



May 4, 2017

Armand Southall
Regulatory Specialist
Office of Natural Resources Revenue
Building 53, Denver Federal Center
West 6th Avenue and Kipling Street
Denver, Colorado 80225

Re: Comments on the Repeal of the Federal Oil and Gas and Federal and Indian Coal Valuation **RIN 1012-AA20**; and Advanced Notice of Proposed Rulemaking, Federal Oil and Gas and Federal and Indian Coal Valuation **RIN 1012-AA21**

Dear Mr. Southall:

Western Energy Alliance strongly supports complete repeal of the Federal Oil and Gas and Federal and Indian Coal Valuation. The rule if left to stand would do to small independent oil and natural gas producers operating on federal lands what Dodd-Frank did to community banks and what the Affordable Care Act did to independent hospitals: render the federal regulatory environment so complex that small businesses cannot possibly comply. Small companies will be unable to take many legal deductions, and will pay royalties on a higher price than they can actually obtain in the market. Even for large companies, the rule is one of many designed to make operating on federal and tribal lands so complex and costly that producers will continue to abandon them and focus new development elsewhere. The revenue lost from decreased federal production will far exceed any benefits of the rule if left as is.

Western Energy Alliance represents over 300 companies engaged in all aspects of environmentally responsible exploration and production of oil and natural gas in the West. The Alliance represents independent producers, the majority of which are small businesses with an average of fifteen employees. Small producers are especially hard hit by these rules and re-interpretation of reporting procedures years after the fact. Small companies lack the extensive staff and legal resources of larger firms. In fact, we have seen very small companies in New Mexico subject to disproportionately large penalties because of ONRR's reinterpretation of reporting requirements. With the confusion sown by the final 2016 rule, that situation would occur nationwide and to companies both large and small.

Despite extensive comments on the proposed rule from Western Energy Alliance and other industry groups like the Council of Petroleum Accountants Societies (COPAS) and API, the final rule did not advance the goal of maximizing royalty revenue from oil and natural gas production on federal lands. By increasing the complexity and imposing burdensome reporting requirements, the rule diverts resources away from productive,

revenue-generating activities and into complex accounting and legal wrangling for both the federal government and the industry. As such, the rule is beyond the point at which it can be usefully reconsidered and improved; ONRR is better served by repealing the rule completely and focusing on narrow, targeted regulations where necessary. ONRR should not waste valuable resources trying to improve what has become hopelessly complex. While there are some areas of valuation reporting that could benefit from better guidance or even updated rules, the best approach is a targeted one focused on ensuring compliance with the Federal Oil and Gas Royalty Management Act (FOGRMA), not regulation that advances new valuation legal interpretations that stretch the bounds of existing law.

Some targeted areas for regulation that ONRR could consider in the future include an index that truly simplifies the calculation and auditing of royalties. Few companies would use the index as construed in the final rule because it would result in costs that significantly exceed any benefit derived from lower complexity reporting.

Similarly, the transportation allowance provisions of the rule are so hopelessly flawed that it is better to start over with a fresh slate. The rule discourages producers from utilizing new technologies that yield a higher return to the federal government, in particular, cryogenic plants which generate larger volumes of natural gas liquids than older technology. Since NGLs derived from processed gas garner higher proceeds than unprocessed gas, the federal government realizes higher royalty revenue. Yet the rule actually penalizes producers trying to achieve a higher return for the government by making it too difficult to take many legitimate deductions for the costs of processing the gas. A few adjustments to regulations in place prior to the 2016 final rule on how transportation and processing allowances are determined could ensure compliance with FOGRMA without discouraging the use of cryogenic plants and their higher royalty potential.

Calculating royalty payments is a complex undertaking, and our members earnestly attempt to comply with all reporting laws, policies and guidance. However, interpretations can vary between how a company reports and ONRR's assessment. When differences arise, a high proportion of those differences are the result of honest mistakes or differing interpretations of highly complex statutes to the particular situation at hand. The fact that the agency has a 490-page handbook is testimony to the complexity of reporting requirements. There are several instances of federal reporting requirements remaining unresolved, leaving companies and auditors no choice but to put their own interpretations on the regulations. Often there is no single "correct" answer to a given situation. Targeted rulemaking to increase clarity is likely wise.

However, the final rule by design is overly complex. Its technical nature and enigmatic language serve to obscure procedure and create inevitable pitfalls, and ONRR has been unable to answer producers' questions on how to comply with it. By providing no certainty on how the valuation methods will be implemented, the rule places companies at great

financial risk if they interpret the requirements differently than ONRR auditors do several years later. Honest mistakes will be treated as willful, with very high penalties assessed for reporting errors. Furthermore, ONRR's own interpretation of the rules has been constantly evolving, providing no certainty even amongst ONRR auditors on what constitutes actual value. This fundamental flaw means the rule should be repealed completely and new targeted regulation considered to correct deficiencies in prior-2016 regulation.

Rather than a collaborative relationship that ensures an open and honest dialogue toward the goal we all share—ensuring royalties are fairly paid—the 2016 rule exacerbates needless tension between ONRR and companies. Ultimately, increasing the complexity and cost of complying with uncertain regulations will further discourage oil and natural gas development on federal lands, resulting in less revenue to the federal treasury. Creating confusing rules that result in companies paying more royalty than is owed by law is not in the best interest of the federal government or taxpayers. By decreasing the value of operating on federal lands to producers, ONRR's rule will drive production off federal lands, resulting in lower returns from federal lands to the American taxpayer. ONRR under the new administration has the opportunity to restore collaboration to ensure not only a fair return to the taxpayer but to encourage oil and natural gas development and production on federal lands, and hence, increase the overall royalty revenue delivered to the federal government.

This rule creates hesitancy on the part of companies to seek ONRR feedback and approval for reporting problems and scenarios that may arise as a result of normal business operations. The breakdown in communication makes the ultimate goal of and the stated function of ONRR unattainable. On the other hand, the oil and natural gas industry, primarily through the technical expertise of COPAS supported by Western Energy Alliance and other trades, is very willing to sit down with ONRR and work out solutions. We encourage ONRR to view industry as a partner in developing solutions that work for the government as well as companies.

Thank you for considering our comments. Western Energy Alliance is available to work collaboratively with ONRR on these issues at any time.

Sincerely,



Kathleen M. Sgamma
President