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Comments to the Office of Natural Resources Revenue on the Proposed Withdrawal of the ONRR 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) Proposed Withdrawal of the 2020 Valuation Reform and Civil Penalty Rule (86 FR 31196). 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.

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 Valuation Reform and Civil Penalty Rule ("2020 Rule") published on January 15, 2021 (86 FR 4312) undermined the taxpayer interest at a cost then estimated at roughly \$290 million over ten years.¹

In response to ONRR's Delay of Effective Date of the 2020 Valuation Reform and Civil Penalty Rule ("First Delay Rule" – 86 FR 9286), TCS submitted comments encouraging ONRR to rescind the 2020 Rule because its provisions and the stated justifications for them are corrosive to the responsible management of taxpayer assets. Correspondingly, TCS appreciates the Proposed Withdrawal Rule and ONRR's careful reconsideration of its proper role in resource revenue collection and regulation.

The historical record surrounding the creation of ONRR during the purposeful division of the responsibilities of the Minerals Management Service (MMS) indicates ONRR's primary role as one of revenue collection, accounting, and auditing as distinct from leasing policy and planning. Intentionally reducing revenue collections in an attempt to incentivize production is antithetical to ONRR's fiduciary responsibility. Admittedly, ONRR's lack of statutory foundation creates ambiguity regarding its authority to issue rules to incentivize production. But to the extent ONRR has such authority, the agency must bear an increased burden to justify the issuance of rules that contravene its primary role. In the 2020 Rule, the agency failed to meet both this threshold and the justification required for any agency action under the Administrative Procedures Act. This failure requires ONRR to withdraw the revenue-impacting provisions of the 2020 Rule, as proposed in the current action.

¹ New analysis presented in the Proposed Withdrawal Rule indicates the 2020 Rule's cost would be even greater than initially estimated.

ONRR's Role in Protecting the Return to Taxpayers

The federal government manages federal lands and waters and the extraction of natural resources from them on behalf of the American public. Agencies including the Department of the Interior (DOI) are obligated to serve the public interest by protecting taxpayers' financial interest. 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;"² for development on the Outer Continental Shelf (OCS), 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."³

For years, this statutory obligation was compromised by the MMS' conflicting efforts to promote drilling in the OCS.⁴ All evidence indicates the DOI cleaved MMS into the Bureau of Ocean Energy Management (BOEM), the Bureau of Safety and Environmental Enforcement (BSEE) and ONRR to restore protection of taxpayer's return from federal resource development. Statements made by Secretary of the Interior Ken Salazar when establishing ONRR⁵ and Gregory Gould as Director of ONRR months later⁶ emphasize the agency's mission as collecting what's due for taxpayers.

TCS appreciates ONRR's reassessment of its responsibilities in the Proposed Withdrawal Rule and the acknowledgement of ONRR's purpose:

Finally, it should be remembered that ONRR's primary functions include ensuring fair return (i.e., fair value) for the public from royalty and revenue collection and disbursement activities. As a result, any decision by ONRR to incentivize or disincentivize production that compromises the attainment of a fair return for the United States would be outside ONRR's primary function. (86 FR 31200)

The 2020 Rule is flawed to the extent it used Executive and Secretarial Orders then in effect to incentivize energy production explicitly by reducing the return to taxpayers. ONRR defended the departure from its founding purpose by noting "it shares the Department's policy goals to promote the development of natural resources and to obtain for the public a reasonable financial return on assets that belong to the public," (86 FR 4623). This is a grossly inaccurate reading of the governing statutes, which require the collection of "fair market value," not a "reasonable financial return." This diminishment of the standard of return may alone undermine any provisions of the 2020 Rule justified by a desire to incentivize production.

For authority to issue rules that incentivize production, the 2020 Rule points to the general regulatory authority granted to the Secretary of the Interior by the Mineral Leasing Act of 1920 (MLA), the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) and Outer Continental Shelf Lands Act of

² Federal Land Policy and Management Act of 1976 (P.L. 94-579)

³ 43 U.S.C. § 1344(a)(4)

⁴ National Commission on the BP Deepwater Horizon Oil Spill & Offshore Drilling – [Final Report To The President: Deep Water, The Gulf Oil Disaster And The Future Of Offshore Drilling](#), January 2011, page 56.

⁵ DOI Press Release, "[Interior Establishes Office of Natural Resources Revenue](#)," Oct 1, 2010, in which Sec. Salazar notes that American taxpayers "will be better protected by the improved collection and management of revenues..." and Rhea Suh, Assistant Secretary for Policy, Management and Budget, encouraged staff saying the would provide "an historic opportunity for all of you to further your vital work of ensuring that taxpayers receive full and fair value from the development of our nation's energy resources."

⁶ [Testimony of Director Gould](#) before the House Committee on Appropriations – Subcommittee on Interior, Environment and Related Agencies, March 17, 2011 in which Director Gould notes: "ONRR is entrusted with an important fiduciary role," and reference efforts to improve ONRR's "ability to collect every dollar due."

1953 (OCSLA). Reference to FOGRMA's rulemaking authority (30 U.S.C. 1751) is misguided in that there is no provision in Chapter 29 of Title 30 of the U.S. Code that provides for encouraging greater production by reducing revenues collected from lessees.

Further, the other two authorities (the MLA and OCSLA) stipulate when the Secretary is permitted to grant royalty relief and the 2020 Rule fails to demonstrate that those circumstances were met. Namely, the Secretary can grant relief under the MLA when he deems it “**necessary** to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated otherwise,” (30 U.S.C. 209, emphasis added). Similarly, the OCSLA grants royalty relief authority “in order to promote increased production on the lease area...” (43 U.S.C. 1337(a)(3)), and authority to make rules broadly “...in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf,” (43 U.S.C. 1334(a)).

It is not clear that ONRR has the delegated authority to make rules that effectively provide royalty relief,⁷ but to do so, ONRR would need to demonstrate: 1) the rule is “necessary ...to promote development,” 2) “leases cannot be successfully operated otherwise,” 3) the rule would “promote increased production on the lease area,” or 4) the rule would “provide for the prevention of waste and conservation of the natural resources.” ONRR failed to demonstrate any of the above when issuing the 2020 Rule. As ONRR amply proves in the Proposed Withdrawal Rule, the 2020 Rule did not provide any evidence that its provisions would have any impact on production (86 FR 31201). Lacking such evidence, the 2020 Rule failed to provide a reasoned explanation for the proposed amendments.

Correspondingly, TCS agrees with ONRR's proposal to withdraw the five revenue-impacting provisions of the 2020 Rule: 1) Inclusion of deepwater gathering costs in lessees' transportation allowances; 2) the renewed ability to claim extraordinary processing allowances; 3) providing an index-based valuation option for arm's-length federal gas sales; 4) guidance to use the average bidweek price instead of highest bidweek price when using index prices to value federal gas; 5) increasing the transportation allowances for lessees using the index-pricing option.

TCS also agrees that the 2020 Rule failed to provide adequate explanation for amending the 2016 Rule in several places in addition to its failure to demonstrate the changes would increase production. The provision allowing lessees adopting the index-pricing option to use the average monthly bidweek price instead of the highest monthly bidweek price is particularly unsupported. ONRR adequately explained its decision NOT to use the average bidweek price when issuing the 2016 Rule by noting the highest bidweek price would protect the lessor interest while simplifying reporting for lessees (81 FR 43347). When reversing course in the 2020 Proposed Rule, ONRR simply concluded that allowing use of the average bidweek price would reduce the value of federal gas by approximately \$0.09 per MMBtu. The agency noted at the time “Doing so should more closely match what many lessees would otherwise receive as gross proceeds...” but refrained from providing any evidence to support that claim (85 FR 62058).

⁷ Further evidence against ONRR's ability to provide royalty relief is available in the “Memorandum of Understanding between BOEM, BSEE, and ONRR for the Collaboration on Processes, Policies and Systems Relating to the Management of [OCS] Energy and Marine Mineral Development” from March 2014. Under the “Royalty Relief” function (page A-21), ONRR is given responsibility only for information sharing and notification.

Additional Comments on the Proposed Withdrawal of the 2020 Rule

The New Economic Analysis

In a published analysis of the 2020 Rule,⁸ TCS questioned whether the extension of index-pricing to arm's-length gas and natural gas liquids (NGL) sales would raise revenue as ONRR estimated at the time. ONRR's recalculation of the provision's impact in the Proposed Withdrawal Rule provides a more reasonable expectation of the 2020 Rule's effect and the methodology used in making the estimate is sound.

Deepwater gathering costs

With regard to deepwater gathering costs, TCS endorses ONRR's analysis in Section II.B.2.b of the Proposed Withdrawal Rule and the restatement of long-held policy that gathering costs are considered part of placing gas in marketable condition and are disallowed as transportation allowances. In addition, TCS notes that ONRR's premise for reinstating the Deepwater Policy in the 2020 Rule was fundamentally flawed. In the 2020 Rule, ONRR points to reduced commodity prices and a drop in Applications for Permits to Drill (APDs) filed from offshore leases as justifications for its amendment (86 FR 4624). Commodity prices cannot be the basis for consistent federal policy. The same logic would now entail that no relief be granted because oil prices have recovered. 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 lessee in certain market conditions.

Sales Records Data

TCS encourages ONRR to consider how it can preserve the 2020 Rule's addition of language to reserve ONRR's right to collect actual sales data (§§ 1206.141(g) and 1206.142(h)) even if it largely withdraws other amendments to 43 CFR 1206.141-142. Evaluating the actual effect of a rulemaking is crucial to sound policy development. If ONRR does not otherwise have the right to collect sales data, the agency should include language preserving that right to allow for comparison of royalty values calculated using the different options for valuing non-arm's length sales of federal gas.

Conclusion

Taxpayers rely on the Department of the Interior and ONRR to manage federal natural resource development and collect a fair return on it. In its fiduciary role, ONRR should aggressively defend the lessor's interest when valuing resources and otherwise. In propagating the 2020 Rule, ONRR departed from its primary accounting and auditing role and betrayed the statutory obligation to collect fair market value on federal resources. Withdrawing the 2020 Rule in whole or in large part is needed to restore taxpayer protections, uphold valuation standards, and prevent the loss of hundreds of millions of dollars in royalty revenue over the next decade.

⁸ TCS. ["Trump Admin. Finalizes Rule to Value Federal Oil, Gas, & Coal"](#) January 22, 2021