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ONRR Repeal of New Royalty Rules

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On August 7, 2017, the Office of Natural Resources Revenue (ONRR) published a Final Rule repealing the *Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule* (2017 Valuation Rule), which significantly amended the longstanding regulations governing the valuation of Federal oil and gas and Federal and Indian coal. ONRR's repeal of the 2017 Valuation Rule reinstates the regulations that were in effect before January 1, 2017. The Final Rule also lifts the stay of the 2017 Valuation Rule that ONRR put in place on February 27, 2017 pending industry members' litigation challenging the 2017 Valuation Rule, and ONRR's rulemaking proceeding to repeal the 2017 Valuation Rule.

According to the Federal Register notice, ONRR repealed the 2017 Valuation Rule for three main reasons:

1. ONRR determined that the 2017 Valuation Rule had a number of defects that made certain provisions challenging to comply with, implement, or enforce;
2. the 2017 Valuation Rule was inconsistent with President Trump's Executive Order 13783, which directed Federal agencies to review existing regulations and suspend, revise, or rescind any regulations that unnecessarily burdened the development of domestic energy resources; and
3. ONRR determined that Secretary Zinke's reestablished Royalty Policy Committee is better positioned to develop new valuation regulations that would address the defects in the repealed rule.

ONRR's repeal of the 2017 Valuation Rule is a victory for the oil and gas and coal industry and highlights the importance of industry participation in the rulemaking and administrative processes. Strategic participation and litigation by industry members was instrumental in halting the implementation of a rule that would have added uncertainty and unfairness to the royalty valuation process, and could have potentially jeopardized energy development on Federal and Indian lands.

History of the ONRR Rule

In January 2015, ONRR proposed a new valuation rule that would have drastically changed the valuation rules governing Federal oil and gas and Federal and Indian coal. Among other things, the 2017 Valuation Rule eliminated valuation benchmarks used to value coal sold to affiliated entities, attempted to value non-arm's length coal sales based on the first arm's-length price of electricity, eliminated historically available oil and gas transportation and processing allowances, and adopted a so-called

“default provision” that would have allowed ONRR to second-guess valuation determinations when ONRR, in its unfettered discretion, disagreed with a producer's valuation.

ONRR received comments from many oil and gas and coal industry stakeholders opposing the proposed valuation amendments because ONRR's proposal was inconsistent with Federal statutes and would ultimately lead to widespread uncertainty in production valuation. Despite unanimous industry opposition, in July 2016 ONRR published its 2017 Valuation Rule adopting the valuation regulations as proposed, with an effective date of January 1, 2017, and a compliance date of February 28, 2017.

Strategic Challenges by Industry Members

After the 2016 election, industry stakeholders challenged the 2017 Valuation Rule on two fronts.

First, a consortium including Cloud Peak Energy (represented by Holland & Hart), the National Mining Association, the Wyoming Mining Association, and Black Hills Corporation and filed a Petition for Review of Final Agency Action in Wyoming Federal District Court challenging the legality of ONRR's 2017 Valuation Rule. On the same day, two additional petitions for review were separately filed by oil and gas and electric utility stakeholders.

Second, the industry petitioners sent a letter to the ONRR Director requesting that the 2017 Valuation Rule be stayed pending litigation and before producers had to implement the extensive valuation and reporting changes. After receiving petitioners' letter, ONRR stayed the implementation of the 2017 Valuation Rule through a Federal Register Notice and a 'Dear Payor' letter posted on ONRR's website.

On April 4, 2017, ONRR published in the Federal Register a proposed rule to repeal the 2017 Valuation Rule and an advance notice of proposed rulemaking seeking comments on ways to improve the royalty valuation regulations. In the Federal Register notices, ONRR recognized that industry petitioners had raised serious questions in their filed court actions concerning the prudence and legality of the 2017 Valuation Rule.

Industry stakeholders submitted comments in early May 2017 supporting the repeal of the 2017 Valuation Rule and suggesting a few revisions to the longstanding valuation benchmarks method to improve and simplify the valuation process for both industry and ONRR.

Despite several environmental groups' intervention in the Wyoming litigation and a separate lawsuit initiated by California and New Mexico challenging ONRR's authority to stay the 2017 Valuation Rule, ONRR endorsed the industry's arguments by repealing the 2017 Valuation Rule.

What's Next?

Oil and gas and coal producers can continue to value and report royalty

under the longstanding valuation regulations that have been in place and worked well for decades. Meanwhile, the reestablished Royalty Policy Committee will evaluate whether any revisions to the valuation rules are warranted.

Although the court cases in Wyoming and California are still pending, the actions may be voluntarily withdrawn and/or dismissed as moot.

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