November 24, 2020

Office of Natural Resources Revenue
ATTN: Dane Templin
Building 85, Entrance N-1, Denver Federal Center
West 6th Ave. and Kipling St.
Denver, Colorado 80225

Via electronic submission

Subject: Comment in Response to Proposed Rulemaking: 2020 Valuation Reform and Civil Penalty, RIN 1012-AA27

Dear Mr. Templin:

The Project On Government Oversight (POGO) submits the following comment in opposition to the proposed rule titled "ONRR 2020 Valuation Reform and Civil Penalty Rule," submitted by the Department of the Interior's Office of Natural Resources Revenue (ONRR) and published in the Federal Register on October 1, 2020.[1] POGO urges the Office of Natural Resources Revenue to withdraw the proposed rule. As written, the rule would unfairly allow corporations to pay less money to the government for the taxpayer-owned resources they extract from public lands.

POGO is a nonpartisan independent watchdog that investigates and exposes waste, corruption, abuse of power, and when the government fails to serve the public or silences those who report wrongdoing. We champion reforms to achieve a more effective, ethical, and accountable federal government that safeguards constitutional principles. For decades, POGO has shed light on the need for the federal government to ensure the oil and natural gas industries are paying their fair share for the publicly owned resources they extract and profit from.[2]

POGO is concerned that the proposed rule would result in taxpayers not getting what they are owed for these natural resources. By vacating the agency's 2016 Valuation Rule, the new rule would reduce the royalties paid by companies by allowing them to deduct more for transportation and processing costs. The agency estimates that the various changes in the

[1] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,054 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

[2] See, for example: "Investigative Series: Drilling Down," Project On Government Oversight, 2018-2019. https://www.pogo.org/series-collections/drilling-down/; *Getting Royalties Right: Recent Recommendations for Improving the Federal Oil & Gas Royalty System: Hearing before the House Committee on Natural Resources, Subcommittee on Energy and Mineral Reserves*, 110th Cong. 95 (March 11, 2008) (testimony of Danielle Brian, Executive Director, Project On Government Oversight). https://www.govinfo.gov/content/pkg/CHRG-110hhrg41378/html/CHRG-110hhrg41378.htm; POGO Staff, "Taxpayers Could Lose $53 Billion from Oil Leases," Project On Government Oversight, May 28, 2008. https://www.pogo.org/analysis/2008/05/taxpayers-could-lose-53-billion-from-oil-leases/

Project On Government Oversight
1100 G Street, NW, Suite 500
Washington, DC 20005
202.347.1122
pogo@pogo.org
www.pogo.org

proposed rule could result in a reduction of more than $42 million per year in royalties.[3] This public comment will address POGO's opposition to several of the agency's proposed changes to royalty calculations. While the government should always ensure a fair return, this is especially important during a global pandemic when state and local governments are struggling to supplement losses in tax revenue.

High to Midpoint Index Price for Non-Arm's-Length Gas Dispositions

Transactions in which buyers and sellers act independently from one another without one party influencing the other, also known as arm's-length transactions, can result in unbiased and therefore more accurate cost evaluations. Although the agency states that arm's-length transactions are more accurate in evaluating a lease, in 2016 the agency instituted an index-based valuation for non-arm's-length sales to increase simplicity and reduce administrative burdens to the agency and industry.[4] The index-based option also set royalty values at the highest monthly bidweek price for unprocessed gas and residue gas, and the average monthly bidweek price for natural gas liquids. However, the proposed rule would amend 30 CFR § 1206 to specify that when a lessee chooses to value a gas lease using this index-based option, the lessee may use the bidweek average price rather than the bidweek high price.

The agency argues that doing so will result in a more accurate valuation of the resources being extracted, as it will more closely match what lessees would receive as gross proceeds by reflecting the fluctuation in prices rather than just the high price. According to the agency, the 2016 rule's index-based valuation resulted in slightly higher valuations than the arm's-length sales, but the newly proposed rule would result in lower average valuations.[5] It is not unreasonable to think companies would prefer to use a simpler option, especially now that the agency is allowing bid values to be lowered from the bid-high to the bid-average. But this will inevitably and unnecessarily reduce the amount of royalties the government collects. The agency even concedes this in estimating that this new type of valuation alone will result in a reduction of nearly $4.5 million in royalty payments on an annual basis.[6] The government should not be making it more financially beneficial to pursue non-arm's-length transactions, given the government's own admission that these are less accurate than arm's-length transactions.

Transportation Deduction Non-Arm's-Length Index-Based Valuation Option

An important variable in calculating an index-based pricing option is the deduction companies can include for transportation costs. The proposed rule would reclassify certain activities that current regulations define as gathering costs and make them transportation costs.[7] "Gathering"

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[3] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf
[4] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,057 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf
[5] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,058 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf
[6] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf
[7] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,058 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

generally refers to moving a product from the point of production to a facility for processing, whereas "transportation" generally refers to moving a final product from a processing facility to distribution facilities.[8]

Based on how transportation costs factor into the calculations of index-based royalty valuations, the proposed rule represents a potential significant savings for the industry. If the proposed rule is adopted, companies would be allowed to subtract their newly configured transportation deduction from the average index-based valuation described above. The agency estimates that this will result in a reduction of more than $7.1 million in royalty payments on an annual basis.[9] This appears to benefit only the industry and not the taxpayer.

Gas Processing Allowances

The proposed rule contains two troubling changes related to gas processing allowances that could represent a total of about $21.1 million in forgone royalties each year. The Office of Natural Resources Revenue is proposing to allow companies to request that the government raise the current 66⅔% processing costs allowance cap for gas. Raising this cap would make way for significant savings for the industry at the taxpayers' expense, as the agency estimates that this change would result in a nearly $10 million annual reduction in royalty payments.[10] On top of that, the agency proposes allowing companies to request that the government raise the cap for extraordinary processing costs, which it estimates would lead to industry paying $11.1 million less in royalties each year.[11] Industry can incur this type of cost when special processing is needed to protect the local environment or drinking water supplies, for example. If companies are extracting resources for profit from publicly owned land, and there is a potential danger to the local communities if extraction goes wrong, these companies should be paying the taxpayers a fair share for these resources. The agency should not allow them to pay less.

Deepwater Drilling

Most concerning is the Office of Natural Resources Revenue's proposal to reclassify certain gathering expenses as transportation expenses for deepwater extraction on the Outer Continental Shelf. Specifically, the agency is proposing to reclassify "the movement of oil from the wellhead to the first platform" as a transportation cost and not a gathering cost. The agency estimates that this could result in $35.9 million in forgone royalties each year.[12] This is particularly concerning because for years the government has not been collecting billions in potential royalties for offshore oil and gas. In 2019, for example, the Government Accountability Office found that leases awarded by the Interior Department between 1996 and 2000 with a guarantee of no

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[8] "What Is The Difference Between Gathering and Transmission Pipelines?," Pennsylvania Energy Infrastructure Alliance, June 26, 2017. https://paallianceforenergy.com/difference-gathering-transmission-pipelines/

[9] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

[10] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

[11] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

[12] ONRR 2020 Valuation Reform and Civil Penalty Rule, 85 Fed. Reg. 62,062 (proposed October 1, 2020). https://www.govinfo.gov/content/pkg/FR-2020-10-01/pdf/2020-17513.pdf

royalties on initial volumes of production had resulted in about $18 billion in forgone royalties through 2018.[13]

Furthermore, as I testified earlier this year before Congress on behalf of POGO, the Department of the Interior's Bureau of Ocean Energy Management engaged in two procedures "that may not have resulted in a full fair market value return for oil and gas leases: retroactively lowering its valuations of tracts of seafloor in order to accept bids that would be unacceptable under the bureau's stated procedures; and accepting lower bids because it unreasonably determined the tracts might be worth less in the future."[14] Combined, these procedures may have resulted in more than $1.4 billion in forgone royalties for offshore oil and gas royalties. This is money that should have gone to the taxpayers.

The oil and gas industries have already received more than enough royalty relief measures for offshore extraction. The federal government should not be continuing such measures, which help the industry at the taxpayers' expense.

Why Are Royalties So Important?

Because resources such as oil and gas extracted from public lands are owned by the taxpayer, the government is legally required to collect royalties for the resources produced from leases on those lands. Since the 1990s, POGO's investigations into the federal government's oversight of the oil, gas, and mining industries have uncovered widespread corruption and ethics violations that allowed industry to cheat U.S. taxpayers out of billions of dollars' worth of potential income.[15] Given the amounts of money at stake, and the industry's history of deliberately concealing the value of oil and gas extracted with the intent of underpaying royalties,[16] the government should be particularly vigilant in ensuring the industry pays its fair share for the resources it extracts.

Accordingly, the government should be seeking to collect more, not less, royalties from industry. For onshore federal oil and gas leases, the government collects a 12.5% royalty,[17] and for

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[13] Government Accountability Office, *Offshore Oil and Gas: Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, GAO-19-531 (September 2019), 1. https://www.gao.gov/assets/710/702062.pdf

[14] *Increasing Accountability and Transparency for Oil and Gas Royalty Policy: Hearing before the House Appropriations Subcommittee on Interior, Environment, and Related Agencies*, 116th Cong. (February 6, 2020) (testimony of Tim Stretton, Policy Analyst, POGO). https://www.pogo.org/testimony/2020/02/royalty-relief-procedures-cost-taxpayers-tens-of-billions/

[15] Letter from POGO Executive Director Danielle Brian to U.S. Securities and Exchange Commission Secretary Vanessa A. Countryman in opposition to the SEC's proposed Resource Extraction Rule, March 13, 2020, 2. https://www.sec.gov/comments/s7-24-19/s72419-6953255-212536.pdf

[16] See, for example: Department of Justice, "United States Recovers Over $137,000 Resolving Allegations that Federal Gas Lessee Violated the False Claims Act," Press Release, September 30, 2019. https://www.justice.gov/usao-mt/pr/united-states-recovers-over-137000-resolving-allegations-federal-gas-lessee-violated; Department of Justice, "Citation Companies Agree to Pay $2.25 Million to Settle Civil False Claims Act Allegations," Press Release, December 19, 2017. https://www.justice.gov/opa/pr/citation-companies-agree-pay-225-million-settle-civil-false-claims-act-allegations

[17] 30 U.S.C. § 226(b)(1)(A) (2019). https://www.law.cornell.edu/uscode/text/30/226

offshore leases the government is only required to collect a "fair market value."[18] The federal onshore royalty rate has remained the same for the past 100 years, since the Mineral Leasing Act of 1920 was signed into law. In fact, many states already have higher onshore royalty rates than the federal government.[19] As the Congressional Budget Office previously pointed out, increasing the federal royalty rate to 18.75% could increase revenue to the federal government by as much as $200 million over a decade, with little or no impact on levels of production.[20]

In addition to not being as effective in collecting royalties it's already authorized to collect, the government even forgoes collecting royalties for some resources altogether. For some minerals extracted from federal land, companies are not required to pay any royalties. Under the General Mining Act of 1872, taxpayers receive zero royalties for minerals extracted from public lands throughout the West and Intermountain West.[21] Mining companies also receive generous tax breaks for extracting our natural resources from federal lands. Not only are taxpayers losing out on their fair share, but the U.S. lags behind the rest of the world by failing to collect a federal royalty for these minerals.[22] Given that the government already collects less in royalties than it should, it would be especially detrimental for the government to give additional handouts to the industry.

Ensuring a fair return is crucial, as revenue from resource extraction contributes significantly to federal, state, and local budgets. In fiscal year 2019, the federal government collected $11.69 billion from energy production on federal land, Native American-owned land, and tracts of seafloor in offshore leases. Of this amount, more than $2.4 billion was disbursed to the states, some of which put the revenue toward infrastructure and education.[23] In New Mexico, for example, 83% of royalties from resource extraction on federal public lands in the state goes toward funding public schools and paying teachers.[24]

During the ongoing pandemic, these royalty payments could be an essential revenue lifeline to state and local governments. The pandemic has put pressure on state and local budgets, due not only to the need for increased spending to cover unemployment insurance and coronavirus

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[18] 43 U.S.C. § 1344(a)(4) (2020). https://www.law.cornell.edu/uscode/text/43/1344

[19] Center for Western Priorities, *A Fair Share: The Case for Updating Federal Royalties* (June 20, 2013), 3. http://westernpriorities.org/wp-content/uploads/2013/07/A-Fair-Share.pdf

[20] Congressional Budget Office, *Options for Increasing Federal Income From Crude Oil and Natural Gas on Federal Lands*, 51421 (April 2016), 3. http://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51421-oil_and_gas_options.pdf

[21] 30 U.S.C. § 22 (2020). https://www.law.cornell.edu/uscode/text/30/22#:~:text=Except%20as%20otherwise%20provided%2C%20all,those%20who%20have%20declared%20their

[22] James Otto et al., *Mining Royalties: A Global Study of Their Impact on Investors, Government, and Civil Society*, 37258 (2006), 40. http://documents1.worldbank.org/curated/en/103171468161636902/pdf/372580Mining0r101OFFICIAL0USE0ONLY1.pdf

[23] Office of Natural Resources Revenue, Department of the Interior, "Energy Revenue and Disbursements Soar Under the Trump Administration," Press Release, October 24, 2019. https://www.onrr.gov/PDFDocs/20191024.pdf

[24] *Leveraging America's Resources as a Revenue Generator and Job Creator: Hearing before the Senate Committee on Energy and Natural Resources*, 113th Cong. 3 (July 22, 2014) (testimony of Greg Gould, Director, Office of Natural Resources Revenue). https://www.energy.senate.gov/public/index.cfm/files/serve?File_id=d8c5d5f4-efce-4c0c-ae87-6b3eecd6316f

testing, but also the loss of tax revenue from the many affected industries and the drop in oil prices.[25] In light of the reduction in state and local tax revenue, it would be unwise to further reduce or eliminate oil and gas royalties during this period.

In addition, the oil and gas industry has received significant support during the pandemic. According to BailoutWatch, the Federal Reserve issued $582 million in loans to 37 fossil fuel companies through its Main Street Lending Program.[26] This lending facility was created for small and medium-sized businesses. In addition, as POGO has previously pointed out, during the pandemic oil and gas companies have been leasing tracts of federal land at much lower rates per acre than the industry had the previous year.[27] During this pandemic, the government should not be providing the oil and gas industries opportunities to save more money at the taxpayers' expense, while the public is understandably more concerned about other pressing matters and state and local budgets are strapped.

Conclusion

Rather than focusing on saving the oil and gas industries money, the Office of Natural Resources Revenue should be working to ensure that taxpayers receive their fair share for resources extracted from public land. This rule would not achieve that. Accordingly, we urge the agency to withdraw the proposed rule. The agency should also explore ways to increase revenue and royalties.

Thank you for your consideration of this comment. Should you have any questions, I can be reached at tstretton@pogo.org.

Sincerely,

Tim Stretton
Policy Analyst

[25] "States Grappling with Hit to Tax Collections," Center on Budget and Policy Priorities, November 6, 2020. https://www.cbpp.org/sites/default/files/atoms/files/4-2-20sfp.pdf
[26] "Fed's Fossil Fuel Bailouts Grow To Half Billion As Focus Shifts To Next Steps," BailoutWatch, November 13, 2020. https://bailoutwatch.org/analysis/fossil-fuel-bailouts-grow-to-half-billion
[27] Tim Stretton, "Interior Department Needs More Oversight to Prevent Corruption Amid a Crisis," Project On Government Oversight, April 8, 2020. https://www.pogo.org/analysis/2020/04/interior-department-needs-more-oversight-to-prevent-corruption-amid-a-crisis/