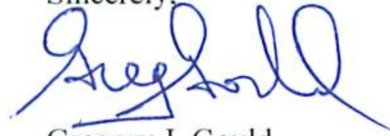
Second, we believe that the stay will enhance the lessees' ability to timely and accurately report and pay royalties. Many lessees, including the petitioners, have raised legitimate questions concerning how to properly report and pay royalties under the Rule. Given these judicial and administrative uncertainties, relying on the previous regulatory system will reduce uncertainty and enhance ONRR's ability to collect and verify natural resource revenues while the litigation is pending, which is in the best interest of the States, Tribes, individual Indian lessors, and the general public.

Third, a postponement will avoid the substantial cost to both the regulated community and ONRR of retroactively correcting and verifying all revenue reports if the Rule is invalidated as a result of the pending litigation. We realize that those lessees that have already updated their accounting systems to report and pay royalties under the Rule will incur a cost to reconvert the systems to report and pay royalties under the previous rule. But the cost of reconverting those systems now is less than what that cost would be if the Rule is invalidated and lessees must reconvert their accounting systems and correct all royalty reports submitted under the invalidated Rule.

Finally, the United States will suffer no significant harm from postponing the effective date of the Rule while the litigation is pending. As you noted, the Rule is not expected to have a significant impact on the economy. 81 FR 43338, 43368 (July 1, 2016). Thus, postponing the effective date of the Rule will not cause any appreciable economic harm to the general public. In fact, we believe the regulatory certainty provided by the postponement will enhance ONRR's mission to collect and verify natural resource revenues, which is in the best interest of the royalty beneficiaries and the United States.

ONRR will publish a Federal Register notice postponing the effective of the Rule under Section 705 of the APA as soon as possible. ONRR will also issue a Dear Reporter that notifies lessees of the postponement and provides guidance on how to report.

Sincerely,



Gregory J. Gould
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United States Senate

COMMITTEE ON
ENERGY AND NATURAL RESOURCES

WASHINGTON, DC 20510–6150

WWW.ENERGY.SENATE.GOV

March 7, 2017

The Honorable Ryan Zinke
Secretary of the Interior
1849 C Street, N.W.
Washington, D.C. 20240

Dear Mr. Secretary:

One of the fundamental tenets of public land law is that the American people should receive fair market value for the natural resources taken from the public lands.[1] You assured me, at your confirmation hearing, that you supported this important principle and agreed that "taxpayers should always get a fair value" for the resources extracted from the public lands.[2]

Consistent with this principle, last July, the Department of the Interior amended its regulations governing the valuation of oil and gas produced from federal onshore and offshore leases and coal produced from federal and Indian leases. One of the stated purposes of the amendments was to ensure that mining "companies have paid every dollar due" to the American people.[3] The new valuation rule went into effect over two months ago, on January 1, 2017.

On February 22, 2017, however, the Director of the Department's Office of Natural Resources Revenue "postponed the effectiveness" of the new rule, even though it had already been in effect for 53 days.[4] He cited section 705 of the Administrative Procedure Act as giving him that authority. Section 705 provides that "[w]hen an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review."[5] The American Petroleum Institute and others have filed suits challenging the new rule. The Director reasoned that "justice requires postponing the effectiveness of the 2017 Valuation Rule until the litigation is resolved."[6]

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1 Federal Land Policy and Management Act, § 102(9), 43 U.S.C. § 1701(9).

2 Hearing Transcript at 37-38 and 132-133.

3 Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 81 Fed. Reg. 43338 (July 1, 2016).

4 Postponement of Effectiveness of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform 2017 Valuation Rule, 82 Fed. Reg. 11823 (Feb. 27, 2017).

5 5 U.S.C. § 705.

6 82 Fed. Reg. at 11824.

There are two major reasons why section 705 does not give the Department the authority the Director claims and why his attempt to postpone the effectiveness of the rule is contrary to law.

First, as the courts have said, section 705 "permits an agency to postpone the effective date of a not yet effective rule, pending judicial review. It does not permit the agency to suspend without notice and comment a promulgated rule...."[7] The operative verb in the statute is "to postpone." "According to the dictionary, to 'postpone' means 'to put off until a future time.' It is implicit in this definition that one can only postpone something that has not yet occurred. If a wedding occurs on September 2, one cannot 'postpone' the wedding until September 30 on September 5."[8] By the same token, the Department cannot "postpone" on February 22 the effectiveness of a rule that went into effect more than seven weeks before, on January 1.

Second, even if section 705 were to allow the Department to "postpone" that which has already occurred, the courts have made it clear that section 705 does not allow agencies to grant stays based upon their own notions of what may constitute "justice." The Department may only grant stays under section 705 upon consideration of the four-part test the courts use to determine whether to grant preliminary injunctions.[9] The Supreme Court has said that the proponent of a preliminary injunction "must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest."[10] The Director failed to apply—or even mention—this four-part test when he postponed the effective date of the new rule. His failure to do was arbitrary and capricious, and his decision to postpone the effective date must be set aside as unlawful.

We know this to be true because this is not the first time an agency has abused section 705 in this manner. In 2011, the Environmental Protection Agency issued a "Delay Notice," staying the effective date of two air pollution rules on the basis of section 705.[11] But the Agency found that "justice requires a stay, according to its broad, discretionary determination of what constitutes justice." It "neither employed nor mentioned the four-part test in its Delay Notice."[12]

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7 *Safety-Kleen Corp. v. Environmental Protection Agency*, 1996 U.S. App. LEXIS 2324 (D.C. Cir. 1996).

8 *Merriweather v. Sherwood*, 235 F. Supp. 2d 339, 342 (S.D. N.Y. 2002) (construing authority to "postpone the effective date of an automatic stay" under the Prison Litigation Reform Act).

9 *Sierra Club v. Jackson*, 833 F. Supp. 2d 11, 30 (D.D.C. 2012).

10 *Winter v. Natural Resources Defense Council*, 555 U.S. 7, 20 (2008).

11 *Sierra Club v. Jackson*, 833 F. Supp. 2d 11 (D.D.C. 2012). Unlike the Department's stay of the valuation rule, EPA tried to postpone the effective date of its rules before they went into effect, not after they were already in effect. *Id.* at 15.

12 *Id.* at 30-31.

The court said that an agency "must set forth its consideration of the [four] factors and its attendant conclusions of law." The court held that "the failure to do so ... is arbitrary and capricious,"[13] and set aside EPA's attempt to postpone the effective date of its two air pollution rules.[14]

The Department has plainly failed to show sufficient grounds for staying the effective date of the valuation rule's effective date under the four-part test. The first test is whether the plaintiffs in the lawsuits challenging the rule have "made a strong showing" that they are "likely to prevail on the merits" in the litigation. The Department's notice announcing the postponement suggests just the opposite. It states that the Office of Natural Resources Revenue "believes the 2017 Valuation Rule was properly promulgated," rather than fatally flawed.

The second test is whether the plaintiffs challenging the rule are "likely to suffer irreparable harm" if the effective date of the rule is not postponed. The Department asserts that its lessees may "incur the unreimbursable costs of reverting back to the old system" and "of correcting its reports and royalty payments" if they pay royalties under the new rule and the courts ultimately find the new rule to be invalid. The Department contends that incurring these costs constitute "potentially irreparable harm."[15]

There are two problems with the Department's reasoning on the second test. The first is that the courts have held that "[m]ere injuries, however substantial, in terms of money, time and energy necessarily expended [complying with a regulation] in the absence of a stay, are not enough."[16] "Purely economic harm is not considered sufficiently grave under this standard unless it will 'cause extreme hardship to the business, or even threaten destruction of the business.'"[17]

The Department's rulemaking record simply does not support the claim that the lessees will suffer "irreparable harm" if the rule goes into effect and is later overturned. While the new rule is expected to result in the Department's lessees paying more royalties,[18] the additional royalties can be reimbursed if the courts later overturn the rule. Payment of reimbursable royalties does not constitute "irreparable harm."

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13 *Id.* at 31, citing *Gordon v. Holder,* 632 F.3d 722, 724 (D.C. Cir. 2011).

14 *Id.* at 35-36.

15 82 Fed. Reg. at 11824.

16 *Virginia Petroleum Jobbers Association v. Federal Power Commission,* 259 F.2d 921, 925 (D.C. Cir. 1958).

17 *Affinity Healthcare Services, Inc. v. Sebelius,* 720 F. Supp. 2d 12, 17 (D.D.C. 2010), quoting *Gulf Oil Corp. v. Department of Energy,* 514 F. Supp. 1019, 1025 (D.D.C. 1981) (holding "irretrievable monetary loss" alone "is not enough" to establish "irreparable injury"). *See also Mexichem Specialty Resins, Inc. v. Environmental Protection Agency,* 787 F.3d 544, 555 (D.C. Cir. 2015), quoting *Wisconsin Gas Co. v. Federal Energy Regulatory Commission,* 758 F.2d 669, 674 (D.C. Cir. 1985).

18 81 Fed. Reg. 43359-43360 (estimating increased royalty collections of $71.9 million to $84.9 million).

Perhaps recognizing this, the Department contends that it is not the additional royalties, but the administrative costs the industry will bear "reverting back to the old" royalty system and "correcting its reports and royalty payments," if the new rule is overturned, which constitute "irreparable harm." But according to the rule's preamble, the Department estimates that the new rule will actually save the industry $3.61 million in administrative costs each year compared to the old system.[19] Allowing the new rule to go into effect will reduce the industry's administrative costs. The industry will reap these savings if the rule is upheld. Staying the new rule's effective date will deprive the industry of these savings. Plainly, then, allowing the new rule to go into effect plainly will not cause the industry "irreparable harm."

The other problem with the Department's reasoning on the second test is that the most the Department claims is "*potentially* irreparable harm." But the Supreme Court has said that is not enough to support a stay. It has made it clear that the four-part test requires a showing that "irreparable harm is *likely*."[20] The "possibility" of irreparable harm simply is not enough.

The third part of the four-part test requires the Department to consider whether postponing the effective date of the rule will "substantially harm other parties,"[21] and whether the "balance of equities" between the harm done to the industry from not postponing the effective date and the harm done to other parties by postponing it, "tips in ... favor" of the industry. In its preamble to the new rule, the Department estimated the new rule will increase royalty collections by over $78 million, of which over $18 million would be paid to states and $60 million would be retained by the Federal Government.[22] But in its notice announcing the postponement of the effective date of the rule, the Department simply dismissed the loss of these royalties as insignificant. It declared that "[t]he United States will suffer no significant harm from postponing the effectiveness" of the rule because "the Rule is not expected to have a significant impact on the economy."[23] It made no effort to balance the equities between the loss of $78 million in additional royalties to the federal and state governments and the cost to the industry of "reverting back to the old system" and "correcting its reports and royalty payments."

Moreover, the Department did not consider the substantial harm to the lessees that have already converted their accounting systems to comply with the new rule, and must now recovert their systems in order to report and pay royalties under the old rule. Nor did it balance the equities between those lessees who are willing to pay what is due and have already incurred the administrative costs of complying with the new rule and those lessees who are challenging the new rule in order to avoid the paying royalties on the fair value of their production. The Department ignored the harm postponement causes the former and considered only the potential harm not postponing the effective date may cause the latter.

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19 81 Fed. Reg. at 43359.

20 *Winter v. United States,* 555 U.S. at 22 (emphasis in original).

21 *Virginia Petroleum Jobbers Association v. Federal Power Commission,* 259 F.2d at 925.

22 81 Fed. Reg. at 43367.

23 82 Fed. Reg. at 11823-11824.

The final part of the four-part test requires the Department to determine if staying the rule is in the public interest. Here, the Department simply declares, without explanation, that "the public interest ... requires postponing the effectiveness" of the new rule. In the absence of any analysis of the public interest, the Department's conclusion is unconvincing.[24] "By summarily citing to the public's interest without elaboration," the Department "abdicated its responsibility to fully analyze" the fourth factor in the four-part test.[25]

In sum, the Department's action in postponing the effective date of the new royalty valuation rule, which had already taken effect, exceeded the Department's authority under section 705 of the Administrative Procedure Act and does not meet the standards the courts have long required agencies to apply when they seek to use their authority under that section.[26] Postponing the effective date of the new rule in this manner was plainly contrary to law.

You testified at your confirmation hearing that you "will follow the law." [27] This may be a good place to start. You should lift the stay and let the royalty valuation rule go back into effect.

Sincerely,

Maria Cantwell
Ranking Member

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[24] *Winter v. United States,* 555 U.S. at 26 (finding that a district court had not given "serious consideration to the public interest factor," where it addressed this consideration "in only a cursory fashion," despite its importance).

[25] *Gordon v. Holder,* 632 F.3d 722, 725 (D.C. Cir. 2011) (finding a "district court erred by addressing" the public interest factor "in conclusory fashion").

[26] *Sierra Club v. Jackson,* 833 F. Supp. 2d at 30 ("the standard for a stay [under section 705] at the agency level is the same as the standard for a stay at the judicial level: each is governed by the four-part preliminary injunction test"), citing *Cuomo v. Nuclear Regulatory Commission,* 772 F.2d 972, 974 (D.C. Cir. 1985); *Virginia Petroleum Jobbers Association v. Federal Power Commission,* 259 F.2d 921, 925 (D.C. Cir. 1958).

[27] Hearing Transcript at 107.

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DISTRICT OF WYOMING
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Attorneys for Petitioners National Mining Association, Wyoming Mining Association, and Black Hills Corporation

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF WYOMING**

CLOUD PEAK ENERGY INC.; NATIONAL MINING ASSOCIATION; WYOMING MINING ASSOCIATION; and BLACK HILLS CORPORATION;

Petitioners,

v.

UNITED STATES DEPARTMENT OF THE INTERIOR; SALLY JEWELL, in her official capacity as Secretary of the U.S. Department of the Interior; OFFICE OF NATURAL RESOURCES REVENUE; and GREGORY GOULD, in his official capacity as Director of the Office of Natural Resources Revenue,

Respondents.

Case No. 16CV315-F

PETITION FOR REVIEW OF FINAL AGENCY ACTION

Petitioners Cloud Peak Energy Inc. (Cloud Peak), National Mining Association (NMA), Wyoming Mining Association (WMA), and Black Hills Corporation submit this Petition under the Administrative Procedure Act (APA), 5 U.S.C.A. §§ 701-706 and U.S.D.C.L.R. 83.6. On

July 1, 2016, the U.S. Department of the Interior's Office of Natural Resources Revenue (ONRR) issued a final rule radically changing how federal and Indian coal production, as well as federal oil and gas production, are valued for royalty purposes. *See* Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, 81 Fed. Reg. 43,338 (July 1, 2016) (the Final Rule). The Final Rule is part of the outgoing administration's war on coal, intended in particular to punish lessees that seek international customers for their coal. It purports to promote "greater simplicity, certainty, clarity, and consistency in product valuation," but does the exact opposite. It is invalid and must be set aside because it exceeds ONRR's authority under applicable statutes and lease terms, is arbitrary and capricious, and violates the Export Clause of the Constitution. 5 U.S.C.A. § 706.

PARTIES

Cloud Peak is one of the largest and safest producers of low sulfur, high quality subbituminous coal in the United States. The company has two distinct businesses. It wholly owns and operates three Powder River Basin coal mines (two in Wyoming and one in Montana), which have been mining and shipping coal since the mid-1970s. It also provides logistics services to some of its domestic and international customers, which requires Cloud Peak to incur substantial risk and costs wholly distinct from its coal mining business. Cloud Peak has received awards for its commitment to safety and environmental compliance and initiatives.

NMA is a national trade association representing America's mining industry. NMA's members are producers of most of America's coal, metals, industrial and agricultural minerals; manufacturers of mining and mineral processing machinery and supplies; transporters; financial and engineering firms; and other businesses related to mining. A significant number of NMA's

members operate leases on federal and Indian lands with royalty obligations in Wyoming and other states.

WMA is a trade organization that represents the interests of mining companies, including coal producers, that operate mining properties in the State of Wyoming. WMA's coal membership is made up of coal companies (Coal Members) producing in the Powder River Basin and Southwest Wyoming. WMA promotes the interests of its Coal Members, including those interests in the present and future economic viability of the coal industry and in the consistent, rational and prudent regulation of that industry.

Black Hills Corporation is the parent corporation of Wyodak Resource Development Corporation, which is the oldest continuously operating surface coal mine in the United States and the oldest coal mine in the Powder River Basin. Black Hills is also the parent corporation of subsidiaries with interests in coal-fired power plants in Gillette that burn coal mined at Wyodak, as well as two Wyoming electric utilities that serve customers with the power generated at those plants.

LEGAL BACKGROUND

Under the Mineral Leasing Act of 1920, as amended by the Federal Coal Leasing Amendments Act of 1976, the value of coal production for royalty purposes is based on the "value of coal," not some other energy commodity like electricity or certain services that may increase the value of the coal. Moreover, as ONRR concedes, pursuant to statutory and lease terms, value is determined at or near the mine where the coal is produced. For decades, ONRR's regulations have followed these basic principles. Thus, where a lessee sells or transfers coal to an affiliated entity, the regulations have employed a series of hierarchical "benchmarks" designed to determine the value of the coal at or near the mine, principally by comparison to

prices paid for comparable coal under arm's-length contracts and index prices in the area where the mine is located. Only if all the preferred benchmarks were inapplicable could ONRR require a lessee to calculate a value of the coal based on a netback method.

A netback method starts with an arm's-length based sale price for the coal (even if the sale occurs several thousand miles from the source mine), and subtracts certain costs incurred to deliver the coal to that sales point. The courts and the Department of the Interior have long recognized that a netback method is complex, difficult to implement, and far less reliable than comparable sales, index prices, and other indicia of value at or near the mine. That is why, for many decades, the ONRR regulations have imposed a netback method only as a "last resort."

OVERVIEW OF THE FINAL RULE

Arbitrarily discarding longstanding and well-functioning rules for valuation of federal and Indian coal for royalty purposes, the Final Rule instead creates widespread uncertainty and in many cases makes compliance impossible.

The Final Rule deprives lessees of the ability to use well-established, reliable methodologies such as the comparable sales approach or index prices to determine a value of the coal at or near the mine, and requires instead the uniform use of a netback method starting with the first arm's-length sale of the coal by the lessee's affiliate. In the case of international resales of coal, which often require a lessee's logistics affiliate to incur substantial risk and costs to provide logistics services, that resale and delivery of the coal could occur at ports on the Pacific Ocean or even in foreign countries in Asia or elsewhere. The Final Rule does not provide an adequate methodology to yield the value of the coal at or near the mine. Determining the value of the coal resold at a distant location necessarily requires adjustment for the value added by logistics services, including transportation, to deliver the coal to that location. The Final Rule

fails to specify the costs that ONRR will allow a lessee to deduct in circumstances involving international resales to arrive at a value of coal at or near the mine.

For certain dispositions of coal production from federal and Indian leases, the Final Rule also values the wrong energy commodity. Contrary to the Mineral Leasing Act which requires payment of a royalty based on the value of coal, under the Final Rule a coal lessee that delivers coal to an affiliated power plant which then sells the electricity at arm's length must calculate royalty based on the price for the electricity generated by "the" coal. The proceeds received from the sale of electricity do not represent the value of the coal at or near the mine. Electricity sales prices are highly regulated and determined based on unique regulatory factors and market forces rather than the value of any particular coal feedstock. Moreover, the allowed deductions do not account for all of the value added by converting coal to electricity, so the Final Rule effectively places a royalty on the value that an electricity generation business adds to the value of the coal at or near the mine. Most importantly, it is infeasible to determine the price of electricity produced from "the" coal due to, *e.g.*, the mix of fuel sources at a given power plant, unavailability of utility and electricity customer information to a coal lessee, stockpiling, accounting limitations, and multiple methods for selling electricity.

ONRR also is improperly applying to the price of electricity a statutorily directed royalty rate percentage applicable only to coal. Moreover, ONRR made no effort to explain how the generation and transmission allowances applicable to geothermal steam power plants, which the Final Rule simply incorporates, apply equally to coal-fired plants. Finally, if the disposition of electricity is not arm's-length, in derogation of ONRR's express statutory responsibility to specify value by rule, the Final Rule specifies no valuation method, and instead unilaterally reserves to ONRR complete discretion to later determine royalty value. Tellingly, ONRR does

not include the price of electricity among the factors it would consider, consistent with its admission that it has "limited experience" with this methodology.

ONRR's Final Rule also adopts what it calls a "default" provision, by which ONRR can retroactively increase the amount of royalty due even if the lessee followed ONRR's valuation regulations to a tee in initially paying its royalties. This gives the agency virtually unlimited power and defeats the very purpose and need of having regulations for lessee valuation in the first instance. ONRR introduces an unreasonably broad "misconduct" trigger, and even this term does not limit ONRR; for example, ONRR can invoke the default provision if "for any reason" ONRR cannot determine that a lessee properly paid royalty. Further, ONRR claims it can demand additional royalty if the lessee's sales price is 10% lower than the "lowest reasonable price," or if transportation or processing allowances are 10% higher than the "highest reasonable measures" of such costs—facially circular and arbitrary standards.

Under the Final Rule, years after a sales contract is made, coal is produced, and royalty is paid, ONRR can arbitrarily demand additional royalty, and substantial late payment interest. Moreover, in doing these unilateral calculations, ONRR ironically would utilize the very benchmarks and metrics proximate to the mine that ONRR is not permitting lessees to use. This reservation of unilateral valuation authority divorced from any predictable, objective criteria observable by lessees is neither fair nor consistent with the statutory authority Congress has delegated to the agency or the lease contract that the lessee entered into.

The Final Rule contains several other legally problematic provisions. For example, many of its shortcomings are exacerbated in its provisions singling out coal cooperatives without support. ONRR also fails to justify its erroneous conclusion that its Final Rule will somehow have a neutral or even positive economic effect on the coal industry.

LACK OF STATUTORY AUTHORITY

The Final Rule exceeds ONRR's statutory authority because, under the applicable statutes and binding corresponding lease terms, the government's royalty must be based on the "value of coal" determined at or near the mine. *See* 30 U.S.C.A. § 207(a); Senate Rep. No. 94-296, 49 (1976). ONRR violated those principles by (i) requiring lessees to value sales or resales based on a netback method which ONRR concedes is unworkable, with no option to value coal based on prices in the mine area, and (ii) requiring lessees that transfer coal production to an affiliated power plant to pay royalty based on the value of electricity, an entirely different commodity than coal. The rule's broad reservation of discretion to ONRR to second guess a lessee's valuation based on vague and unworkable standards violates the Mineral Leasing Act's directive that the Secretary define value by rule.

THE FINAL RULE IS ARBITRARY AND CAPRICIOUS

The Final Rule is arbitrary and capricious for numerous reasons, including: (i) lessees face perpetual uncertainty on whether their royalty payments are correct, or whether ONRR will interject its own black box valuation under its default provision many years in the future; (ii) ONRR prohibits coal lessees from valuing coal based on a published or adjusted index price proximate to the mine, yet in the same Final Rule grants oil and gas lessees the ability to use index prices instead of limiting valuation to a netback method; (iii) ONRR does not identify deductible transportation costs for coal lessees, but does so for oil and gas lessees, leaving coal lessees to speculate on deductible costs at their peril; and (iv) while ONRR claims the Final Rule provides "greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees," the Final Rule is anything but simple, certain, clear or consistent. ONRR does not

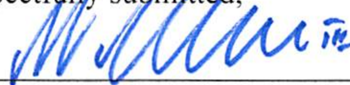
articulate any reasoned basis for why wholesale changes are needed to the existing royalty valuation system which is already subject to robust audits by regulatory authorities.

JURISDICTION AND VENUE

This Court has jurisdiction under 28 U.S.C.A. § 1331. Respondent Department of the Interior is a federal agency of the United States within the scope of 5 U.S.C.A. § 701(b)(1) (APA) and 28 U.S.C.A. § 1391 (venue). Respondent Office of Natural Resources Revenue is a federal agency within the U.S. Department of the Interior with responsibility for implementing the federal and Indian royalty program. Respondents Jewell and Gould are respondents in their official capacities and officers of the United States, which has waived its sovereign immunity under the APA, 5 U.S.C.A. § 702. Venue is proper under 28 U.S.C.A. § 1391(e) because multiple petitioners and their members have their principal place of business in Wyoming and the Final Rule will directly and adversely affect their mining and operations involving federal coal leases in Wyoming.

Dated this 29th day of December, 2016.

Respectfully submitted,



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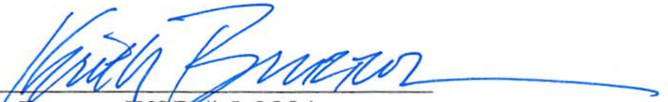

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ATTORNEYS FOR PETITIONERS NATIONAL MINING ASSOCIATION, WYOMING MINING ASSOCIATION, AND BLACK HILLS CORPORATION

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View EO 12866 Meeting 1012-AA13

Title: Federal Oil and Gas Valuation and Federal and Indian Coal Valuation

Agency/Subagency: 1012-DOI/ONRR

Stage of Rulemaking: Proposed Rule Stage

Meeting Date/Time: 11/03/2014 11:00 AM

Requestor: National Mining Association

Attendees:

List of Attendees	Participation
• Stuart Levenbach - OMB/OIRA	In Person
• John Mehlhoff - DOI/ONRR	In Person
• Mark Lawyer - DOI	In Person
• Jacqueline Wong - DPC	In Person
• Jim Orchard - Cloud Peak Energy	In Person
• Scott Krentzer - Alpha Natural Resources	In Person
• Jay Martin - ANR	In Person
• Ray Shepherd - Peabody Energy	In Person
• Chris Wittenauer - Peabody Energy	In Person
• Richard Adamski - DOI/ONRR	In Person
• Amy Lunt - DOI/ONRR	In Person
• Armand Southall - DOI	In Person
• Peter Christnacht - DOI/ONRR	In Person
• Mike DeBeard - DOI/ONRR	In Person
• Bonnie Robson - DOI/ONRR	In Person
• David Finnerty - Arkland Company	In Person
• Katie Sweeney - National Mining Association	In Person

Documents:

List of Documents

Handout

61047

Congress of the United States
Washington, DC 20515

February 10, 2015

751307

The Honorable Sally Jewell
Secretary
U.S. Department of Interior
1849 C Street NW
Washington, DC 20240

Subject: Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform (ONRR-2012-0004 (1012-AA13))

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Dear Secretary Jewell:

We are writing to request the Department of the Interior provide a 60-day extension of the comment period for the "Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform."

The complexity of this proposed rule requires additional time for impacted parties to review the changes and provide the informed comments necessary to developing a sensible policy for states, Indian tribes, taxpayers, producers, energy customers and others. Our states and Indian tribes in particular depend heavily on the sale of federal coal, oil and gas within their borders, using royalties and other payments to pay for education, infrastructure and other public services. It is imperative that states and Indian tribes have adequate time to analyze the impact of the rule on these revenues and the health of their economies.

Thank you for your attention to this matter and we look forward to a timely response.

Sincerely,

STEVE DAINES
United States Senator

CYNTHIA LUMMIS
Member of Congress

JOHN BARRASSO, M.D.
United States Senator

RYAN ZINKE
Member of Congress

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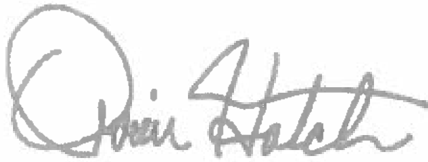

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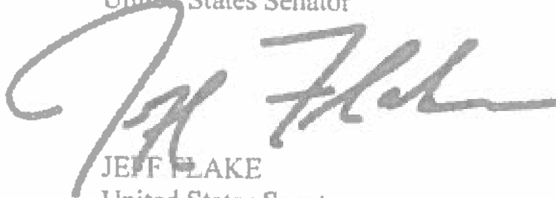
United States Senator

MIKE ENZI
United States Senator

CORY GARDNER
United States Senator

JAMES E. RISCH
United States Senator



JEFF FLAKE
United States Senator

MIKE LEE
United States Senator

CHRIS STEWART
Member of Congress

JASON CHAFFETZ
Member of Congress

SCOTT TIPTON
Member of Congress

DOUG LAMBORN
Member of Congress

PAUL GOSAR
Member of Congress

RYAN K. ZINKE
MONTANA AT-LARGE

113 CANNON HOUSE OFFICE BUILDING
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Congress of the United States
House of Representatives
Washington, DC 20515–2600

April 6, 2015

The Honorable Jay Inslee
Governor of Washington
Post Office Box 40002
Olympia, WA 98504-0002

Dear Governor Inslee:

I write to ask for your attention to a matter of significant importance to both our states. As you are surely aware, Montana and the people of the Crow Nation are eagerly awaiting the approval of the Gateway Pacific Terminal (GPT) at Cherry Point, based in Whatcom County, Washington. Although project organizers submitted their application more than two years ago, a draft Environmental Impact Statement (EIS) has yet to be released. Therefore, I wanted to highlight the numerous economic benefits this project will have, as well as discuss the implications of stalling its progress.

With the potential to tap Pacific Rim markets worth over $1.5 trillion dollars, the GPT will create good-paying, blue collar jobs for Montana and Washington and provide much needed tax revenue to all levels of state and local government. In turn, critical education and infrastructure projects will gain necessary funding. In Washington State alone, more than 4,400 jobs will be created if the project is approved. With the January 2015 unemployment rate hovering above 7 percent in Bellingham, those are welcome jobs. For Montana, building the GPT also means more employment opportunities, particularly for the Crow Nation, whose unemployment rate often tops 50 percent.

The Crow Nation has been mining coal on its reservation lands for over 40 years. Montana has more than 30 percent of the nation's recoverable coal reserves—enough to power America for 250 years—and the tribe currently sits on an estimated 9 billion tons of coal. However, due to transportation challenges, they have not been able to move coal to the market and actualize on their energy potential. Fully tapping into one of the largest coal reserves in the nation would provide vital opportunities for economic growth for the Crow people and the people of Washington State.

Our states have a long history of working together, and this project will be a prosperous opportunity for Washington and Montana to lead America into an energy independent future. As the EIS process continues, I respectfully ask that you assist with the completion of the draft and permitting process for the terminal. I also request you support the Crow's involvement in discussions about the fate of the GPT with the U.S. Army Corps of Engineers and Washington-based tribes. I cannot stress enough how access to this terminal will revitalize the Crow Nation

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and empower thousands of its members who remain unemployed. I urge you, Governor: Please do not let the GPT infrastructure project become the next Keystone XL pipeline.

Thank you for your assistance and consideration. I look forward to working with you on this issue.

Sincerely,

Ryan Zinke
Member of Congress

RYAN K. ZINKE
MONTANA AT-LARGE

113 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225–3211

Congress of the United States
House of Representatives
Washington, DC 20515–2600

May 6, 2015

The Honorable Sally Jewell
Secretary
U.S. Department of the Interior
1849 C Street, NW
Washington, DC 20240

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

Dear Secretary Jewell:

I write to express my concerns regarding the proposed rules the Department of the Interior (DOI) released in January to adjust the valuation process for coal on Federal and Indian lands. As you accept public comments on this critical issue, I wish to convey my thoughts on how finalizing the proposed rule in its current form will have detrimental impacts on the state of Montana and beyond.

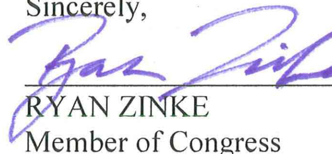
As I had mentioned during the House Natural Resources Committee hearing on March 5, 2015, the basis of the proposed rule change is not justifiably grounded on reputable claims. In fact, the GAO and IG reports you referenced in your response to my question did not assess coal royalty underpayments or make any recommendations to coal royalty valuations. GAO confirmed this information during a private staff briefing. The very basis of this rule is compromised when the authenticity of its origins is questionable.

Furthermore, moving forward will create unnecessary uncertainty for an industry that is already under intense scrutiny. In particular, I remain concerned that tribes across Montana will face negative ramifications. For instance, the Crow Nation sits on an estimated 9 billion tons of coal. Tapping into their reserves would have a revitalizing impact on every facet of their livelihoods, from creating good-paying jobs to supplying affordable energy options to its members. This rule will further complicate their efforts and jeopardize their ability to receive fair royalty rates for coal sold or used.

In Montana, we sit on one-third of our nation's recoverable coal reserves, which are valued at more than $1.5 trillion dollars on the global marketplace. This incredible amount of resources will create jobs, fund vital infrastructure projects, and restore our local and state economies. The potential is great across my state of Montana. However, the Obama Administration has made its agenda clear – an all-of-the-above energy approach does not include clean coal, even if it has the potential to revitalize our nation. I ask that you withdraw these proposed coal valuation rules as swiftly as possible.

Thank you for your attention to this matter and I look forward to working forward to working with you further on this issue.

Sincerely,



RYAN ZINKE
Member of Congress

H.R. 2822

OFFERED BY: MR. BEYER

AMENDMENT NO. 37: Page 73, strike lines 8 through 23.

H.R. 2822

OFFERED BY: MR. ZINKE

AMENDMENT NO. 38: At the end of the bill (before the short title), insert the following:

LIMITATION ON USE OF FUNDS WITH RESPECT TO VALUATION OF COAL

SEC. ____. None of the funds made available by this Act may be used to finalize, implement, or enforce the provisions related to coal valuation of the proposed rule by the Department of the Interior entitled ''Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform'' and dated January 6, 2015 (80 Fed. Reg. 608).

H.R. 2822

OFFERED BY: MR. ZINKE

AMENDMENT NO. 39: At the end of the bill (before the short title), insert the following:

LIMITATION ON USE OF FUNDS WITH RESPECT TO VALUATION OF COAL

SEC. ____. None of the funds made available by this Act may be used to finalize, implement, or enforce subparts F and J of part 1206 of the proposed rule by the Department of the Interior entitled ''Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform'' and dated January 6, 2015 (80 Fed. Reg. 608).

valuation report. Section 3002 requires the Secretary of Energy to establish transparent and uniform procedures and criteria to ensure that energy-related actions that significantly affect the supply, distribution, or use of energy are evaluated with respect to their potential impact on energy security, including their impact on the consumer and the economy and energy supply and diversity.

I think it is a good amendment. I urge my colleagues to support it.

Mr. Chairman, I yield back the balance of my time.

Mr. GARAMENDI. Mr. Chairman, I came in prepared for a brawl, and all I get is acceptance of an amendment. I think I will go with that and say thank you, Mr. Chairman, for the extraordinary wisdom that apparently we both seem to have.

Mr. Chairman, I yield back the balance of my time.

The Acting CHAIR. The question is on the amendment offered by the gentleman from California (Mr. GARAMENDI).

The amendment was agreed to.

AMENDMENT NO. 13 OFFERED BY MR. MCKINLEY

The Acting CHAIR. It is now in order to consider amendment No. 13 printed in House Report 114–359.

Mr. MCKINLEY. Mr. Chairman, I have an amendment at the desk.

The Acting CHAIR. The Clerk will designate the amendment.

The text of the amendment is as follows:

At the end of title III, add the following new section:

SEC. 3007. ENVIRONMENTAL REVIEW FOR ENERGY EXPORT FACILITIES.

Notwithstanding any other provision of law, including any other provision of this Act and any amendment made by this Act, to the extent that the National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.) applies to the issuance of a permit for the construction, operation, or maintenance of a facility for the export of bulk commodities, no such permit may be denied until each applicable Federal agency has completed all reviews required for the facility under such Act.

The Acting CHAIR. Pursuant to House Resolution 542, the gentleman from West Virginia (Mr. MCKINLEY) and a Member opposed each will control 5 minutes.

The Chair recognizes the gentleman from West Virginia.

Mr. MCKINLEY. Mr. Chairman, again, I applaud the committee, and particularly the staff, for the hard work they have done in putting together this comprehensive piece of legislation on energy. It has been long overdue to have that energy bill, so I am delighted it is here on the floor.

I rise today in support of an amendment which is cosponsored by my colleague from Montana, Congressman ZINKE. This amendment will ensure that no permit for a coal export facility can be denied until all reviews required under the National Environmental Policy Act, known as NEPA, have been completed.

The NEPA review process is critical to ensure that the communities can provide input on any proposed project, and it allows the developer the opportunity to work with the citizens of a community and the regulatory agency to address any concerns that may arise. Denying a permit request for a coal export facility before the NEPA process is complete would send a precedent that indicates that those voices of affected parties don't matter and diminish the value of the NEPA process.

This amendment will ensure that a regulatory agency must first take into consideration the merits of the project, voices of the people, their thoughts, concerns, and the findings of the NEPA report before acting on a permit and simply not advancing an anticoal ideology.

I urge my colleagues to support this amendment.

Mr. Chairman, I reserve the balance of my time.

Mr. PALLONE. Mr. Chairman, I claim the time in opposition to the amendment.

The Acting CHAIR. The gentleman from New Jersey is recognized for 5 minutes.

Mr. PALLONE. Mr. Chairman, time after time, Democratic Members have come to the floor to strike bad NEPA language from bills, only to be voted down by Republicans who use streamlining as a euphemism for letting polluters do whatever they want. Now they expect us to believe that they are sincere about keeping NEPA strong in one perverse scenario in which they think it could help them. Well, I don't think that passes the smell test. What is more, the amendment undermines the treaty rights of the Lummi Nation and jeopardizes the sovereignty of all tribes with rights to natural resources.

Mr. Chairman, tomorrow we will be here on the House floor to vote on the conference report for a highway bill which includes, over the opposition of many Democrats, sweeping exemptions from the requirements of the National Environmental Policy Act. I have no doubt that both of the sponsors of this amendment support those exemptions and will vote to pass the bill without a second thought about the fact that it short-circuits NEPA review for many, many infrastructure projects.

I am shocked to see them standing here with straight faces arguing that, when it benefits them and their friends in the coal industry, the NEPA process should be thorough and complete. It is a level of audacity that I think is almost laughable.

I urge my colleagues to vote ''no'' on this damaging and disingenuous amendment.

Mr. Chairman, I yield back the balance of my time.

Mr. MCKINLEY. Mr. Chairman, I yield such time as he may consume to the gentleman from Montana (Mr. ZINKE).

Mr. ZINKE. Mr. Chairman, to clarify, this amendment does not violate treaty rights, and to suggest it does is disingenuous and false.

This is about fairness. It is not about two tribes. It is about fairness of a process. It would be unprecedented for the Army Corps of Engineers to bypass the EIS to make a decision, and that is what this amendment does.

It is not about coal. It is not about commodities, nor is it about treaty rights because, quite frankly, the Crow Tribe in Montana has treaty rights, too. This is not to pit one poor nation against a rich nation. It is about simple fairness.

It would be unprecedented for the Army Corps of Engineers or any government body to give judgment before the process is complete, and that is what we are asking for. The EIS is the process that needs to be done.

Mr. MCKINLEY. Mr. Chairman, I yield back the balance of my time.

The Acting CHAIR. The question is on the amendment offered by the gentleman from West Virginia (Mr. MCKINLEY).

The amendment was agreed to.

AMENDMENT NO. 14 OFFERED BY MR. GENE GREEN OF TEXAS

The Acting CHAIR. It is now in order to consider amendment No. 14 printed in House Report 114–359.

Mr. GENE GREEN of Texas. Mr. Chairman, I have an amendment at the desk.

The Acting CHAIR. The Clerk will designate the amendment.

The text of the amendment is as follows:

At the end of title III, insert the following new section:

SEC. 3007. AUTHORIZATION OF CROSS-BORDER INFRASTRUCTURE PROJECTS.

(a) FINDING.—Congress finds that the United States should establish a more uniform, transparent, and modern process for the construction, connection, operation, and maintenance of pipelines and electric transmission facilities for the import and export of liquid products, including water and petroleum, and natural gas and the transmission of electricity to and from Canada and Mexico.

(b) AUTHORIZATION OF CERTAIN INFRASTRUCTURE PROJECTS AT THE NATIONAL BOUNDARY OF THE UNITED STATES.—

(1) REQUIREMENT.—No person may construct, connect, operate, or maintain a cross-border segment of a pipeline or electric transmission facility for the import or export of liquid products or natural gas, or the transmission of electricity, to or from Canada or Mexico without obtaining a certificate of crossing for such construction, connection, operation, or maintenance under this subsection.

(2) CERTIFICATE OF CROSSING.—

(A) ISSUANCE.—

(i) IN GENERAL.—Not later than 120 days after final action is taken under the National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.) with respect to a cross-border segment described in paragraph (1), the relevant official identified under subparagraph (B), in consultation with appropriate Federal agencies, shall issue a certificate of crossing for the cross-border segment unless the relevant official finds that the construction, connection, operation, or maintenance of the cross-border segment is not in the public interest of the United States.

RYAN K. ZINKE
MONTANA AT-LARGE

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HOUSE ARMED SERVICES COMMITTEE

NATURAL RESOURCES COMMITTEE

Congress of the United States
House of Representatives
Washington, DC 20515

March 15, 2016

The Honorable Glenn A. Fine
Acting Inspector General
Department of Defense
1000 Defense Pentagon
Washington, D.C. 20301-1000

Dear Inspector General Fine:

I write to call your attention to a matter of significant and immediate importance. Currently, the Seattle District of U.S. Army Corps of Engineers (USACE) is looking to make a de minimis determination on the Gateway Pacific Terminal project in Whatcom County, Washington. Every indication is that they intend to deny the permit before the draft Environmental Impact Statement (EIS) is set to be completed in October 2016. Colonel John Buck, Commander of the USACE's Seattle District, has personally told me and my staff that he intends to make a final determination this month. Not only is such a move completely unprecedented, but it is also seems politically motivated, which directly violates his military orders.

As a Colonel in the United States Army, it is illegal for Mr. Buck to be politically swayed in any manner, as his primary duty is to defend this nation in its entirety. He has sided with environmental interests without thorough consideration of the comprehensive data that will be revealed upon the completion of the draft EIS, which shatters all existing protocol. No export facility has ever been approved without a completed EIS. By the same token, no project should be denied until all the facts are available. Colonel Buck is setting a dangerous standard that has absolutely no legal merits and will have far reaching implications across the nation. As a former Commander myself, I know firsthand the challenges of balancing competing interests and making difficult decisions in the face of the unknown. This is why having information and data to back up any significant decision is vital.

I am incredibly concerned by Colonel Buck's unwillingness to follow set protocol. Therefore, I urge you to investigate his apparent inclination to skirt military procedure to appease politically motivated interests. Considering the magnitude of the de mimimis determination, I ask that you begin this process immediately.

Thank you for your attention to this matter. I look forward to your swift response.

Sincerely,

RYAN ZINKE
Member of Congress

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF WYOMING

CLOUD PEAK ENERGY INC., et al.,	)	
	)	
Petitioners,	)	
	)	
v.	)	Civil Case No. 16-cv-315-F
	)	
UNITED STATES DEPARTMENT OF THE INTERIOR, et al.,	)	**UNOPPOSED MOTION FOR TEMPORARY STAY**
	)	
Respondents.	)	

Respondents respectfully request a stay of this litigation for 90 days because Respondents are presently developing a notice of proposed rulemaking to repeal the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform 2017 Valuation Rule ("2017 Valuation Rule"), which is the subject of this litigation.

Pursuant to Local Civil Rule 7.1(b)(1)(A), counsel for Respondents conferred with

counsel for Petitioners and potential Intervenors via telephone on March 23, 2017. Petitioners and potential Intervenors informed Respondents that they do not oppose the temporary stay.

For the following reasons, good cause exists to grant the temporary stay:

1. On February 27, 2017, Respondents Office of Natural Resources Revenue ("ONRR") and the Department of the Interior published a Federal Register notice entitled "Postponement of Effectiveness of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform 2017 Valuation Rule." 82 Fed. Reg. 11,823-01 (Feb. 27, 2017). This Federal Register notice postponed the effective date of the 2017 Valuation Rule under 5 U.S.C. § 705 because ONRR concluded that "justice require[d] it to postpone the effectiveness of the 2017 Valuation Rule until the judicial challenges to the Rule are resolved." *Id.* at 11823. Accordingly, the 2017 Valuation Rule is not currently in effect.

2. Respondents are also in the process of completing a second Federal Register notice, which consists of a proposed rulemaking to repeal the 2017 Valuation Rule, because they have concluded that several provisions of the 2017 Rule do not meet its policy and implementation objectives of offering greater simplicity, certainty, clarity, and consistency in mineral valuation and reporting. Ex. A ¶ 4, Declaration of ONRR Director Gregory J. Gould. Respondents intend to publish this notice as soon as it and any necessary supporting documents are completed and approved, and to conduct the rulemaking in compliance with applicable law. Ex. A ¶ 5. ONRR expects to publish the notice within 90 days. Ex. A ¶ 5.

3. To conserve the Court's and the parties' resources pending completion of the Federal Register repeal notice process outlined above, Respondents respectfully request that the Court temporarily stay this litigation and suspend all litigation deadlines, including responding to

the Motion to Intervene and filing the administrative record, for 90 days.[1]

4. There would be no prejudice to potential intervenors or Petitioners if the Court grants the temporary stay because ONRR's implementation of the Rule has been stayed pending litigation, *see* ECF No. 23, and merits briefing cannot commence until after Respondents file the administrative record.

5. Respondents thus request a temporary stay of litigation for 90 days while ONRR develops the notice of proposed rulemaking to repeal the 2017 Valuation Rule.

Respectfully submitted this 23rd day of March 2017.

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[1] Once ONRR publishes the Federal Register notice regarding the repeal, Respondents will notify the Court and request a further stay of litigation pending completion of the rulemaking. ONRR will seek that further stay because "waiting to resolve this case allows [ONRR] to apply its expertise and correct any errors, preserves the integrity of the administrative process, and prevents piecemeal and unnecessary judicial review." *Am. Petroleum Inst. v. E.P.A.*, 683 F.3d 382, 388 (D.C. Cir. 2012).

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of March 2017 a copy of the foregoing **UNOPPOSED MOTION FOR TEMPORARY STAY** was electronically filed with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to all counsel of record.

/s/ Rebecca Jaffe
REBECCA JAFFE

`

EXHIBIT A

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF WYOMING

CLOUD PEAK ENERGY INC., et al.,	)	
	)	
Petitioners,	)	
	)	
v.	)	Civil Case No. 16-cv-315-F
	)	
UNITED STATES DEPARTMENT OF THE INTERIOR, et al.,	)	
	)	
Respondents.	)	

DECLARATION OF GREGORY J. GOULD

1. My name is Gregory J. Gould. I am over 21 years of age and am fully competent and duly authorized to make this declaration. The facts contained in this declaration are based on my personal knowledge, and are true and correct.

2. I have been employed by the U.S. Department of the Interior for nearly 35 years. I am presently the Director of the Office of Natural Resources Revenue (ONRR). I have served as the ONRR Director since ONRR was established by Order of the Secretary of the Interior in 2010. *See* Secretarial Order No. 3299. As the ONRR Director, I am responsible for the collection and disbursement of natural resource and energy revenues owed to the Federal government and American Indians from production on Federal and American Indian lands.

3. I am familiar with ONRR's statutory authorities, and its regulations, processes and procedures. I am familiar with the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule that was published in the Federal Register on July 1, 2016 ("2017 Valuation Rule"). *See* 81 FR 43338, dated July 1, 2016. I am also familiar with the substantive

issues and arguments raised in the litigation challenging the 2017 Valuation Rule in the United States District Court for the District of Wyoming.

4. ONNR promulgated the 2017 Valuation Rule to offer greater simplicity, certainty, clarity, and consistency in mineral valuation and reporting for Federal and Indian lessees. ONRR has since identified several provisions of the 2017 Valuation Rule that do not meet those policy and implementation objectives. As a result, in order to preserve the regulatory status quo, ONRR postponed the effectiveness of the 2017 Valuation Rule pending resolution of ongoing litigation. *See* 82 FR 11823, dated February 27, 2017.

5. The Department of the Interior, through ONRR, is now preparing a notice of proposed rulemaking for publication in the Federal Register to rescind the 2017 Valuation Rule. The Department intends to publish the notice as soon as it and the necessary supporting documents are completed and approved. ONRR intends to publish the rescission notice as expeditiously as possible and expects to publish the notice no later than ninety (90) days from the date of this Declaration. ONRR intends to conduct the rulemaking in compliance with the applicable law.

6. As the ONRR Director, I am also familiar with ONRR's efforts to compile the administrative record in this proceeding. ONRR has identified approximately 40 potential custodians of administrative record documents. Approximately 10 of those custodians are no longer employed with ONRR. To date, ONRR has obtained nearly 100,000 documents. ONRR expects that there are several hundred thousand documents from an approximately 7 year period that need to be compiled, organized and reviewed to complete the administrative record. This includes documents that ONRR needs to retrieve from the National Archives. In December 2012, ONRR converted to a new email server. Thus, ONRR must also retrieve and review the email

records of 40 potential custodians, from two different email servers, each with different formatting and search capabilities.

I submit this Declaration under penalty of perjury.

Gregory J. Gould

Date: 3/22/17

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF WYOMING

CLOUD PEAK ENERGY INC., et al.,	)	
	)	
Petitioners,	)	Civil Case No. 16-cv-315-F
	)	
v.	)	**ORDER GRANTING TEMPORARY**
	)	**STAY**
UNITED STATES DEPARTMENT OF THE INTERIOR, et al.,	)	
	)	
	)	
Respondents.	)	

Upon consideration of Respondents' Unopposed Motion for Temporary Stay, it is hereby

ORDERED that this action is stayed and all litigation deadlines are suspended for ninety days.

Dated this ____ day of March, 2017,

____
U.S. District Judge

Colin Marshall
President and Chief Executive Officer

April 29, 2015

Armand Southall
Regulatory Specialist
Office of Natural Resources Revenue
P.O. Box 25165
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[Submitted electronically: http://www.regulations.gov on April 29, 2015]

RE: Comments on the Office of Natural Resource Revenue's Proposed Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform, Docket No. ONRR-2012-0004 and RIN No. 1012-AA13

To Whom It May Concern:

Cloud Peak Energy Inc. appreciates the opportunity to comment on the Office of Natural Resource Revenue's (ONRR) Proposed Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform, 80 Fed. Reg. 608 (January 6, 2015) (the Proposed Rule).

I. Executive Summary

Cloud Peak Energy has a number of fundamental objections to ONRR's Proposed Rule:

1. *The Existing Benchmarks Have Worked Well for Many Years, are Subject to Robust Auditing by the Government, and Lead to a Proper Value of the Coal.* Cloud Peak Energy opposes ONRR's proposal to eliminate the valuation benchmarks and use an affiliate resale (or netback) approach as the *only* option for lessees to value coal sold to affiliated services businesses, such as Cloud Peak Energy's logistics business. *See* 80 Fed. Reg. at 628-29. The current system has led to a proper royalty value of the coal in accordance with the Mineral Leasing Act of 1920 – a value "at the mine" based on arm's-length transactions. It has also generated substantial revenues for Federal and state governments for many years and is subject to robust auditing and enforcement. Put simply, despite the assertions of well-funded anti-fossil fuel activists, the current system is not broken. To the extent changes may be needed to improve the benchmark system, ONRR should make those changes, not abandon the benchmarks entirely. In its comments below, Cloud Peak Energy offers suggested revisions, such as revising the benchmarks to include the lessee's comparable sales of coal under benchmark one and an index price option, to enable easier application of the benchmarks for both industry and ONRR.

2. *Netbacks Are The Least Reliable Method of Last Resort to "Value the Coal at the Mine".* ONRR's proposed method to value sales of coal to an affiliate – based on the affiliate resale to a third party, no matter where that resale occurs, less certain deductions – adopts the least reliable method for valuing coal. Both ONRR and the courts have long recognized that the most reliable method looks to comparable arm's-length sales of coal at or near the mine. Affording lessees like Cloud Peak Energy only one valuation method—a netback method—for determining royalties on coal sold under non-arm's-length contracts will lead to unreliable coal valuations, which do not reflect the true value of the coal "at the mine" as required by the Mineral Leasing Act. Merely subtracting the transportation costs to deliver the coal to distant sales points (for Cloud Peak

Energy's logistics business, over 1,500 miles away to Pacific Northwest ports) does not account for all the differences in value between the mine and the distant sales points due to the value added for the logistics services. *See Indep. Petroleum Ass'n of Am. v. Armstrong*, 91 F. Supp. 2d 117, 120 (D.D.C. 2000) ("from an economic standpoint, the higher sale prices obtained in a downstream market are, in part, a reflection of the costs and *risks involved*"), *aff'd in part, rev'd in part sub nom. Indep. Petroleum Ass'n of Am. v. DeWitt*, 279 F.3d 1036 (D.C. Cir. 2002) (emphasis added).

3. *There is No Legal Basis to Afford Multiple Options to Natural Gas Producers, While Mandating a Netback for Coal.* ONRR's Proposed Rule denies coal lessees the option to value affiliate sales based on a published index price or an adjusted index price and, instead, requires the use of the unreliable netback approach. ONRR, however, already provides oil lessees with an index price valuation option (*see* 30 C.F.R. §§ 1206.102(a)(2), (d)(1), (d)(2)(i) and 1206.103), and ONRR now proposes to give gas lessees a similar option. 80 Fed. Reg. at 609. There is an established, reliable index valuing PRB coal. Providing oil and gas lessees valuation options for non-arm's-length sales that are denied coal lessees arbitrarily discriminates against coal lessees.

4. *Logistics Services is a Separate Business That Carries Significant Costs and Risks and is Not Subject to Royalties.* The Proposed Rule fails to recognize the separate nature of logistics services businesses, which are already subject to income taxes and assume substantial risks and costs independent from mine site sales to arrange for delivery of commodities to remote locations including logistics services for our domestic industrial and agricultural users of PRB coal. In effect, the Proposed Rule would amount to an unlawful royalty on the value of services provided by vertically integrated companies such as Cloud Peak Energy's logistics business. It is well-established that third party logistics companies are not required to pay Federal royalties on their re-sales of the same coal, yet the Proposed Rules would require an affiliated logistics services business to pay royalties for engaging in precisely the same business activities.

5. *The Proposed Default Rule is Arbitrary and At Odds with the Stated Purpose of the Proposed Rule.* ONRR's proposed "default" rule would give ONRR extraordinarily broad, even unbridled, discretion to impose a different royalty value many years after a royalty was reported and paid. The default rule is arbitrary on its face and would only cause uncertainty of the proper royalty value, contrary to the express purpose of the proposed regulations ("greater simplicity, certainty, clarity, and consistency"). In addition, when Cloud Peak Energy's logistics business experiences the risk of selling coal in distant locations through lower international prices or higher transportation costs, ONRR's "default" rule would allow ONRR to arbitrarily select an "at the mine" comparable sales valuation method that would disregard our logistics business' risk and loss. The Proposed Rule would also allow ONRR to apply the "default" rule to recalculate Cloud Peak Energy's transportation allowance if ONRR arbitrarily believes it is "unreasonably high." In short, ONRR seeks to share in the profits when Cloud Peak Energy's logistics business pays off, but if transporting the coal over 1,500 miles away for export becomes unprofitable, ONRR seeks to insulate itself from that risk. ONRR wants to have it both ways but gives no basis for reserving to itself such a broad power. The default provision would introduce massive uncertainties to royalty calculations. Further, the default rule would not necessarily be applied to oil and gas because of the ONRR rules allowing for the use of an index to those entities.

6. *The Rule Falsely Claims Revenue Neutrality to Evade Congressional Scrutiny and Oversight.* Neither the ONRR nor the Department of the Interior is authorized under the Mineral Leasing Act of 1920 to establish energy policy or to use their regulatory authority under the Act to address climate change concerns. They are directed by the Act to optimize Federal revenue from leased federally owned lands. The seemingly intended effect of the unbridled "default provision," along with the unreasonably vague net-back provision, is to end the vertical integration of mining operations on Federal lands necessary for the development of West Coast coal terminals and

expansion of export sales for Federal coal. This impact would likely shut down the potential 100 million tons per year shipped to international customers from the PRB; potentially costing the Federal government $166 million per year in coal royalties based on 2014 PRB prices (source: Energy Information Administration PRB spot price index). A proper economic analysis of the proposed rule is warranted by the GAO.

7. *The Request for Comments on a Possible Proposal to Cap Transportation Deductions at 50% of the Value of the Coal Highlights the Apparent Goal to End Export Coal Sales.* ONRR's Proposed Rule does not include a cap on transportation deductions for its proposed net-back calculation, but ONRR nonetheless specifically requests comments on whether it should cap transportation deductions at 50% of the value of the coal. As ONRR surely knows, transportation costs to reach logistics customers often significantly exceed 50% of the value of the coal and may even be over three times or more of the value of the coal at the mine. That ONRR would even raise the possibility of capping transportation deductions at 50% of the coal value highlights what appears to be ONRR's goal: to impose new royalty rules making logistics customers less economic, thereby reducing the Federal royalty stream.

8. *The Rule Imposes an Unconstitutional Tax on Exports.* The background of the Proposed Rule strongly suggests it is targeted directly at exports. The U.S. Constitution specifically prohibits the imposition of duties on goods by reason of exportation to the international country. Since under the Rule, coal that is being exported is valued in a manner that is different than how coal is valued for traditional domestic customers, the incremental royalty on exports amounts to an unconstitutional tax or levy.

Summary Conclusion

Cloud Peak Energy urges ONRR to retain the existing benchmark system. Improvements to the existing benchmark system may include adding to the first benchmark the use of the lessee's comparable arm's-length sales at the same mine and an index valuation benchmark. ONRR's proposal to impose a netback methodology on affiliate sales of coal to international coal customers, along with a proposed "default" rule, is contrary to the Congressional intent of creating clarity and well-established principles of royalty valuation.

II. Introduction to Cloud Peak Energy and Its Two Separate Businesses

Cloud Peak Energy is one of the safest producers of low sulfur, high quality subbituminous coal in the United States. The company has two distinct businesses: (1) it wholly owns and operates three Powder River Basin (PRB) coal mines, which have been mining and shipping coal since the mid-1970s, and (2) the company provides logistics services to some of our domestic and international customers. The Antelope and Cordero Rojo mines are located in northeast Wyoming and the Spring Creek Mine is located in southeast Montana. We also have two development projects, the Youngs Creek project and the Big Metal project with the Crow Tribe in the northern PRB. In 2014, the coal we produced generated approximately 4% of the electricity produced in the United States. Cloud Peak Energy is the only Wyoming-headquartered company listed on the New York Stock Exchange (NYSE: CLD).

A. Substantial Payments to Federal and State Governments

Through the leasing and mining of Federal coal reserves, Cloud Peak Energy is a major contributor of Federal lease bonuses, Federal lease rentals, Federal royalties, and state severance taxes and royalties. To obtain and maintain Federal leases issued by the U.S. Bureau of Land Management (BLM), Cloud Peak Energy pays a bonus at the time BLM issues the lease and annual rentals. Since 2009, Cloud Peak Energy's Federal lease payments have been substantial: $93 million in 2009, $64 million in 2010, $133 million in 2011, $129 million in 2012, $79 million in 2013, and $69 million in 2014. In 2015, Cloud Peak

Energy is committed to make approximately $69 million in Federal coal lease payments to BLM. In the last six years, Cloud Peak Energy has paid a total of $567 million in Federal lease payments.

In addition, in 2014, Cloud Peak Energy incurred approximately $315 million in Federal and state royalties and excise taxes. Of the $315 million, approximately $130 million was paid directly to and retained by the Federal government. Cloud Peak Energy paid approximately $61 million to the Federal government for distribution to the states, and Cloud Peak Energy paid approximately $124 million directly to the local and State governments. In total, the State of Wyoming received $136 million, and the State of Montana received $49 million in royalties and taxes.

By comparison to the amount of royalties and taxes incurred, Cloud Peak Energy's net income for 2014 was $79 million.

B. Employees, Community Contributions, and Industry Leading Safety Record

Cloud Peak Energy's 1,600 employees live in Wyoming, Montana, Colorado and South Dakota. Mining and the family wage-jobs created by mining help sustain communities in this region. Cloud Peak Energy is proud to support our communities, work with our local businesses and purchase goods and services in the region. In 2014, Cloud Peak Energy expenditures in Wyoming totaled $250 million, $18 million in Montana and $8 million in Colorado. In addition, our business indirectly supports employees of rail and port operators.

Cloud Peak Energy is one of the safest coal producers in the nation. During 2013, Mine Safety and Health Administration data for employee injuries showed that Cloud Peak Energy mines collectively had among the lowest injury rates of the 25 largest U.S. coal companies. By way of example, based on Cloud Peak Energy's injury rate in 2013, an individual employee would expect to be injured once every 155 years working at our mines. It was notable that two of our mines, Spring Creek and Cordero Rojo, each passed 1.2 million work hours without a reportable injury in early 2014. In 2014, Cloud Peak Energy received the Governor's Summit Safety Award in the Large Mine Category presented by the Wyoming Department of Workforce Services, Mines Inspection and Safety Division. We continue to hold safety as a core value and will always work toward our goal of zero injuries.

C. Strong Environmental Stewardship

Cloud Peak Energy has strong programs in environmental stewardship and performance. In 2014, Cloud Peak Energy's Environmental Management System was recertified under the internationally recognized ISO 14001 standards for the eighth consecutive year. The company continues to be recognized for environmental compliance and initiatives. Most recently, Cloud Peak Energy's Antelope Mine was honored to receive the prestigious 2014 National Excellence in Surface Mining and Reclamation Award from the Office of Surface Mining Reclamation and Enforcement for the sustainable control of cheatgrass.

D. Mine Site Coal Sales

The vast majority (95% for 2014) of the coal we produce is sold under arm's-length contracts at or near the mine. Our mine site coal sales business sells thermal coal at the mine site, where title and risk of loss pass to the customer at that point. This business includes our Antelope Mine, Cordero Rojo Mine, and Spring Creek Mine. Sales are primarily to domestic electric utilities. In 2013 and 2014, Cloud Peak Energy shipped approximately 86 million and 85.9 million tons of coal, respectively, from our three mines.

In 2014, of the 85.9 million tons of coal sold, approximately 81.9 million tons (95%) were sold at the mine under arm's-length contracts, which provides very robust evidence of value at the mine. In 2014, nearly 100% of the 68.5 million tons of coal sold from the Antelope and Cordero Rojo Mines was sold at the

mine under arm's-length contracts. Of the 17.4 million tons of coal sold from our Spring Creek Mine, approximately 12.2 million tons (70%) were sold at the mine under arm's-length contracts.

E. Logistics Business Services

Our logistics business provides services to our international and domestic customers, where we deliver coal to the customer at a terminal or the customer's plant or other delivery point, remote from our mine site. Our logistics services include the purchase of coal from third parties or from our owned and operated mines, at market prices, as well as the contracting and coordination of the transportation and other handling services from third-party operators, which are typically rail and terminal companies. Title and risk of loss are retained by our logistics services business through the transportation and delivery process. Title and risk of loss pass to the customer in accordance with the contract and typically occur at a vessel loading terminal, a vessel unloading terminal, or an end use facility. Significant risks associated with rail and terminal take-or-pay agreements are also borne by our logistics services business.

In 2013 and 2014, Cloud Peak Energy's logistics business exported approximately 4.7 million and 4.0 million tons of coal, respectively, to international customers primarily through the Westshore Terminal in British Columbia, Canada, in addition to domestic logistics deliveries. For 2015, we anticipate our logistics business will export approximately 5.8 million tons through the Westshore Terminal, which leads directly to jobs for miners, rail employees, and port operators.

Cloud Peak Energy's marketing of coal both domestically and internationally is made possible by its strong logistics business, which in 2013 and 2014 was the largest U.S. exporter of thermal coal into South Korea by volume. Spring Creek coal is increasingly well-regarded by international customers and, due to its relatively high energy content and consistent quality, is considered equivalent to the best Indonesian coal brands by Asian utilities. We anticipate that international demand will continue to strengthen over the long-term, providing Cloud Peak Energy's logistics business with more opportunities to market its high-quality coal to international countries.

That being said, marketing to international customers carries significant expenses and risks, well beyond the expenses and risk associated with producing and selling coal at the mine site. In 2014, for instance, Cloud Peak Energy's logistics business was faced with weak international prices for seaborne coal, which resulted in lower revenue in 2014. For 2014, our logistics business incurred an operating loss of $1.6 million.

Cloud Peak Energy's logistics business continues to incur substantial cost and risk associated with transporting coal over 1,500 miles to Pacific Northwest ports, including the inherent increased risk of dealing with overseas customers, retaining legal title to the coal and risk of loss until it is loaded on the customer's vessel at the terminal, incurring terminal and rail fees, risking rail interruptions, and paying demurrage charges. As customarily required by logistics operators (rail and port), our business must commit to long-term contracts, which include take-or-pay commitments. As of December 31, 2014, our logistics business had future take-or-pay commitments under long-term transportation agreements of $691.5 million, which would be payable regardless of market conditions if our logistics business fails to meet future minimum annual shipment commitments.

Further, in 2014, Cloud Peak Energy's logistics business paid approximately $6.1 million in demurrage charges—which are levied against Cloud Peak Energy when the vessel is detained beyond the scheduled time of departure—because rail interruptions slowed deliveries to the Westshore Terminal causing delays in loading the coal. In August 2014, Cloud Peak Energy paid $37 million to secure additional committed capacity at the fully-utilized Westshore Terminal. As a result, we increased our long-term committed capacity from 2.8 million tons to approximately 6.6 million tons initially and increasing to 7.2 million tons in 2019 and extended the term of our throughput agreement by two years through the end of 2024. Cloud

Peak Energy has also obtained throughput options at the proposed (yet undeveloped) Millennium Bulk Terminals and the SSA Marine Gateway Pacific Terminal at Cherry Point, both in Washington State.

Cloud Peak Energy's diverse logistics opportunities allows us to maximize coal sales, both domestically and internationally, and plan for future Federal and Tribal coal development, which in turn benefits the Federal, state, and Tribal governments through increased royalties, taxes, and fees on new leases.

Production increases at Spring Creek Mine, in part to meet international customer demand, have generated significant revenue in the form of lease, royalty and tax payments for both the federal government and the state of Montana. In addition, this production increase supported and sustained new direct and indirect jobs. These jobs are an important part of the region's economy.

A recent study by the University of Montana for the Montana Chamber of Commerce examined a hypothetical 20-million ton per year increase of production at Spring Creek Mine and found that more than 1,400 new, permanent jobs would be created and more than $70 million per year would be generated in state and local government revenue, not including increased property tax collections.

III. The Proposed Rule

On January 6, 2015, ONRR announced the Proposed Rule which will amend the valuation regulations applicable to Federal and Indian oil and gas and Federal and Indian coal. 80 Fed. Reg. at 608. While changes to the regulations are broad sweeping, including consolidation and renumbering of the existing regulations, the main changes include:

- *Valuation Options Provided for Natural Gas.* For valuing non-arm's-length gas sales, eliminating the long-standing valuation benchmarks and instead proposing valuation methodology options based on how gas is sold using the first arm's-length sale price (affiliate resales), optional index prices, or weighted average pool prices, at the election of the natural gas producer. *Id.* at 609.

- *Mandated Netback Approach for Coal.* For valuing non-arm's-length coal sales, eliminating the long-standing benchmarks and instead proposing only one valuation method—valuing coal based on the proceeds received from the first arm's-length sale (affiliate resales) less certain allowable transportation and washing deductions (a netback approach). *Id.* at 609, 628-29.

- *The "Default" Rule.* For valuing all oil, gas, and coal, ONRR proposes a new unpredictable "default" rule which would apply when ONRR believes a lessee's valuation is too low and would allow ONRR to "exercise considerable discretion to establish the reasonable value of production using a variety of discretionary factors and any other information [it] believes is appropriate." *Id.* at 609-10, 614.

ONRR's stated purpose of the Proposed Rule is greater simplicity, clarity, and certainty. *Id*. at 608.

IV. Comments

A. The Long-Standing Rules on Affiliate Sales Work

The existing Federal and Indian coal regulations have been in effect since 1989. *See Revision of Coal Product Valuation Regulations and Related Topics,* 54 Fed. Reg. 1492 (January 13, 1989). Under the existing regulations, if the lessee sells coal under a non-arm's-length arrangement, the regulations prescribe an ordered series of "benchmarks" that look to outside indicia of market value. The value of the coal is based on the first applicable benchmark.

Under the first of those benchmarks, the gross proceeds accruing to the lessee under its non-arm's-length contract will be accepted as value, if they are within the range of the gross proceeds derived from or paid under comparable arm's-length contracts (from other producers, i.e. NOT comparable sales by the lessee) for the sale or purchase of like-quality coal produced in the area. 30 C.F.R. §§ 1206.257(c)(2)(i) (Federal coal) and 1206.456(c)(2)(i) (Indian coal). If the first benchmark does not apply, the second benchmark establishes value based on "[p]rices reported for that coal to a public utility commission." *Id.* §§ 1206.257(c)(2)(ii) and 1206.456(c)(2)(ii). Under the third benchmark, value would be established based on "[p]rices reported for that coal to the Energy Information Administration of the Department of Energy." *Id.* §§ 1206.257(c)(2)(iii) and 1206.456(c)(2)(iii). If the third benchmark does not apply, then value is based on "other relevant matters," which include, but are not limited to, "published or publicly available spot market prices" or "information submitted by the lessee concerning circumstances unique to a particular lease operation or the saleability of certain types of coal." *Id.* §§ 1206.257(c)(2)(iv) and 1206.456(c)(2)(iv). Lastly, if none of the four preceding benchmarks apply, then "a net-back method or any other reasonable method shall be used to determine value." *Id.* §§ 1206.257(c)(2)(v) and 1206.456(c)(2)(v).

These benchmarks have been applied since 1989 with little indication that the benchmarks are not workable. At most, there has been occasional disagreement between lessees and ONRR over whether sales are considered arm's-length or non-arm's-length or over which is the first applicable benchmark. For example, in *Decker Coal Co. v. United States*, No. CV-07-126-BLG-RFC, 2009 WL 700221 (D. Mont. Mar. 17, 2009), the issue was not that the benchmarks were unworkable or led to unreliable valuations; the issue was that ONRR's predecessor, the Minerals Management Service (MMS), erred by proceeding to the fourth benchmark when the first benchmark was applicable, contrary to the regulation's mandate. *Id.* at *2, *9.

Nonetheless, if any improvement or clarification is needed for the benchmarks, that should be the approach ONRR takes, not abandonment of the benchmarks altogether and adoption of the affiliate resale price approach. In section E below, Cloud Peak Energy offers suggested improvements to the benchmarks, such as including comparable arm's-length sales of coal by the lessee in the first benchmark and adding an index price valuation benchmark.

B. ONRR's Proposed Use of Affiliate Resale Prices Disregards Basic Principles Rooted in the Mineral Leasing Act of 1920 and Long-Standing Regulations

ONRR's proposal to abandon the benchmarks in favor of an affiliate resale or netback approach ignores two basic royalty principles: *first*, Federal royalty is to be valued "at the mine" and, *second*, arm's-length comparable sales are the best evidence of value "at the mine."

Principle #1: Royalty is Based on the Value "At the Mine"

Where Federal royalty is based on the value of the mineral, it has always been based on the value of the mineral "at the mine." When the Mineral Leasing Act of 1920 (MLA), 30 U.S.C. §§ 181-287, was first enacted, the royalty on most minerals (but not coal) was set as a percentage of the value of the mineral. *See, e.g.,* 41 Stat. 437, 443 (1920) (royalty for oil and gas "shall not be less than 12 1/2 per centum in amount or value of the production"). For the value-based royalties, the legislative history is replete with evidence that Congress and the Department of Interior intended the value to be determined "at the mine." For example, for Federal phosphates and phosphate rock reserves, the legislative history provides that value is based "at the mine." *See, e.g.*, 53 CONG. REC. 1098 (1916) (royalties shall be based on "the gross value of the output of phosphates or phosphate rock at the mine"); H.R. REP. No. 17, 11 (1916) (Secretary Lane's report provides that phosphate royalty should be based on "the gross value of the output at the mine"); 58 CONG. REC. 4055 (1919) ("the gross value of the output of phosphates or phosphate rock at the mine"). The MLA legislative history is the same for potassium and sodium. *See,*

e.g., H.R. REP. No. 17, 8 (1916) (potassium or sodium royalty is based on "the value of the output at the point of production").

In 1920, royalty on coal under the MLA was based on a cents per ton calculation that had little to do with the value of the coal. 41 Stat. 437, 439 (1920) (royalty for coal "shall not be less than 5 cents per ton of two thousand pounds"). It was not until the Federal Coal Leasing Act Amendments of 1976 (FCLAA), Pub. L. 94-377, 90 Stat. 1083, that Congress changed the royalty basis for coal to a percentage of its value. H.R. REP. No. 94-681, 81 (1975) ("the revised language changes the minimum royalty from $.05 per ton to twelve and one half per centum of the value of the coal, except that the Secretary may determine a lesser amount for underground mining operations").

When Congress adopted a value-based royalty for coal, Congress reiterated its intent that when royalty is based on the value of the mineral, the value is determined "at the mine." The legislative history for the FCLAA amendments regarding advance royalty payments provides that standard royalty rates are based on "the gross value of the coal at the mine." *See* Senate Rep. No. 94-296, 49 (1976). One year after the FCLAA was enacted, Congress passed the Abandoned Mine Reclamation Fund, Pub. L. 95–87, 91 Stat. 445 (1977), which is administered by the Secretary of the Interior and imposes a reclamation fee on all coal mines. The fee is assessed as a percentage of "the value of the coal at the mine." 30 U.S.C. § 1232.

Consistent with legislative and Departmental intent, courts since the 1940s have held that the government's royalty interest is limited to the value of production at the mine. *United States v. Gen. Petroleum Corp. of Cal.*, 73 F. Supp. 225, 258 (S.D. Cal. 1946) (gas royalty obligation is determined "at the mines, that is before it left the field"), *aff'd sub. nom. Cont'l Oil Co. v. United States*, 184 F.2d 802, 820 (9th Cir. 1950) ("royalties were to be calculated at values at the wells, not at the . . . destination"); *Indep. Petroleum Ass'n of Am. v. Armstrong*, 91 F. Supp. 2d at 119 ("the essential bargain embodied in federal and Indian leases entitled the lessor to a royalty based upon the value of production at the mine").[1]

Further, courts have consistently invalidated any Department of Interior regulation or policy that is contrary to the MLA's intent. *See, e.g., Plateau, Inc. v. Dep't of Interior*, 603 F.2d 161, 164 (10th Cir. 1979) (invalidating regulation governing Federal royalty oil because, based on legislative history, the court found the regulation "goes beyond what Congress authorized"); *Marathon Oil Co. v. Andrus*, 452 F.Supp. 548, 552-53 (D. Wyo. 1978) (invalidating agency oil and gas royalty policy as conflicting with "the legislative history of the Mineral Leasing Act, together with its many enactments and re-enactments"); *Indep. Petroleum Ass'n*, 91 F. Supp. 2d at 125 (invalidating MMS regulation which disallowed transportation deduction for unused pipeline firm transportation charges, which MMS claimed were not "actual" costs incurred to move gas downstream, because the disallowance led to a definition of "value" inconsistent with the MLA's intent that royalty should be based at the mine), *rev'd on other grounds,* 279 F.3d at 1042-43.

ONRR's Proposed Rule violates Congressional intent in the MLA. ONRR seeks to obtain royalty on more than the "at the mine" coal value; ONRR seeks to value the coal based on affiliate resales taking place over 1,500 miles away from the mine without accounting for the change in value due to logistics services provided to deliver coal to the distant location.

Principle #2: The Best Way to Determine Value "At the Mine" is by Arm's-Length Comparable Sales

[1] Although these cases involve royalty on oil and gas, the stated principles are equally applicable to coal royalty valuation. *See Black Butte Coal Co. v. United States*, 38 F. Supp. 2d 963, 971 (D. Wyo. 1999) ("Simply because [prior cases] involve gas and oil as opposed to coal is not a compelling reason to ignore them. The decisions' discussion of the assessment of royalties is functionally indistinguishable . . .").

The current benchmarks reflect the long-held and universal view that the best method for determining value at the mine is examining comparable arm's-length sales. *See* 76 Fed. Reg. at 30882 ("The Department of the Interior has long held the view that the sales prices agreed to in arm's-length transactions are the best indication of market value. The 1989 regulations reflect that view."). When the benchmarks were adopted, MMS included a comparison to arm's-length sales in the first benchmark and placed the less reliable valuation method—the netback approach—as the last benchmark. 54 Fed. Reg. at 1506. Accordingly, it was MMS's intent that it "will use a net-back valuation method only when other methods of determining value, such as those specified in the rules, are inapplicable." *Id.*; *see also* 30 C.F.R § 1206.257(c)(2)(i),(v).

Consistent with reliance on a comparable sales approach, MMS's 1996 guidance on affiliate sales of coal provides that affiliate resales of coal may be used to determine value, but only where the resale occurs in the same area as the mine. *See* "General Guidance for Auditing Affiliate Sales of Coal" at 1 (November 26, 1996) ("If a resale of production from the affiliate to a third party occurs *in the same field or area* as the sale from the lessee to its affiliate, the proceeds under the arm's-length resale contract may be used in calculating the applicable benchmark value." (emphasis added)). The use of affiliate resales in the same area as the mine is very different than ONRR's proposed new approach, which would require royalty valuation based on affiliate resales regardless of location.

In royalty cases on private lands involving affiliate sales, courts have applied the comparable arm's – length sales approach to determine market value at the mine as "[t]he first, and most desirable" approach. *Potts v. Chesapeake Exploration, L.L.C.*, No. 3:12-CV-1596-O, 2013 WL 874711, at *5 (N.D. Tex. Mar. 11, 2013), *aff'd*, 760 F.3d 470 (5th Cir. 2014) ("The most desirable method is to use comparable sales"). In other valuation cases, not involving affiliate sales, courts similarly prefer the comparable sales valuation approach to determine a value at the mine. *E.g., Ashland Oil, Inc. v. Phillips Petroleum Co.*, 554 F.2d 381, 387 (10th Cir. 1975) ("It is obvious that the comparable sales-current market price is by far the preferable method when it can be used."); *Bice v. Petro-Hunt, L.L.C.*, 2009 ND 124, ¶ 14, 768 N.W.2d 496, 501 ("Most courts prefer the comparable sales method."); *Ashland Oil, Inc. v. Phillips Petroleum Co.*, 463 F. Supp. 619, 620 (N.D. Okla. 1978), *aff'd in part, rev'd in part,* 607 F.2d 335 (10th Cir. 1979) ("Optimally, a product's 'fair market value' is determinable by examining comparable sales of the same product."); *Anderson Living Trust v. ConocoPhillips Co., LLC*, 952 F. Supp. 2d 979, 1040 (D. N.M. 2013) ("evidence of comparable wellhead sales is the best possible evidence for analyzing market value at the well.").

As companies do not have access to their competitors' sales agreements, review of arms-length sales are limited to those transacted by the company, which is currently captured within benchmark 4.

It is only when information about comparable arm's-length sales at the mine is not available that courts resort to the netback approach. *See, e.g., Ashland Oil,* 554 F.2d at 387 (holding the trial court properly used the "less desirable" netback approach to value gas at the mine where evidence of comparable sales was lacking). That was the situation in the *Marathon* case, where the courts upheld MMS's use of a netback approach to value liquefied natural gas (LNG) exported to Japan. *Marathon Oil Co. v. United States*, 604 F. Supp. 1375, 1385 (D. Alaska 1985), *aff'd*, 807 F.2d 759 (9th Cir. 1986). In *Marathon,* MMS could not use the comparable sales approach, as Marathon urged, because "[t]he gas delivered to the LNG plant presents a special, unique situation." 604 F.Supp. at 1385. There was no other gas in the field or area being sold to an LNG plant for comparison. *Id.*

Unlike the situation in *Marathon*, arm's-length coal sales at the mine of substantial volumes are common and there is generally comparable sales data at the mine available. For Cloud Peak Energy, there is ample evidence of comparable arm's-length sales at the mine as approximately 95% of the total coal sold is under arm's-length contracts at the mine. Of the 17.4 million tons of coal sold from our Spring Creek Mine, approximately 12.2 million (70%) was sold at the mine under arm's-length contracts. ONRR's Proposed Rule, which would ignore this best evidence of value in favor of the unreliable, uncertain

netback approach for valuing non-arm's-length coal sales, is contrary to basic royalty principles. There is also a robust publicized index available whereby coal should have the option to use an index similar to oil and gas.

C. An Affiliate Resales Netback Approach Leads to Complicated Valuations and an Uncertain Regulatory Environment, Made Worse by Inclusion of an Unbridled "Default" Rule

Not only is ONRR's proposal contrary to the basic royalty principles in the Mineral Leasing Act and long-standing regulations, but using an affiliate resales netback approach will be complicated in practice, lead to unreliable and unfair valuations that do not accurately reflect "at the mine" values, and do nothing to provide certainty to lessees in calculating royalties.

Under the netback approach, "costs of transportation, washing, handling, etc., are deducted from the ultimate proceeds received for the coal . . . to ascertain value at the mine." 30 C.F.R. § 1206.251. However, the netback approach is complicated by the lessee's need to calculate, based on ONRR's regulations, which costs are allowable deductions. ONRR's Proposed Rule, however, does nothing to provide certainty to a lessee in calculating allowances.

Most concerning to Cloud Peak Energy is ONRR's proposed use of the "default" rule if it disagrees with a lessee's transportation allowance calculation, or if in the ONRR's sole discretion the transportation allowance is deemed "unreasonably high." 80 Fed. Reg. at 666. Under the Proposed Rule, ONRR may recalculate a lessee's transportation allowance under the "default" rule if ONRR determines the lessee's or lessee's affiliate's costs under an arm's-length transportation contract "does not reflect the reasonable cost of the transportation" because the lessee or its affiliate "breached [the] duty to market the coal for the mutual benefit of [the lessee] and the lessor by transporting [the] coal at a cost that is unreasonably high." *Id.* A transportation allowance will be considered "unreasonably high if it is 10-percent higher than the highest reasonable measures of transportation costs including, but not limited to, transportation allowances reported to ONRR and the cost to transport coal through the same transportation system." *Id.*

In Cloud Peak Energy's case, the uncertainty surrounding the Proposed Rule's treatment of the transportation allowance could have severe repercussions. As explained above, Cloud Peak Energy's separate logistics business transports coal over 1,500 miles away to the Westshore Terminal in Canada for sale to international customers, and intends to transport coal just as far to proposed terminals in Washington State. In doing so, our logistics business incurs a whole range of transportation expenses, including but not limited to, rail and port fees under long-term take or pay contracts, upfront costs to secure long-term committed capacity at the terminals, upfront costs to obtain options for committed capacity on the newly proposed (yet undeveloped) terminals in the Pacific Northwest, additives and sprays, and demurrage charges when rail interruptions cause delays in loading vessels. While all of these are actual costs Cloud Peak Energy incurs to transport the coal to the point of sale, it is unclear under the Proposed Rule whether ONRR would allow us to deduct these costs as allowable deductions.

In addition, if the international prices are weak at any given time, but Cloud Peak Energy is fulfilling long-term contracts and paying transportation costs at long-term rates, ONRR's proposed netback value of the coal could be lower than sales prices of coal at or near the mine.

Our concern with the application of ONRR's Proposed Rule to international coal sales is not hypothetical. Using our 2014 sales data and ONRR's proposed netback approach leads to a royalty value that is less than the arm's-length "at the mine" sales price on which we paid royalty. In such situations (as in 2014), under ONRR's Proposed Rule, Cloud Peak Energy could face a claim many years later that its transportation costs are "unreasonably high" or that we breached our duty to market the coal.

ONRR's proposal to use the "default" rule to recalculate the transportation allowance and/or recalculate the reasonable value of the coal if, in ONRR's view, the transportation allowance is too high or the coal value is too low, is unfair. It seeks to benefit from Cloud Peak Energy's logistics business profits when the risk pays off, but at the same time insulate ONRR from that risk if it doesn't.

D. A Possible 50% Cap on Transportation Costs Would be Arbitrary and is Grossly Illogical in Consideration of the Netback

While ONRR's Proposed Rule does not include a cap on transportation deductions for its proposed net-back calculation, ONRR does request comments "on whether we should limit coal allowances [for washing and transportation] to 50% of the value of the coal." *See* 80 Fed. Reg. at 629. That ONRR would suggest capping transportation deductions at 50% of the value of the coal shows that it either does not understand the economics of logistics services (and the transportation costs required) or – more likely – that its true objective is to use new royalty rules as a back-door way of depriving Federal coal lessees of a viable export opportunity, which will negatively impact employment.

In many export coal sales, transportation costs can exceed $35 per ton. Therefore, at any price of less than $70 per ton, a 50% limitation would arbitrarily shift the value of transportation services into the value of coal. The effect of ONRR's possible proposal is that Federal coal producers who deliver coal (either to foreign customers or domestic customers) would pay a royalty on far more than the value of the coal at the mine.

Further, Cloud Peak Energy believes that by even requesting comments on a 50% limitation on transportation costs, ONRR is continuing to demonstrate that it has completely abandoned any interest in establishing the value of coal 'at the mine' as required by the 1920 Mineral Act.

E. If Revision is Needed, ONRR Should Amend the Benchmarks and Not Eliminate them Altogether

Cloud Peak Energy believes that the current valuation benchmarks are workable, providing different valuation options based on how the coal is sold and what information is available to ONRR and the lessee. However, Cloud Peak Energy agrees with ONRR that it is problematic that the first benchmark does not include the use of comparable arm's-length sales by the lessee or its affiliates at or near the mine. *See* 80 Fed. Reg. at 628.

As discussed above, comparable arm's-length sales at the lessee's own mine is the most accurate means of determining an "at the mine" value. In addition, examination of the lessee's own arm's-length sales at or near the mine best ensures compliance with ONRR's comparability factors set forth in 30 C.F.R. §§ 1206.257(c)(2)(i) (for Federal leases) and 1206.456(c)(2)(i) (for Indian leases). Those factors include "[p]rice, time of execution, duration, market or markets served, terms, quality of coal, quantity, and such other factors as may be appropriate to reflect the value of the coal[.]" *Id.* § 1206.257(c)(2)(i). In the case of Cloud Peak Energy, the vast majority of coal is sold at or near the mine under arm's-length contracts. Accordingly, there is ample evidence of the value of the coal at the mine, including the coal that is ultimately shipped to international customers.

ONRR should amend the current benchmarks to include in the first benchmark the use of the lessee's comparable arm's-length sales at the same mine. Significantly ONRR has included this valuation option in the first benchmark for gas (*id.* § 1206.152(c)(1)); there is no reason to exclude it for coal. Including the option for coal would eliminate the need to resort to the complicated and unreliable netback approach.

If sufficient comparable arm's-length sales data are not available for a particular mine, ONRR could include as a subsequent benchmark the option to value non-arm's-length sales of coal based on an

applicable index price, or an appropriately amended index price. Coal index prices are available through Argus/McCloskey's Coal Index Price Service[2] and through Platts Market Data service.[3]

Platts has been publishing daily and weekly index prices, also known as price assessments, for standardized products since 2003. The four standard products are Central Appalachian barge-delivered coal, Central Appalachian rail-delivered coal, and two low-sulfur Powder River Basin coal products, one with 8,800 Btu/lb. and the other with 8,400 Btu/lb. Weekly assessments of the traditional physical market include five assessments for coal from the Powder River Basin, Colorado, and Utah: (1) PRB 8,800 Btu/lb., 0.8 SO_2 lb./MMBtu; (2) PRB 8,400 Btu/lb., 0.8 SO_2 lb./MMBtu; (3) Colorado 11,700 Btu/lb., 0.8 SO_2 lb./MMBtu; (4) Colorado 11,000 Btu/lb., 0.8 SO_2 lb./MMBtu; and (5) Utah 11,500 Btu/lb., 0.8 SO_2 lb./MMBtu. Platts also publishes weekly assessments for production from the Appalachian and Illinois basins.

Similarly, Argus publishes daily and weekly price assessments for all world market centers, including Central Appalachia, Northern Appalachia/Pittsburgh Seam, Illinois Basin, Powder River Basin, Western Bituminous, U.S. export prices, U.S. import prices, and Latin America. Argus coal price assessments rely on a wide variety of sources for information including producers, generators, marketers, importers, exporters, traders, brokers, and data from electronic trading platforms.

The published index prices are reliable, as reflected by their widespread use for indexation of long-term contracts, spot market contracts, derivatives transactions such as swaps and exchange settlements, internal transfer pricing, market analysis, and performance measures. In fact, Cloud Peak Energy relies on published index prices for indexation of some of its long-term contracts. Because of the increasing volumes of sales being reported to Argus and Platts for indexing (Cloud Peak Energy reports 100% of its sales), and the verification analysis conducted by these services, the indexed values are a much better indicator of value at or near the lease. Importantly, the index prices can be (and are) adjusted to determine the value of the coal from various mines.

The use of an index price, or appropriately adjusted index price, for determining value at the mine is a simple and reliable option for lessees and ONRR to use for valuing non-arm's-length coal sales. An index price option should be an available benchmark option if evidence of comparable arm's-length sales at the mine is not available.

F. There Are Other Serious Legal Defects in the Proposed Rule

As explained above, the Proposed Rule is contrary to basic royalty principles, Congressional intent in the Mineral Leasing Act, and long-standing regulations. And there are ways ONRR can improve any weaknesses in the current benchmark system without embarking on such a radical change in the way non-arm's-length contracts are valued. Beyond these fundamental points, there are serious and potentially fatal legal defects and analytical gaps in ONRR's proposal.

1. The Proposed Rule Unfairly Discriminates Against Federal Coal Producers Compared to Federal Oil & Gas Lessees

ONRR's Proposed Rule unfairly treats coal lessees differently than oil and gas lessees. The Proposed Rule will deny coal lessees the option to value non-arm's-length coal sales based on a published index price or adjusted index price. ONRR, however, already provides this option to oil lessees (*see* 30 C.F.R. §§ 1206.102(a)(2), (d)(1), (d)(2)(i) and 1206.103) and ONRR is now proposing to provide the option to gas lessees. 80 Fed. Reg. at 609, 620. Providing oil and gas lessees valuation options for non-arm's-

[2] Available at http://www.argusmedia.com/Coal/Argus-McCloskeys-Coal-Price-Index-Report (last accessed February 26, 2015).
[3] Available at http://www.platts.com/product-list/coal/all/market-data (last accessed February 26, 2015).

length sales that are denied coal lessees unfairly discriminates against coal lessees. An index price option will enable oil and gas producers to pay royalty on a reasonable value at or near the lease, but coal lessees will not have such option.

Coal producers will not have any option but to use affiliate resale prices. If ONRR is going to abandon the benchmark system for non-arm's-length coal sales, it needs to provide an option for coal producers to use publicly available index prices for coal, with adjustments to reflect differences in location and quality of coal. As explained above, the available index prices are reliable and, with some adjustment in appropriate cases, provide true "at the mine" values. Withholding an index price option from coal lessees, while providing the option to oil and gas lessees, is inconsistent and discriminatory. Inconsistent treatment of similar situations is the very definition of arbitrary and capricious – and thus unlawful – agency action. *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996) ("[a]n agency must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so.").

2. ONRR Erroneously States That the Proposed Rule Will Have "No Net Revenue Impact" on Federal Coal Royalties

ONRR contends that the proposed change to use affiliate resale prices for valuing non-arm's-length coal sales will have "no royalty effect" on lessees; it further asserts that "there is no cost to lessees who produce Federal coal due to this valuation change in the proposed rules." 80 Fed. Reg. at 639. ONRR's contention is based on the false conclusion that "non-arm's-length sales of Federal coal that is then resold at arm's-length are rare." *Id.* In reality, as ONRR knows, non-arm's-length coal sales are quite common. *See* Report to the Royalty Policy Committee, *Mineral Revenue Collection From Federal and Indian Lands and the Outer Continental Shelf,* at 72 (Dec. 17, 2007) ("Nonarms-length transactions are common in the coal industry."). As in Cloud Peak Energy's case, some coal is sold to an affiliated logistics company for transport to distant customers, and in other cases, coal is sold to an affiliate so that the affiliate can fulfill independent coal supply contracts. *See, e.g. Decker Coal*, 2009 WL 700221. The commonality of non-arm's-length coal sales in general is evidenced by the several administrative decisions involving the valuation of non-arm's-length coal sales under the past and current benchmarks. *See Western Fuels-Utah, Inc.*, 130 IBLA 18 (1994) (involving non-arm's-length sales to a coal fired electrical generation facility); *Dry Fork Coal Co. Appellant,* MMS-95-0245-MIN, 1997 WL 34844653 (July 1, 1997) (same).

Cloud Peak Energy strenuously disagrees with ONRR's claim that the Proposed Rule will have "no royalty effect." For the coal industry in general and in Cloud Peak Energy's case, the use of an affiliate resales approach for valuing non-arm's-length coal sales will lead to a dramatic change in the royalty valuation by imposing a royalty obligation on far more than the coal itself. The Proposed Rule seeks to impose a royalty on services provided by vertically integrated companies such as Cloud Peak Energy's logistics business. ONRR's Proposed Rule, however, fails to recognize the separate nature of our logistics services business, which is already subject to income taxes and assumes substantial risks and costs independent from our mine site sales to arrange for delivery of commodities to remote locations. It is well-established that third party logistics companies are not required to pay Federal royalties on their re-sales of the same coal, yet the Proposed Rules attempts to impose a royalty on affiliated logistics services businesses.

Further, the allowed transportation deduction, even if not recalculated and reduced by ONRR, will not come close to covering the costs and risks of our logistics business. The Proposed Rule will make it difficult for affiliated logistics companies to compete with unaffiliated companies (such as non-mine brokers) because of the additional royalty cost. Non-mine brokers would be able to buy the coal at the mine and transport it for export without having to pay royalty on the increased value achieved away from the mine. These effects caused by the Proposed Rule will be felt only by the coal industry because oil

and gas lessees have other valuation options, such as the index price option, that allow for "at the mine" valuations and will lessen the effects of the Proposed Rule.

Of course, if non-arm's-length coal sales are "rare," and the Proposed Rule will have "no effect" on Federal royalty payments, then why is ONRR seeking to make such a dramatic change in its regulations? ONRR's claim that the Proposed Rule will have "no effect" seems designed to avoid Congressional review for its attempt to use the royalty rules to discourage, if not stop, exports of Federal coal. Given the magnitude of the proposed changes, it would be inconceivable to claim that there is no net change to royalty payments.

3. The Proposed Rule Improperly Discourages Federal Coal Exports

Under the Proposed Rule, it will cost more for Cloud Peak Energy to export Federal coal than it will to export private or state coal. Accordingly, the Proposed Rule makes international coal shipments for Federal coal less attractive, creating incentive to forego Federal coal exports or to produce private or state coal instead of Federal or Tribal coal. Such effect is in direct conflict with the MLA's intent to encourage Federal coal development. *See, e.g.,* 58 CONG. REC. 7784 (1919) ("It is very important that the Federal Government should conserve all the rights and resources it now holds in these public lands and at the same time provide for their development with such financial returns as will aid greatly in the improvement of these portions of the country.").

As discussed above, Cloud Peak Energy makes millions of dollars in lease and royalty payments to the Federal government every year—in 2014, $69 million in lease payments to BLM and $191 million in royalties to ONRR to be retained by the Federal government and/or distributed to the States. Discouraging Federal and Indian coal development could deprive the Federal and Tribal governments, as well as the States who share in Federal coal royalty, of much needed revenue.

4. The Proposed Rule Levies an Unconstitutional Export Tax

The U.S. Constitution Prohibits Tax on exports. As it relates to coal, the background of the Proposed Rule strongly suggests it is targeted directly at exports. The U.S. Constitution specifically prohibits the imposition of duties on goods by reason of exportation to an international country.

Since under the ONRR's proposal Federal royalties would be based upon a value of coal at the point of delivery (which includes the value of transport, handling, logistical services, financial risk mitigation, elimination of shipping risks, and so forth), there will necessarily be a much higher royalty on exports of Federal coal when compared to non-exported coal. As such, the economic substance of the Proposed Rule is an imposition of an export tax, in contravention of the U.S. Constitution, Article 1, section 9, clause 5 ("No Tax or Duty shall be laid on Articles exported from any State."). Courts have recognized that fees or taxes that apply to the sale of coal into export markets violate the Export Clause. *See Consolidation Coal Co. v. United States*, 528 F.3d 1344, 1347 (Fed. Cir. 2008) (finding that if the Surface Mining Control and Reclamation Act reclamation fee was calculated based on the extraction *and sale* of coal, such that it applied to coal exports, it would be an unconstitutional violation of the Export Clause as a tax on exports); *see also Ranger Fuel Corp. v. United States*, 33 F. Supp. 2d 466, 467 (E.D. Va. 1998) (holding an IRS-imposed coal excise tax unconstitutional and in violation of the Export Clause).

G. Cloud Peak Energy Supports the Portion of the Proposed Rule Concerning Royalty Valuation Agreements

ONRR proposes to amend 30 C.F.R. § 1206.250 to clarify that an express provision of any individualized settlement agreement, written agreement, or lease provision, establishing a method to determine the value of coal production, will govern over any inconsistent regulation in the Proposed Rule. 80 Fed. Reg. at 663. This is consistent with the current gas regulation. *See* 30 C.F.R. § 1206.150. Cloud Peak Energy

agrees that ONRR should be able to enter into written valuation agreements with lessees that supersede any inconsistent provisions in the regulations. Such agreements give flexibility to ONRR and lessees to address potentially unique or different circumstances. There is no reason that such agreements can be made for royalty valuation of gas, but not for coal.

H. Honoring Existing Agreements

If ONRR finalizes the Proposed Rule eliminating the benchmarks and drastically changing the coal royalty valuation methods, ONRR should include a grandfather clause which would provide for the continuation of current royalty benchmark rules until the existing sales and transportation contracts have expired.

V. Conclusion

Cloud Peak Energy urges ONRR to retain the existing benchmark system. Improvements to the existing benchmark system may include adding to the first benchmark the use of the lessee’s comparable arm’s-length sales at the same mine and an index valuation benchmark. ONRR’s proposal to impose a netback methodology on affiliate sales of coal to international coal customers, along with a proposed “default” rule, is contrary to the Congressional intent of creating clarity and well-established principles of royalty valuation.

Thank you in advance for your consideration of these comments and for incorporation of these points into any subsequent phases of this proposed rulemaking process. Please feel free to contact me if additional details or explanation of these comments would be helpful in that process.

Yours sincerely,

Colin Marshall

Summary: An Assessment of U.S. Federal Coal Royalties

Current Royalty Structure, Effective Royalty Rates, and Reform Options

Headwaters Economics | January 2015

Introduction

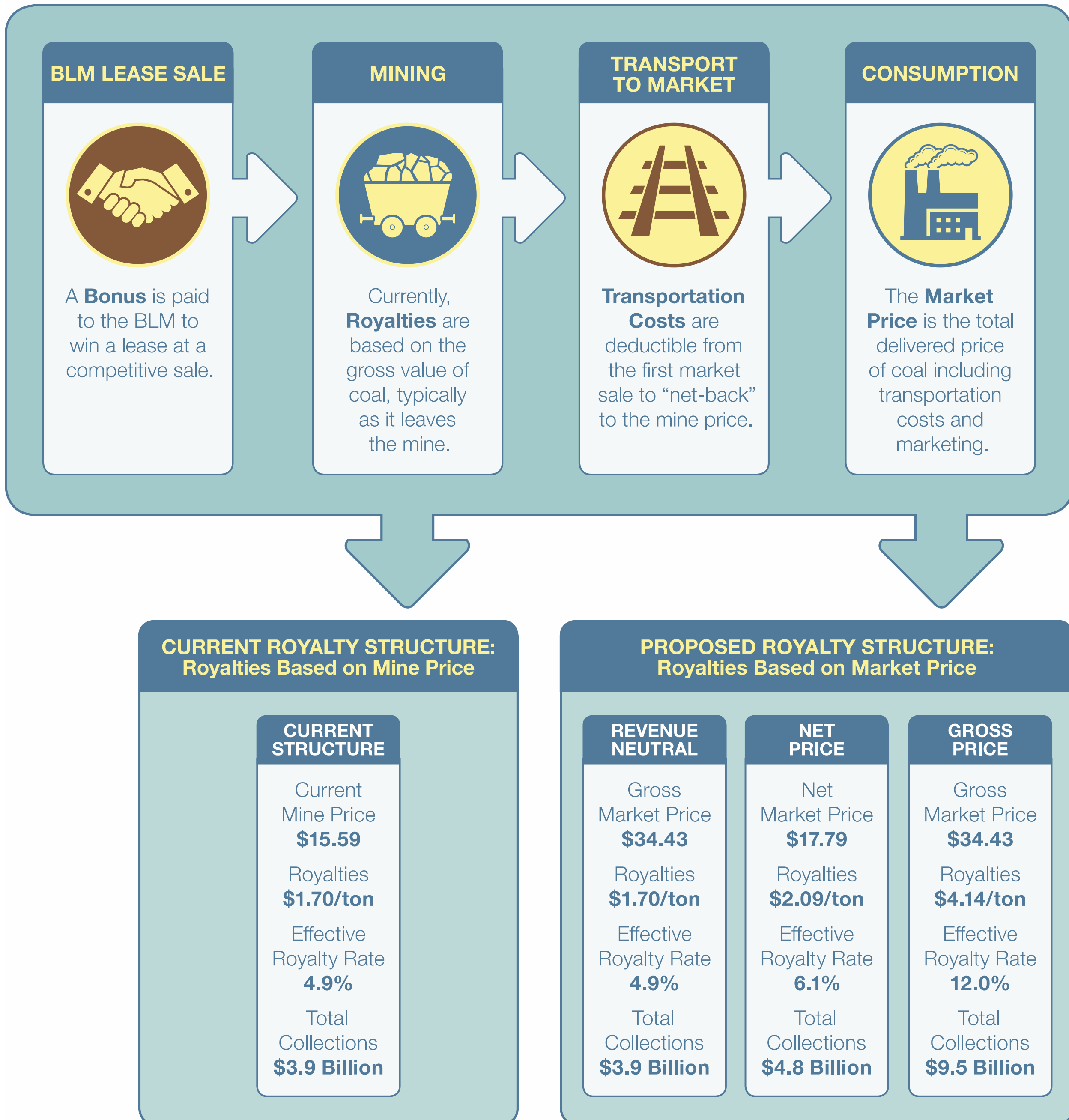
This is an executive summary of a larger report that analyzes how revenues from federal coal are obtained, reviews problems with the current system, estimates current effective royalty rates, and offers several reform options.

Coal extracted from federal land is an important source of energy and revenue in the United States. The U.S. government owns roughly one-third of total coal reserves. Bonus payments and royalty revenue from minerals extracted from public lands and waters represent the largest non-tax source of income for the federal government. Despite the importance of this revenue stream, little information is available to describe accurately the return to the public from taxation of federal coal resources. This paper analyzes how revenues from federal coal are obtained, estimates current effective royalty rates, reviews problems with the current system, and assesses policy reform options.

Challenges with Royalty Structure

The Bureau of Land Management (BLM) and the Office of Natural Resources Revenue (ONRR) administer the federal coal leasing program and have multiple and diverse objectives: a fair return for U.S. taxpayers, economic development and jobs, energy costs and security, and environmental protection. Royalties are the owner's share of the resource value, but the ONRR often accepts less than full value—the effective royalty rate is 4.9 percent of the gross market value of coal extracted between 2008 and 2012 (compared to the average statutory rate of 12.3 percent). Evaluating the effective returns earned by the ONRR under the current royalty structure reveals several problems:

- The first problem is transparency. The royalty rates applied to each lease, prices used to determine royalties due, and allowable cost deductions are all considered proprietary and data are withheld. As a result, there is little outside oversight of the royalty structure, engendering uncertainty about how the government is balancing competing interests.
- Second, the cost of administering the current royalty structure is high. Royalties are often based on non-market transactions where prices are uncertain and the ONRR uses complex valuation methods that are expensive to administer.
- Third, coal valuation procedures raise questions about fair returns to the U.S. government. The ONRR values coal for royalties at the first point of sale at or near the mine, limiting royalty collections when the coal is remarketed at significantly higher prices, including for export.


Current U.S. Coal Royalty Structure,
Valuation Policy, and Reform Options
BLM LEASE SALE
A Bonus is paid to the BLM to win a lease at a competitive sale.
MINING
Currently, Royalties are based on the gross value of coal, typically as it leaves the mine.
TRANSPORT TO MARKET
Transportation Costs are deductible from the first market sale to “net-back” to the mine price.
CONSUMPTION
The Market Price is the total delivered price of coal including transportation costs and marketing.
CURRENT ROYALTY STRUCTURE: Royalties Based on Mine Price
CURRENT STRUCTURE
Current Mine Price $15.59
Royalties $1.70/ton
Effective Royalty Rate 4.9%
Total Collections $3.9 Billion
PROPOSED ROYALTY STRUCTURE: Royalties Based on Market Price
REVENUE NEUTRAL
Gross Market Price $34.43
Royalties $1.70/ton
Effective Royalty Rate 4.9%
Total Collections $3.9 Billion
NET PRICE
Net Market Price $17.79
Royalties $2.09/ton
Effective Royalty Rate 6.1%
Total Collections $4.8 Billion
GROSS PRICE
Gross Market Price $34.43
Royalties $4.14/ton
Effective Royalty Rate 12.0%
Total Collections $9.5 Billion
http://headwaterseconomics.org

Royalty Reform Options

A range of alternative policy options would remedy problems with the current system and offer benefits to the U.S. public. The figure on the next page illustrates the current coal royalty structure, valuation policy, and returns, and illustrates the projected outcomes of reforms that would value coal for royalties using market prices. Changing the point of valuation would achieve several benefits:

- Moving the point of valuation would improve transparency. Market prices of coal are known. The BLM and the public would have easy access to coal valuation data.
- Reform would greatly simplify the valuation process and reduce administrative costs.
- Reforming the royalty structure also makes it easier to assess what a fair return is, and balance these returns against other competing interests.

The figure compares the current royalty structure to three reform options. For current policy, the analysis uses actual coal sales and royalty collections between 2008 and 2012. The figure shows that the effective royalty rate over this period was 4.9 percent, and royalty collections averaged about $1.70 per ton. The price used to determine royalties averaged $15.59 for all federal coal sales.

The first reform option would be revenue neutral, achieving transparency and administrative cost reductions without changing royalty collections.

The second reform option shows that had coal valuation been based on net market prices during the same period, the effective royalty rate would have been 6.1 percent, royalty collections would have averaged $2.09 per ton, and total collections more than $850 million higher ($4.8 billion in total revenue compared to $3.9 billion in revenue under the current system). Royalty collections would have been higher because the average net market price paid for coal delivered from states with federal leases between 2008 and 2012 was $17.72, about two dollars per ton higher than the current reported sales price. The difference is an estimate of the margins (or profits) earned by affiliated and non-affiliated brokers that paid a low price at the mine for federal coal, and then remarketed this coal at higher domestic and export market prices.

The third reform option shows that had coal been valued for royalties using the gross market value—meaning transportation costs would no longer be deductible expenses—the effective royalty rate would have been 12 percent and average collections per ton would have been about $4.14 per ton. Total royalty collections would have been about $5.5 billion higher than actual royalties.

Interpreting Results

The Office of Natural Resources Revenue (ONRR) is currently proposing to change the regulations governing valuation of coal for royalty purposes. While this paper does not specifically address the rulemaking process, the results can inform the public comment and ultimately the rule that ONRR adopts.

The ONRR proposes to retain royalty valuation at or near the lease, using gross proceeds from the first arm's-length transaction (or market sale) as the basis for royalties. The rule is specifically designed to address situations where the first sale is to an affiliate broker—in other words, it is not at arm's-length and may be structured only to avoid paying royalties on the higher market value of federal coal. In making this change, ONRR would use the first market sale to determine royalty valuation.

One way to interpret our results is that the rule would effectively change royalty valuation to the net market price of coal (if transportation costs are still deductible). However, non-affiliated brokers may still play an important role in the coal market, and the rulemaking would do little to affect royalty collections. Our results define the upper end of the possible outcomes that could range from very little change up to an increased

royalty payment per ton averaging about $0.18 for federal coal in Montana and Wyoming (after accounting for state severance tax and corporate income tax interactions).

If the rulemaking additionally limits transportation costs deductions to 50 percent of actual costs, the effect of the rulemaking could be an average increase in royalty payments per ton of about $0.85 per ton (after accounting for state severance tax and corporate income tax interactions). Again, this estimate should be considered the upper end of costs that would accrue only if closing the affiliate broker loophole results in mines in Montana and Wyoming marketing all federal coal directly to consumers. If, however, brokers remain an important player in the market structure (and they still retain a cost advantage over a mine marketing coal directly by avoiding royalty payments), then changing royalty valuation and transportation deductions will have little, if any, effect on collections.

Data Withholdings and Error

Throughout this report we endeavor to use publically available data. We do this for two reasons: so that our methods and data can be easily assessed and replicated; and to document the challenges created by federal data withholdings. Understanding the current coal royalty structure is limited primarily by data availability. Detailed descriptions of data, methods, and results are presented in three appendices. In Wyoming, coal sales from federal leases account for 93 percent of all coal sales in the state. As a result, we are more confident in estimates of effective tax rates in Wyoming compared to results in states where sales from federal leases account for a small share of all coal sales in the state.

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About Headwaters Economics

Headwaters Economics is an independent, nonprofit research group with the mission of improving community development and land management decisions in the West: http://headwaterseconomics.org/.

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IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

PEOPLE OF THE STATE OF CALIFORNIA, ex rel. XAVIER BECERRA, ATTORNEY GENERAL; STATE OF NEW MEXICO, ex rel. HECTOR BALDERAS, ATTORNEY GENERAL,

Plaintiff,

v.

UNITED STATES DEPARTMENT OF THE INTERIOR; OFFICE OF NATURAL RESOURCES REVENUE; RYAN ZINKE, Secretary of the Interior; and **GREGORY GOULD,** Director, Office of Natural Resources Revenue,

Defendants.

Case No. ________________________

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

(Administrative Procedure Act, 5 U.S.C. § 551 *et seq.*)

INTRODUCTION

1. On July 1, 2016, the Office of Natural Resources Revenue ("ONRR"), a division of the U.S. Department of the Interior ("DOI"), finalized the "Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform" rule ("Rule") in order to clarify the process for calculating royalties on oil, gas, and coal extracted from federal and Indian lands. 81 Fed. Reg.

43,338 (July 1, 2016). ONRR finalized the Rule after five years of public engagement including public workshops and an extended notice-and-comment period.

2. The Rule responded to dramatic changes that have taken place in domestic energy markets by providing much-needed updates to existing regulations. Significantly, the Rule addressed a coal industry practice of depressing commodity values by selling coal to affiliated companies at artificially low prices. *Id*. at 43,339. By offering greater simplicity, clarity, and consistency in product valuation, the Rule sought to ensure that American taxpayers received royalties reflecting the fair market value for natural resources extracted from public lands. 80 Fed. Reg. 608 (Jan 6, 2015).

3. The effective date of the Rule was January 1, 2017. However, nearly two months after the Rule went into effect, ONRR issued a notice "postponing" the effectiveness of the Rule until the resolution of pending litigation that had been filed against the Rule. ONRR has instructed oil, gas, and coal lessees to operate under regulations that predated the Rule—the very regulations that the agency determined were unclear, inconsistent, and unfair to taxpayers.

4. An agency cannot "postpone" the effective date of a rule when that effective date has already come and gone. Further, the legal basis on which the agency relied for the postponement, Section 705 of the Administrative Procedure Act ("APA"), does not apply to rules that have already gone into effect. ONRR's attempt to delay the Rule after it became effective is facially invalid, and constitutes an attempted end-run around the APA's notice-and-comment requirements.

5. Accordingly, Plaintiffs People of the State of California, ex rel. Xavier Becerra, Attorney General, and State of New Mexico, ex rel. Hector Balderas, Attorney General ("Plaintiffs") seek a declaration that Defendants' action violated the APA, and an injunction requiring Defendants to vacate the postponement and immediately reinstate the Rule.

JURISDICTION AND VENUE

6. This Court has jurisdiction pursuant to 28 U.S.C. § 1331 (action arising under the laws of the United States), 28 U.S.C. § 1361 (action to compel officer or agency to perform duty owed to Plaintiffs), and 5 U.S.C. §§ 701-706 (Administrative Procedure Act). An actual

controversy exists between the parties within the meaning of 28 U.S.C. § 2201(a), and this Court may grant declaratory relief, injunctive relief, and other relief pursuant to 28 U.S.C. §§ 2201-2202 and 5 U.S.C. §§ 705-706.

7. Venue is proper in this Court pursuant to 28 U.S.C. § 1391(e) because this is the judicial district in which Plaintiff People of the State of California, ex rel. Xavier Becerra, Attorney General resides and this action seeks relief against federal agencies and officials acting in their official capacities.

INTRADISTRICT ASSIGNMENT

8. Pursuant to Civil Local Rules 3-5(b) and 3-2(c), there is no basis for assignment of this action to any particular location or division of this Court.

PARTIES

9. Plaintiff, PEOPLE OF THE STATE OF CALIFORNIA, brings this action by and through Attorney General Xavier Becerra. The Attorney General is the chief law enforcement officer of the State and has the authority to file civil actions in order to protect public rights and interests, including actions to protect the natural resources of the State. Cal. Const., art. V, § 13; Cal. Gov. Code §§ 12600-12612. This challenge is brought pursuant to the Attorney General's independent constitutional, statutory, and common law authority to represent the public interest.

10. Fifteen percent of California's land area—15.2 million acres of public lands and 592,000 acres of Native American tribal land—is managed by the federal government. These lands contain approximately 600 producing oil and gas leases covering more than 200,000 acres and 7,900 usable oil and gas wells. California is a leading state in terms of oil extraction on public lands, producing about 15 million barrels annually, and also produces approximately 7 billion cubic feet of natural gas. Since 2008, California has received an average of $82.5 million annually in royalties from federal mineral extraction within the state.

11. Plaintiff STATE OF NEW MEXICO brings this action by and through Attorney General Hector Balderas. The Attorney General of New Mexico is authorized to prosecute in any court or tribunal all actions and proceedings, civil or criminal, when, in his judgment, the interest of the state requires such action. N.M. Stat. Ann. § 8-5-2.

1 12. New Mexico is second only to Wyoming in the number of producing oil and natural
2 gas leases on federal land. More than one-third of New Mexico's land is federally administered.
3 Annually, New Mexico produces approximately 1,220 billion cubic feet of natural gas (5% of the
4 U.S. total), of which approximately 60% is from federal and Indian lands; 85,200 million barrels
5 of crude oil (4% of the U.S. total), of which approximately 45% is from federal and Indian lands;
6 and about 22 million short tons of coal (2% of the U.S. total). Since 2008, New Mexico has
7 received an annual average of $470 million in federal mineral extraction royalties.
8 13. The People of California and the State of New Mexico have an interest in the proper
9 management of their respective States' natural resources and in receiving an appropriate share of
10 royalty payments from oil and gas that is produced on federal lands within their States. ONRR's
11 delay of the Rule has impacted or will impact the amount of royalties received by the States on
12 the extraction of these resources. Plaintiffs have suffered legal wrong by ONRR's illegal action
13 and have standing to bring this suit.
14 14. Defendant UNITED STATES DEPARTMENT OF THE INTERIOR is an agency of
15 the United States government and bears responsibility, in whole or in part, for the acts
16 complained of in this Complaint. The DOI is responsible for managing the collection and
17 calculation of royalties and other payments due on oil, gas and coal produced on federal and
18 Indian lands. 30 U.S.C. §§ 187, 1701.
19 15. Defendant OFFICE OF NATURAL RESOURCES REVENUE is an agency of the
20 U.S. Department of the Interior and bears responsibility, in whole or in part, for the acts
21 complained of in this Complaint. ONRR is the federal agency charged with managing and
22 ensuring full payment of revenues owed for development of the nation's federally-owned natural
23 resources. 30 CFR § 1201 *et seq*.
24 16. Defendant RYAN ZINKE is the Secretary of the Interior, and is sued in his official
25 capacity. Mr. Zinke oversees the responsible development of energy supplies, including natural
26 resource extraction, on public lands and waters, and has authority to promulgate regulations
27 establishing the value of federal oil and gas production, and federal and Indian coal production.
28 25 U.S.C. § 396(d); 30 U.S.C. §§ 189, 359; 43 U.S.C. § 1334.

17. Defendant GREGORY GOULD is the Director of ONRR, and is sued in his official capacity. Mr. Gould is responsible for the collection and disbursement of billions of dollars annually in revenues from energy production on all federal and Indian lands. 30 CFR § 1201.100.

STATUTORY BACKGROUND

18. The Administrative Procedure Act governs the procedures and practices of administrative law, including the procedural requirements that agencies must employ when making decisions. 5 U.S.C. § 553. The APA places on agencies the obligation to engage in a notice-and-comment process prior to formulating, amending, or repealing a rule. *Id.* §§ 551(5), 553. This process is designed to "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments." *Id.* § 553(c).

19. Section 705 of the APA states: "When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review." 5 U.S.C. § 705.

20. Under the APA, a "reviewing court shall…hold unlawful and set aside" agency action found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law…in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," or "without observance of procedure required by law." 5 U.S.C. § 706.

FACTUAL AND PROCEDURAL BACKGROUND

21. Each year ONRR collects billions of dollars in royalties on coal, oil and gas extracted from public lands. A significant portion of this revenue is distributed to states through direct disbursements and grants. 30 U.S.C. § 191(a). Since 2008, California and New Mexico have received tens or hundreds of millions of dollars respectively in royalties from federal mineral extraction within their states.

22. Existing regulations governing the valuation of federally-owned natural resources largely date back to the 1980s and fail to take into account dramatic changes that have occurred in the industry and marketplace for these minerals. 80 Fed. Reg. at 608. As a result, taxpayers receive inadequate returns from the extraction of domestic energy resources. *Id.*

23. In 2007, the DOI's Royalty Policy Committee issued a report recommending that ONRR clarify its regulations governing gas valuation and revise its regulations for "calculating

prices used in checking royalty compliance for solid minerals, with particular attention to non-arm's-length transactions." *Id*.

24. In 2011, ONRR began a five-year rulemaking process to update existing regulations for oil, gas, and coal produced from federal leases and coal produced from Indian leases. 76 Fed Reg. 30,878, 30,881 (May 27, 2011). The agency conducted outreach to stakeholders and tribes including six public workshops, and considered the information gained through this outreach in crafting a revised set of regulations. 81 Fed. Reg. at 43,338.

25. On January 6, 2015, ONRR issued a Proposed Rule to amend the valuation regulations. In particular, ONRR stated that its intent was "to provide regulations that (1) offer greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees and mineral revenue recipients; (2) are more understandable; (3) decrease industry's cost of compliance and ONRR's cost to ensure industry compliance; and (4) provide early certainty to industry and ONRR that companies have paid every dollar due." 80 Fed. Reg. at 608.

26. ONRR accepted public comment on the Proposed Rule through May 8, 2015 and received more than 1,000 pages of written comments from over 300 commenters. 81 Fed. Reg. at 43,338. For example, the California State Controller's Office submitted comments on the Proposed Rule on May 5, 2015, acknowledging "the impact of ONRR's proposals for gas valuation on California's revenue interests" and "applaud[ing] its effort to pursue some long-overdue reforms." A coalition of non-governmental organizations submitted comments on May 8, 2015, acknowledging that the Proposed Rule took important steps to "close an accounting loophole that in recent years has enabled coal companies to sell federal coal to [their] own subsidiaries, pay royalties on the initial sale, then reap windfall profits when those subsidiaries sell the same coal at a much higher price without any additional royalty."

27. After carefully considering public comments, ONRR finalized the Valuation Rule on July 1, 2016. 81 Fed. Reg. 43,338. ONRR estimates that the Rule would increase royalty collections by between $71.9 million and $84.9 million annually. *Id*. at 43,359.

28. The Rule was issued pursuant to ONRR's authority to collect, account for, and verify natural resource and energy revenues—authority granted by Congress through statutes including

1 the Mineral Leasing Act (30 U.S.C. § 181 *et seq*.), the Outer Continental Shelf Lands Act (43
2 U.S.C. § 1331 *et seq*.), and the Federal Oil & Gas Royalty Management Act of 1982 (30 U.S.C. §
3 1701 *et seq*.). 81 Fed. Reg. at 43,369.

4 29. The Rule contains a number of provisions designed to ensure the accurate calculation
5 of royalties and commodity values. By amending the processes for valuating non-arm's-length
6 coal sales, the Rule seeks to prevent an industry practice of minimizing royalty payments by
7 selling coal to subsidiaries for less than market value. 80 Fed. Reg. at 609. The Rule further
8 allows ONRR to consider downstream commodity prices, thus ensuring sufficient collection of
9 royalties on exported minerals that garner higher prices overseas than they would in the domestic
10 market. *Id*. Additionally, the Rule gives ONRR discretion to set a "reasonable value of
11 production" where there is evidence that a lessee has engaged in fraudulent practices when
12 determining commodity values. 81 Fed. Reg. at 43,341.

13 30. On December 29, 2016, various coal and oil industry groups challenged the Rule in
14 U.S. District Court for the District of Wyoming. *Cloud Peak Energy, Inc. v. United States Dep't*
15 *of the Interior,* Case No. 16-cv-315–NDF (D. Wyo.); *American Petroleum Inst. v. United States*
16 *Dep't of the Interior,* Case No. 16-cv-316–NDF (D. Wyo.); *Tri- State Generation and*
17 *Transmission Ass'n, Inc. et al., v. United States Dep't of the Interior,* Case No. 16-cv-319–NDF
18 (D. Wyo.). On March 24, 2017, prior to the submission of any briefing on the merits, the district
19 court granted the federal government's request for a 90-day stay of the litigation.

20 31. On January 1, 2017, the Rule went into effect. 81 Fed. Reg. at 43,338.

21 32. On February 22, 2017, James D. Steward, Deputy Director of ONRR, issued a letter
22 entitled "Stay of the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation
23 Reform Final Rule," which announced that the agency had "decided to postpone the effective date
24 of the 2017 Valuation Rule" and directed federal and Indian lessees to value, report and pay
25 royalties under preexisting rules. The Deputy Director cited Section 705 of the APA as the basis
26 for this postponement and stated that the agency would publish a Federal Register notice to this
27 effect.
28

1 33. On February 27, 2017, ONRR issued a delay notice for the Rule in the Federal
2 Register, citing Section 705 of the APA and the pending litigation. 82 Fed. Reg. 11,823 (Feb. 27,
3 2017) ("Postponement of Effectiveness of the Consolidated Federal Oil & Gas and Federal &
4 Indian Coal Valuation Reform 2017 Valuation Rule") ("Delay Notice"). Specifically, ONRR
5 stated that: "In light of the existence and potential consequences of the pending litigation, ONRR
6 has concluded that justice requires it to postpone the effectiveness of the 2017 Valuation Rule
7 pursuant to 5 U.S.C. 705 of the Administrative Procedure Act, pending judicial review." *Id*. The
8 agency attempted to justify the delay by arguing it would be easier for industry to maintain
9 existing accounting practices. *Id*. ONRR further noted that "[a]lthough the 2017 Valuation Rule
10 took effect on January 1, 2017, Federal and Indian Lessees are not required to report and pay
11 royalties under the Rule until February 28, 2017." *Id*.

12 34. ONRR's action was swiftly rebuked by members of Congress. Senator Maria
13 Cantwell (ranking member of the Senate Energy and Natural Resources Committee) and
14 Representative Raúl Grijalva (ranking member of the House Committee on Natural Resources)
15 both sent letters to the DOI decrying the illegal postponement as a contravention of the APA and
16 demanding that the agency reinstate the Rule.

17 35. On April 4, 2017, ONRR published an "advance notice of public rulemaking" in the
18 Federal Register seeking comment on whether the Rule is needed and what, if any, revisions
19 should be made to it. 82 Fed. Reg. 16,323 (Apr. 4, 2017). On the same day, ONRR published a
20 proposal to repeal the Rule "in its entirety" in order to "maintain the current regulatory status
21 quo," notwithstanding that the Rule had been illegally stayed. 82 Fed. Reg. 16,325 (April 4,
22 2017).

23 **FIRST CAUSE OF ACTION**

24 **(Violation of the APA, 5 U.S.C. §§ 553, 705)**

25 36. Paragraphs 1 through 35 are realleged and incorporated herein by reference.

26 37. By applying Section 705 of the APA to a rule that was already in effect, Defendants
27 contradicted the plain meaning of "postpon[ing] the effective date" of a rule. 5 U.S.C. § 705.
28

38. Because the Rule was already in effect prior to its postponement, Defendants have effectively revoked the Rule without completing the notice-and-comment procedures required by the APA. 5 U.S.C. § 553.

39. Accordingly, Defendants' action was unlawful and contrary to the requirements of the APA. 5 U.S.C. §§ 553, 705.

SECOND CAUSE OF ACTION

(Violation of the APA, 5 U.S.C. § 706)

40. Paragraphs 1 through 39 are realleged and incorporated herein by reference.

41. Defendants, by invoking APA Section 705 to "delay" the Rule after it had already gone into effect, acted in a manner that was arbitrary, capricious, an abuse of discretion, not in accordance with law, and in excess of their statutory authority. 5 U.S.C. § 706.

THIRD CAUSE OF ACTION

(Violation of the APA, 5 U.S.C. § 706)

42. Paragraphs 1 through 41 are realleged and incorporated herein by reference.

43. Defendants did not, in issuing the Delay Notice, adequately consider economic and environmental harms to the public as required by the four-part test for postponing a rule pursuant to Section 705 of the APA.

44. The grounds offered by Defendants do not justify the delay of the Rule.

45. Delay of the Rule is therefore arbitrary and capricious, an abuse of discretion, not in accordance with law, and in excess of Defendants' statutory authority. 5 U.S.C. § 706.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs respectfully request that this Court:

1. Issue a declaratory judgment that Defendants acted arbitrarily, capriciously, contrary to law, abused their discretion, and failed to follow the procedure required by law in their delay of the Valuation Rule, in violation of the APA;

2. Vacate Defendants' unlawful postponement of the Rule;

3. Issue a mandatory injunction compelling Defendants to reinstate the Rule;

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4. Award Plaintiffs their costs, expenses, and reasonable attorneys' fees; and

5. Award such other relief as the Court deems just and proper.

Dated: April 26, 2017

Respectfully Submitted,

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