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Comments to the Office of Natural Resources Revenue on the Delay of Effective Date of the 2020 Valuation Reform and Civil Penalty Rule

Taxpayers for Common Sense (TCS) provides the following comments to the Office of Natural Resources Revenue's (ONRR's) Delay of Effective Date of the 2020 Valuation Reform and Civil Penalty Rule (86 FR 9286). TCS is a national non-partisan budget watchdog that has been working on behalf of the nation's taxpayers since 1995. TCS works to ensure taxpayers receive a fair return on all resources extracted or developed on federal lands and waters. This includes oil, gas, coal, hardrock minerals, wind, solar and timber. Revenues collected from resource development represent an important source of income for the federal government and must be collected, managed, and accounted for in a fair and accurate manner.

TCS appreciates the delay of the effective date of the final 2020 Valuation Reform and Civil Penalty Rule ("2020 Rule") published on January 15, 2021 (86 FR 4312) as well as the opportunity to provide comments. In general, ONRR's "Consolidated Federal Oil and Gas and Federal and Indian Coal Valuation Reform" final rule ("2016 Rule") published in July 2016 represented an important measure to better ensure taxpayers receive a fair return from the development of federal resources. By rolling back several advances made by the 2016 Rule, the 2020 Rule undermined the taxpayer interest at a cost of roughly $290 million over ten years.

TCS welcomes the delay of the effective date of the 2020 Rule as an opportunity for the Department of the Interior (DOI) and ONRR to reconsider the recent changes to valuation policy. The costly determination that deepwater gathering costs can be deducted from resource value, the reimposition of "soft caps" on allowances, the renewed availability of extraordinary processing allowances, many other provisions of the 2020 Rule, and ONRR's stated justifications for them are corrosive to the responsible management of taxpayer assets. TCS encourages ONRR to rescind the 2020 Rule and anticipates submitting more extensive comments for any such action. In response to the specific issues presented in the notice of the delay, TCS provides the following comments:

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

The federal government manages federal lands and waters and the extraction of natural resources from them on behalf of the American public. Agencies like the DOI are obligated to serve the public interest by protecting taxpayers' financial interest unless otherwise directed by statute. Congress has consistently affirmed this obligation: regarding onshore development, by making it policy that the federal government receive “fair market value of the use of the public lands and their resources;”[1] for development on the Outer Continental Shelf, by directing that “[l]easing activities shall be conducted to ensure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government.”[2]

This statutory obligation entails that ONRR should preserve the valuation of oil and natural gas for royalty purposes as close to the market value as possible. The 2020 Rule fails to protect the taxpayer interest in several places because it allows for practices and allowances that devalue resources and ultimately reduce federal revenue without adequate justification. In particular, allowing lessees to include deepwater gathering costs as part of the transportation allowance is completely inconsistent with law and longstanding policy.

ONRR’s precursor, the Minerals Management Service (MMS), considered the issue of deepwater gathering costs in 1987 regulations. In its final 1988 rule, MMS concluded: “that gathering is a cost of making oil marketable, which must be borne exclusively by the lessee.”[3] The MMS’ subsequent decision to allow for exceptions to this policy through its “Guidance for Determining Transportation Allowances for Production from Leases in Water Depths Greater Than 200 Meters” should not be overweighted. As ONRR stated in 2016, the policy was meant “to incentivize deep water leasing by allowing lessees to deduct broader transportation costs than the regulations allowed,”[4] and expressly did not change the principle undergirding the regulation.

By writing the “Deepwater Policy” into federal regulation, the 2020 Rule did more than “reinstitute” the excessive allowance, it cemented the policy beyond the pre-2016 rule status quo. ONRR’s cost estimates associated with the 2016 Rule and 2020 Rule demonstrate the difference. When ONRR revoked its Deepwater Policy guidance in the 2016 Rule, royalties were expected to increase by $20.5 million per year. Now, because lessees can include gathering costs in transportation allowances *by rule*, taxpayers will lose an estimated $32.9 million per year.

Congress made it official policy that DOI must make the Outer Continental Shelf “available” for development.[5] Current law does not require DOI to incentivize production for industry’s benefit. The original determination of MMS in 1988 was correct, gathering costs should be borne by producers, and ONRR’s 2016 decision to eliminate the Deepwater Policy as an incentive served the taxpayer interest.

Lastly, the 2020 Rule’s premise for reinstating the Deepwater Policy was fundamentally flawed. Commodity prices cannot be the basis for consistent federal policy and the taxpayer interest is not served by improving the profitability of Gulf of Mexico (GOM) oil and gas production by reducing the federal return. The mandate to conserve resources requires DOI to be responsive to operator economics in select circumstances, but it neither authorizes nor requires federal policymaking that suits any specific lessee when dealing with certain market conditions.

For example, according to ONRR data, GOM gas production has steadily declined since at least fiscal year (FY) 2003. However, GOM lessees produced 637 million barrels of oil in FY2020, more than any year since FY2003 with the exception of only FY2019. This reflects a market that rewards oil production over gas production through prices established by supply and demand dynamics. By accommodating the market and promoting gas production, ONRR would not only be reducing federal revenues, it would also contribute to prolonging low price levels.

[1] Federal Land Policy and Management Act of 1976 (P.L. 94–579)
[2] 43 U.S.C. § 1344(a)(4)
[3] 53 FR 1191 (January 15, 1988)
[4] 81 FR 43340 (July 1, 2016)
[5] 43 U.S.C. § 1332(3)

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

No, the reinstatement of extraordinary processing allowances is not consistent with current law and policy. As outlined above, ONRR is obligated to collect fair market value for the development of federal resources. That obligation is not conditional on how strenuously certain producers or States ask for an exception. ONRR's reasons for the reinstatement in the 2020 Rule are inadequate to justify such extensive revenue loss.

The elected representatives of the State of Wyoming may be willing to forego revenue because they otherwise value the two lessees that have historically received approval for extraordinary processing allowances. But the interest of the United States is distinct from the interest of the State of Wyoming and changing regulation to suit the economics of two lessees is inequitable and unjustified. There is no mandate that DOI ensure all natural resources are developed regardless of the economic feasibility of production. If the two natural gas streams cannot be economically developed by the current lessees, then the federal interest is served either by allowing lease turnover to accommodate potentially cheaper operators or allowing the lessees to present their case for other existing accommodations without altering the underlying valuation regulations.

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

TCS refrains from assessing whether ONRR appropriately considered all public comments during the 2020 rulemaking process. However, ONRR's actions indicate its process violated the directive of Executive Order 13563 to establish rules based "on the open exchange of information and perspectives…"[6] While preparing the proposed rule, ONRR engaged exclusively with representatives of the oil and gas industry without seeking out the perspective of other stakeholders. ONRR's exclusion of "contrary facts and arguments" had an expected result: the final 2020 Rule largely reflects the stated position of the regulated industry.

In March 2019, the United States District Court for the Northern District of California vacated the 2017 repeal of the 2016 Valuation Rule and reinstated the underlying rule (*California, v. U.S. Dep't of the Interior,* 381 F. Supp. 3d 1153). In the Fall 2019 Unified Agenda of Regulatory and Deregulatory Actions, the DOI stated its intent to publish a proposed rule regarding valuation of minerals for royalty purposes. In March 2020, staff from the White House Office of Management and Budget (OMB) and DOI met with representatives from the oil and gas industry.[7]

These meetings, disclosed in compliance with EO 12866, reflect proper engagement with entities "likely to be affected" by a rulemaking before the issuance of a notice of proposed rulemaking.[8] ONRR had

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[6] Executive Order 13563, Sec. 2(a); 76 FR 3821 (Jan. 21, 2011)

[7] EO 12866 Meetings reported for RIN: 1012-AA27, available at: https://www.reginfo.gov/public/do/eom12866SearchResults?pubId=201910&rin=1012-AA27&viewRule=true

[8] Executive Order 13563, Sec. 2(c); 76 FR 3821 (Jan. 21, 2011)

similar meetings with representatives of the coal industry in 2014 before issuing its proposed valuation rule in 2015.[9] At that time, ONRR also engaged other stakeholders including groups representing environmental concerns and the perspective of communities with resource production.[10] In the 2020 rulemaking, however, DOI staff not only forewent meetings from a diversity of perspectives, it evidently also accepted the suggestions it received exclusively from industry groups.

In one March 2020 meeting, the Independent Petroleum Association of America explained specific changes it wanted to the 2016 Rule, including: scrapping use of the highest bidweek price for index valuation; inclusion of deepwater gathering costs in transportation allowances; and re-instatement of "soft" caps for allowances, among others.[11] The 2020 Proposed Rule as well as the 2020 Final Rule included all these changes, even though they reduced revenue to the federal government and directly contradicted prior ONRR positions. The 2020 Rule is not the result of an "open exchange of information and perspectives," but rather the codification of a single perspective.

To remedy this procedural issue, ONRR should seek out a broader array of perspectives in an any subsequent action related to the rules for resource valuation for royalty purposes.

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

The 2020 rule should be rescinded through a process complying with all Executive Orders guiding agency rulemakings and the Administrative Procedures Act. ONRR can address any outstanding issues with the 2016 Rule, and the problem of valuing federal coal sold through non-arm's length transactions, more efficiently in a subsequent rulemaking than by attempting to amend the fatally flawed 2020 Rule.

[9] U.S. Department of the Interior, ONRR – "Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform," January 6 2015, 80 FR 608

[10] EO 12866 Meetings reported for RIN: 1012-AA13, available at: https://www.reginfo.gov/public/do/eom12866SearchResults?pubId=201504&rin=1012-AA13&viewRule=true

[11] EO 12866 Meeting on March 12 2020, document: IPAA OIRA Meeting