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Federal Court Brings Back Obama-Era Royalty Rules

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Producers of oil, gas, and coal received welcome news in 2017, when the Office of Natural Resources Revenue (ONRR) repealed Obama-era regulations governing federal royalty valuation.

That good news is now in jeopardy after a recent ruling from a California federal court, which invalidated ONRR's repeal of those 2017 regulations. The court's ruling reinstates the Obama-era rules, meaning producers on federal oil and gas leases, and on federal and Indian coal leases, will soon be going back to the more burdensome rules.

Background

The Obama-era rules initially were proposed in 2015 and were met with unanimous industry opposition due to their uncertainty and inconsistency with federal royalty statutes. The Administration ignored these concerns, and ONRR adopted the new valuation rules with an effective date of January 1, 2017.

The new rules upset traditional valuation benchmarks governing sales to affiliated entities, and also eliminated historic allowances for oil and gas transportation and processing. ONRR also gave itself unfettered discretion to second-guess producers' valuations.

The Trump Administration stayed, and then repealed, the new valuation rules in 2017. The Administration thereby restored ONRR's long-standing valuation regulations, first adopted in 1988.

The California lawsuit

California and New Mexico challenged the repeal in federal court, arguing it violated ONRR's rulemaking constraints under the Administrative Procedure Act (APA). Environmental and industry groups intervened on both sides of the dispute.

Last month, the federal court held that that ONRR's repeal of the new rules violated the APA. Among other things, the court found that ONRR failed to provide a reasoned explanation for rejecting industry concerns when adopting the new rules, but using those same concerns to justify their repeal in 2017.

ONRR and the industry groups have 60 days to appeal the decision to the Ninth Circuit. While no appeal has yet been filed, ONRR or the industry groups may request that the Ninth Circuit stay the district court's order,

which would preserve the current regulatory scheme pending appeal.

What this means for you.

Absent a stay, producers will soon be required to value royalties under the Obama-era rules. Those rules will return by the end of April without a stay, which would mean the valuation rules adopted in 2017 will apply beginning with May 2019 production.

While ONRR has not yet issued any guidance or “Dear Payor” letters instructing lessees on how or when to comply with the 2017 rules, producers likely can expect to see something in the near future.

If you have any questions about federal or Indian royalty valuation, or would like more information about the current state of the law, please contact Tina Van Bockern at 303-295-8107 or TRVanBockern@hollandhart.com.

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