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9
10 IN THE UNITED STATES DISTRICT COURT
11 FOR THE NORTHERN DISTRICT OF CALIFORNIA

12 **STATE OF CALIFORNIA, by and through**
13 **XAVIER BECERRA, ATTORNEY**
14 **GENERAL; and STATE OF NEW**
15 **MEXICO, by and through HECTOR**
16 **BALDERAS, ATTORNEY GENERAL,**

Plaintiffs,

17 v.

18 **UNITED STATES DEPARTMENT OF**
19 **THE INTERIOR; OFFICE OF NATURAL**
20 **RESOURCES REVENUE; RYAN ZINKE,**
Secretary of the Interior; and **GREGORY**
GOULD, Director, Office of Natural
Resources Revenue,

21 Defendants.

Case No. _____

**COMPLAINT FOR DECLARATORY
AND INJUNCTIVE RELIEF**

(Administrative Procedure Act,
5 U.S.C. § 551 *et seq.*)

22
23 **INTRODUCTION**

24 1. Plaintiffs State of California, by and through Xavier Becerra, Attorney General, and
25 State of New Mexico, by and through Hector Balderas, Attorney General (“Plaintiffs”) bring this
26 action to challenge the decision by the Office of Natural Resources Revenue (“ONRR”) to repeal
27 a long-awaited update to its rules governing the calculation of royalties on oil, gas, and coal
28

1 extracted from federal and Indian lands, without any reasoned explanation and in violation of its
2 statutory mandates.

3 2. ONRR, a division of the U.S. Department of the Interior (“DOI”), finalized the
4 “Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform” rule (“Rule”) on
5 July 1, 2016 after five years of public engagement, including public workshops and an extended
6 notice-and-comment period. 81 Fed. Reg. 43,338 (July 1, 2016). The Rule responded to
7 dramatic changes that have taken place in domestic energy markets by providing much-needed
8 revisions to decades-old regulations. By offering greater simplicity, clarity, and consistency in
9 product valuation, the Rule sought to ensure that American taxpayers received royalties reflecting
10 the fair market value for fossil fuel resources extracted from public lands.

11 3. However, following a change in the Presidential Administration, ONRR began to roll
12 back the Rule. First, the agency unlawfully delayed the Rule less than two months after it became
13 effective. ONRR subsequently initiated a rulemaking to entirely repeal the Rule, which was
14 completed in just four months. To justify this regulatory about-face, ONRR now claims that
15 various provisions of the Rule were challenging to comply with, implement, or enforce.

16 4. Defendants’ repeal of the Valuation Rule was arbitrary and capricious because the
17 agency failed to supply a reasoned basis for its wholesale repeal of a Rule which fulfills the
18 agency’s statutory mandate to ensure a fair and accurate return on the use of public resources.
19 ONRR’s proffered reasons for repealing the Rule are nothing more than trumped-up technicalities
20 that do not justify throwing out the Rule in its entirety. Further, ONRR failed to explain why it
21 reversed course based on the same information that it considered when it formulated and
22 promulgated the Rule just a year earlier.

23 5. Accordingly, Plaintiffs seek a declaration that Defendants’ action violated the
24 Administrative Procedure Act (“APA”) and multiple federal land and mineral management
25 statutes, and an injunction requiring Defendants to vacate the repeal and immediately reinstate the
26 Rule.

JURISDICTION AND VENUE

1
2 6. This Court has jurisdiction pursuant to 28 U.S.C. § 1331 (action arising under the
3 laws of the United States), 28 U.S.C. § 1361 (action to compel officer or agency to perform duty
4 owed to Plaintiffs), and 5 U.S.C. §§ 701-706 (Administrative Procedure Act). An actual
5 controversy exists between the parties within the meaning of 28 U.S.C. § 2201(a), and this Court
6 may grant declaratory relief, injunctive relief, and other relief pursuant to 28 U.S.C. §§ 2201-
7 2202 and 5 U.S.C. §§ 705-706.

8 7. Venue is proper in this Court pursuant to 28 U.S.C. § 1391(e) because this is the
9 judicial district in which Plaintiff State of California, by and through Xavier Becerra, Attorney
10 General resides and this action seeks relief against federal agencies and officials acting in their
11 official capacities.

INTRADISTRICT ASSIGNMENT

12
13 8. Pursuant to Civil Local Rules 3-5(b) and 3-2(c), there is no basis for assignment of
14 this action to any particular location or division of this Court. However, this case is related to
15 Case No. 3:17-cv-02376-EDL, which challenged ONRR’s illegal attempt to delay the Rule
16 pursuant to APA Section 705, 5 U.S.C. § 705, and was recently decided in the San Francisco
17 Division. Pursuant to Civil Local Rule 3-12(b), Plaintiffs intend to promptly file an
18 Administrative Motion to Consider Whether Cases Should Be Related.

PARTIES

19
20 9. Plaintiff, STATE OF CALIFORNIA, brings this action by and through Attorney
21 General Xavier Becerra. The Attorney General is the chief law enforcement officer of the State
22 and has the authority to file civil actions in order to protect public rights and interests, including
23 actions to protect the natural resources of the State. Cal. Const., art. V, § 13; Cal. Gov. Code §§
24 12600-12612. This challenge is brought pursuant to the Attorney General’s independent
25 constitutional, statutory, and common law authority to represent the public interest.

26 10. California contains millions of acres of federal and tribal lands that are managed by
27 Defendants for energy production. These lands contain approximately 600 producing oil and gas
28 leases covering more than 200,000 acres and 7,900 usable oil and gas wells. California is a

1 leading state in terms of oil extraction on public lands, producing about 15 million barrels
2 annually, and also produces approximately 7 billion cubic feet of natural gas. Since 2008,
3 California has received an average of \$82.5 million annually in royalties from federal mineral
4 extraction within the state.

5 11. Plaintiff STATE OF NEW MEXICO brings this action by and through Attorney
6 General Hector Balderas. The Attorney General of New Mexico is authorized to prosecute in any
7 court or tribunal all actions and proceedings, civil or criminal, when, in his judgment, the interest
8 of the state requires such action. N.M. Stat. Ann. § 8-5-2.

9 12. New Mexico is second only to Wyoming in the number of producing oil and natural
10 gas leases on federal land. More than one-third of New Mexico's land is federally administered.
11 Annually, New Mexico produces approximately 1,220 billion cubic feet of natural gas (of which
12 approximately 60% is from federal and Indian lands); 85,200 million barrels of crude oil (of
13 which approximately 45% is from federal and Indian lands); and about 22 million short tons of
14 coal. Since 2008, New Mexico has received an annual average of \$470 million in federal mineral
15 extraction royalties. The majority of this royalty revenue is used to fund public education. N.M.
16 Stat. Ann. § 22-8-34.

17 13. California and New Mexico have an interest in the proper management of their
18 respective States' natural resources and in receiving an appropriate share of royalty payments
19 from oil, gas and coal that is produced on federal lands within their States. ONRR's repeal of the
20 Rule has impacted the amount of royalties received by the States from the extraction of these
21 resources. Plaintiffs have suffered legal wrong by ONRR's illegal action and have standing to
22 bring this suit.

23 14. Defendant UNITED STATES DEPARTMENT OF THE INTERIOR is an agency of
24 the United States government and bears responsibility, in whole or in part, for the acts
25 complained of in this Complaint. DOI is responsible for managing the collection and calculation
26 of royalties and other payments due on oil, gas and coal produced on federal and Indian lands. 30
27 U.S.C. §§ 187, 1701.
28

1 discussion and final formulation of rules.” *Connecticut Light & Power Co. v. Nuclear Regulatory*
2 *Comm’n*, 673 F.2d 525, 528-30 (D.C. Cir. 1982); *see also Prometheus Radio Project v. F.C.C.*,
3 652 F.3d 431, 449 (3d Cir. 2011) (“[A]n agency proposing informal rulemaking has an obligation
4 to make its views known to the public in a concrete and focused form so as to make criticism or
5 formulation of alternatives possible.”).

6 19. Under the APA, a “reviewing court shall...hold unlawful and set aside” agency action
7 found to be “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with
8 law,” “in excess of statutory jurisdiction, authority, or limitations, or short of statutory right,” or
9 “without observance of procedure required by law.” 5 U.S.C. § 706. When an agency reverses
10 course by repealing a fully-promulgated regulation, the “agency changing its course by rescinding
11 a rule is obligated to supply a reasoned analysis for the change.” *Motor Vehicle Mfrs. Ass’n of*
12 *U.S., Inc. v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 42 (1983). Further, the agency
13 must show that “there are good reasons” for the replacement. *F.C.C. v. Fox Television Stations,*
14 *Inc.*, 556 U.S. 502, 515 (2009). An agency must “provide a more detailed justification than what
15 would suffice for a new policy created on a blank slate” when “its new policy rests upon factual
16 findings that contradict those which underlay its prior policy.” *Id.* Moreover, an agency cannot
17 suspend a validly promulgated rule without first “pursu[ing] available alternatives that might have
18 corrected the deficiencies in the program which the agency relied upon to justify the suspension.”
19 *Public Citizen v. Steed*, 733 F.2d 93, 103 (D.C. Cir. 1984).

20 **II. Federal Land Management Statutes.**

21 20. Defendants’ duty to regulate the valuation of oil and gas produced from Federal
22 onshore and offshore leases and coal produced from federal and Indian leases is derived from
23 several federal statutes. In particular, the Federal Oil & Gas Royalty Management Act of 1982
24 (“FOGRMA”), 30 U.S.C. § 1701 *et seq.*, requires Defendants to “to implement and maintain a
25 royalty management system for oil and gas leases on Federal lands, Indian lands, and the Outer
26 Continental Shelf.” 30 U.S.C. § 1701(b)(2). FOGRMA mandates that Defendants “establish a
27 comprehensive inspection, collection and fiscal and production accounting and auditing system to
28 provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees,

1 deposits, and other payments owed, and to collect and account for such amounts in a timely
2 manner.” *Id.* § 1711(a). The Mineral Leasing Act of 1920 (“MLA”), 30 U.S.C. § 181 *et seq.*,
3 requires that coal leases “shall require payment of a royalty in such amount as the Secretary shall
4 determine of not less than 12½ per centum of the value of coal as defined by regulation, except
5 the Secretary may determine a lesser amount in the case of coal recovered by underground mining
6 operations.” 30 U.S.C. § 207(a). In addition, the Federal Land Policy and Management Act
7 (“FLPMA”), 43 U.S.C. § 1701 *et seq.*, requires that “the United States receive fair market value
8 of the use of the public lands and their resources.” 43 U.S.C. § 1701(a)(9).

9 **PROCEDURAL BACKGROUND AND ADDITIONAL FACTS**

10 21. Each year ONRR collects billions of dollars in royalties on coal, oil and gas extracted
11 from public lands. A significant portion of this revenue is distributed to states through direct
12 disbursements and grants. 30 U.S.C. § 191(a). Since 2008, California and New Mexico have
13 received tens or hundreds of millions of dollars annually in royalties from federal mineral
14 extraction within their states.

15 22. Existing regulations governing the valuation of federally-owned natural resources
16 largely date back decades and fail to take into account dramatic changes that have occurred in the
17 industry and marketplace for these resources, including a coal industry practice of depressing
18 commodity values by selling coal to affiliated companies at artificially low prices. As a result,
19 taxpayers receive inadequate returns from the extraction of domestic energy resources.

20 23. In 2007, DOI’s Royalty Policy Committee Subcommittee on Royalty Management
21 (“RPC”) developed and submitted to the Secretary over 100 recommendations related to the
22 management of mineral leasing activities. The RPC concluded that, by the end of fiscal year
23 2008, DOI “should review, and (as appropriate) revise and implement the regulations and
24 guidance for calculating prices used in checking royalty compliance for solid minerals, with
25 particular attention to non-arm’s-length transactions.” The Committee also recommended that
26 DOI “publish proposed revisions to the gas valuation regulations,” and consider “incorporating
27 into the proposed revisions the use of market indices for gas valuation in the context of non-arm’s
28 length transactions in lieu of the benchmarks that have been employed since 1988.”

1 24. In 2011, ONRR began a five-year rulemaking process to update existing regulations
2 for oil, gas, and coal produced from federal leases and coal produced from Indian leases. 76 Fed.
3 Reg. 30,878, 30,881 (May 27, 2011). The agency conducted outreach to stakeholders and tribes
4 including six public workshops, and considered the information gained through this outreach in
5 crafting a revised set of regulations. 81 Fed. Reg. at 43,338.

6 25. On January 6, 2015, ONRR issued a Proposed Rule to amend its existing valuation
7 regulations. 80 Fed. Reg. 608. In particular, ONRR stated that its intent was “to provide
8 regulations that (1) offer greater simplicity, certainty, clarity, and consistency in product valuation
9 for mineral lessees and mineral revenue recipients; (2) are more understandable; (3) decrease
10 industry’s cost of compliance and ONRR’s cost to ensure industry compliance; and (4) provide
11 early certainty to industry and ONRR that companies have paid every dollar due.” *Id.*

12 26. ONRR accepted public comment on the Proposed Rule through May 8, 2015 and
13 received more than 1,000 pages of written comments from over 300 commenters, including
14 “industry, industry trade groups, Congress, State governors, States, local municipalities, two
15 Tribes, local businesses, public interest groups, and individual commenters.” 81 Fed. Reg. at
16 43,338. For example, the California State Controller’s Office submitted comments on the
17 Proposed Rule on May 5, 2015, acknowledging “the impact of ONRR’s proposals for gas
18 valuation on California’s revenue interests” and “applaud[ing] its effort to pursue some long-
19 overdue reforms.” A coalition of non-governmental organizations submitted comments
20 acknowledging that the Proposed Rule took important steps to “close an accounting loophole that
21 in recent years has enabled coal companies to sell federal coal to [their] own subsidiaries, pay
22 royalties on the initial sale, then reap windfall profits when those subsidiaries sell the same coal at
23 a much higher price without any additional royalty.”

24 27. Industry groups also responded with critiques of the Proposed Rule. For example, the
25 Western Fuels Association commented that ONRR’s proposed method of valuing coal based on
26 the net-back from sale of electricity would be “impossible” to implement, and the National
27 Mining Association opined that the Rule’s default provision created unnecessary uncertainty.
28

1 28. After carefully considering these public comments, and in some instances revising the
2 language of the final rule based on these comments, ONRR finalized the Valuation Rule on July 1,
3 2016. 81 Fed. Reg. at 43,338. The Final Rule specifically addressed all major comments, and
4 made certain “technical or clarifying changes to the proposed rule.” *Id.* ONRR estimated that the
5 Rule would increase royalty collections by between \$71.9 million and \$84.9 million annually and
6 reduce industry’s administrative costs by \$3.61 million annually. *Id.* at 43,359.

7 29. The Rule contains a number of provisions designed to ensure the accurate calculation
8 of royalties and commodity values. By amending the processes for valuing non-arm’s-length coal
9 sales, the Rule seeks to prevent an industry practice of minimizing royalty payments by selling
10 mineral resources to subsidiaries for less than market value. 80 Fed. Reg. at 609. The Rule
11 further allows ONRR to consider downstream commodity prices, thus ensuring sufficient
12 collection of royalties on exported minerals that garner higher prices overseas than they would in
13 the domestic market. *Id.* Additionally, the Rule’s “default provision” clarifies ONRR’s
14 discretion to set a “reasonable value of production” where there is evidence that a lessee has
15 engaged in fraudulent practices when determining commodity values. 81 Fed. Reg. at 43,341,
16 43,366.

17 30. On December 29, 2016, various coal and oil industry groups challenged the Rule in
18 U.S. District Court for the District of Wyoming. *Cloud Peak Energy, Inc. v. United States Dep’t*
19 *of the Interior*, Case No. 16-cv-315–NDF (D. Wyo.); *American Petroleum Inst. v. United States*
20 *Dep’t of the Interior*, Case No. 16-cv-316–NDF (D. Wyo.); *Tri- State Generation and*
21 *Transmission Ass’n, Inc. et al., v. United States Dep’t of the Interior*, Case No. 16-cv-319–NDF
22 (D. Wyo.) (collectively, the “Wyoming Litigation”).

23 31. On January 1, 2017, the Rule went into effect. 81 Fed. Reg. at 43,338.

24 32. On February 27, 2017, ONRR issued a delay notice for the Rule in the Federal
25 Register, citing Section 705 of the APA and the pending litigation. 82 Fed. Reg. 11,823. This
26 Court found the delay to be an illegal violation of the plain text of APA Section 705, and an
27 improper end-run around the APA’s notice-and-comment requirements. *Becerra v. U.S. Dep’t of*
28 *Interior*, Case No. 17-cv-02376-EDL, 2017 WL 3891678 (N.D. Cal. Aug. 30, 2017).

1 33. On March 28, 2017, President Trump issued Executive Order 13783, which directed
2 federal agencies to review existing regulations that “unduly burden the development of domestic
3 energy resources beyond the degree necessary to protect the public interest.” 82 Fed. Reg.
4 16,093. The Executive Order defined “to burden” as “to unnecessarily obstruct, delay, curtail, or
5 otherwise impose significant costs on the siting, permitting, production, utilization, transmission,
6 or delivery of energy resources.” *Id.*

7 34. On March 29, 2017, Secretary Zinke announced his intention to reestablish the
8 Royalty Policy Committee (“RPC”) under the Federal Advisory Committee Act. On September
9 1, 2017, the Secretary announced the appointment of 20 primary members to the Committee,
10 including representatives from Wyoming, North Dakota, Alaska, Texas, Alabama, and Utah, and
11 four tribes, as well as six industry representatives, three members representing academia, and one
12 member from a mining consultancy group.

13 35. On April 4, 2017, ONRR published a proposal to repeal the Rule “in its entirety,” 82
14 Fed. Reg. 16,323 (“Proposed Repeal”). ONRR also published an “advance notice of public
15 rulemaking” seeking comment on whether the Rule is needed and what, if any, revisions should
16 be made to it. 82 Fed. Reg. 16,325 (Apr. 4, 2017). As justification for the Proposed Repeal,
17 ONRR cited “serious questions concerning the validity or prudence” of certain provisions of the
18 Rule, including its default provision and the use of the sales price of electricity to value coal. *Id.*
19 These concerns, according to the Proposed Repeal, were raised by petitioners in the Wyoming
20 Litigation and in a letter authored by certain industry groups. *Id.* ONRR acknowledged that
21 these “lawsuits and correspondence echoed the concerns voiced by many industry representatives
22 in workshops during the public comment period that preceded the 2017 Valuation Rule’s
23 promulgation.” *Id.* The Proposed Repeal contained no analysis or data related to any purported
24 deficiencies in the Rule. Instead, the Proposed Repeal referred the reader to the section-by-
25 section analyses that ONRR had previously provided *in support* of the Rule. *Id.* at 16,234. The
26 Proposed Repeal also stated, incorrectly, that the repeal would “preserve the regulatory status
27 quo” while ONRR reconsidered “whether the changes made by the 2017 Valuation Rule are
28 needed.” *Id.* The public was permitted 30 days to submit comments. *Id.* The States of

1 California and New Mexico, by and through their Attorneys General, commented in opposition to
2 the Proposed Repeal.

3 36. On April 27, 2017, following the issuance of the Proposed Repeal, the Wyoming
4 Litigation was stayed by the court at the request of the parties pending ONRR's completion of the
5 rulemaking process.

6 37. On August 7, 2017, ONRR published a final rule entitled "Repeal of Consolidated
7 Federal Oil & Gas and Federal & Indian Coal Valuation Reform," which repealed the Valuation
8 Rule "in its entirety" and reinstated preexisting royalty regulations. 82 Fed. Reg. 36,934 ("Final
9 Repeal"). ONRR presented three principal reasons for the repeal. First, the agency claimed that
10 the Valuation Rule had "a number of defects that make certain provisions challenging to comply
11 with, implement, or enforce." *Id.* Second, ONRR claimed that that repeal was appropriate in
12 light of Executive Order 13783 because certain provisions of the Rule would "unnecessarily
13 burden the development of Federal oil and gas and Federal and Indian coal." *Id.* Third, ONRR
14 claimed that the reestablishment of the Royalty Policy Committee "will lead to the development
15 and promulgation of a new, revised valuation rule that will address the various problems that have
16 now been identified in the rule we are repealing." *Id.*

17 38. On September 6, 2017, the Final Repeal went into effect. 82 Fed. Reg. at 36,934.

18 39. On October 6, 2017, the parties in the Wyoming Litigation filed a joint status report
19 stating that they are working toward resolution of the matter without further litigation, and that by
20 November 3, 2017, either the Petitioners would withdraw their petitions pursuant to Fed. R. Civ.
21 P. 41(a), or the parties would file another joint status report proposing a schedule for any further
22 proceedings.

23 **FIRST CAUSE OF ACTION**

24 **(Violation of the APA, 5 U.S.C. § 706)**

25 40. Paragraphs 1 through 39 are realleged and incorporated herein by reference.

26 41. The Administrative Procedure Act requires that an "agency changing its course by
27 rescinding a rule is obligated to supply a reasoned analysis for the change." *State Farm*, 463 U.S.
28 at 42. "[E]ven when reversing a policy after an election, an agency may not simply discard prior

1 factual findings without a reasoned explanation.” *Organized Village of Kake v. U.S. Dept. of*
2 *Agriculture*, 795 F.3d 956, 968 (9th Cir. 2015). Moreover, the existence of an ambiguity in a rule
3 is not a “good reason” to repeal the entire rule rather than clarifying such ambiguities, a process
4 which would be completely within the agency’s control. *Fox*, 556 U.S. at 515.

5 42. Here, Defendants failed to provide a reasoned analysis or explanation for repealing
6 the Valuation Rule based on the same factual record that was before the agency during the five-
7 year rulemaking proceeding that resulted in the adoption of the Rule. Defendants’ alleged
8 discovery of “significant defects” in “certain provisions” of the Rule runs counter to the prior
9 findings and conclusions of Defendants in the rulemaking process and is not supported by
10 evidence.

11 43. Defendants also failed to provide a reasoned basis for repealing the Rule in its
12 entirety without giving any consideration to modifying the Rule in light of its alleged defects,
13 such as by issuing guidance or by making adjustments necessary to clarify specific provisions of
14 the Rule.

15 44. Accordingly, Defendants acted in a manner that was arbitrary, capricious, an abuse of
16 discretion, not in accordance with law, and in excess of their statutory authority. 5 U.S.C. § 706.
17 Consequently, the Final Repeal should be held unlawful and set aside.

18 SECOND CAUSE OF ACTION

19 (Violation of FOGRMA, FLPMA, MLA and the APA;

20 30 U.S.C. § 1711; 43 U.S.C. § 1701, 30 U.S.C. § 181, 5 U.S.C. § 706)

21 45. Paragraphs 1 through 44 are realleged and incorporated herein by reference.

22 46. FOGRMA mandates that Defendants establish a comprehensive accounting and
23 auditing system “to accurately determine oil and gas royalties...and other payments owed, and to
24 collect and account for such amounts in a timely manner.” 30 U.S.C. § 1711(a). The MLA
25 requires that Defendants define the value of coal by regulation in order to calculate and collect
26 royalties. 30 U.S.C. § 207(a). FLPMA requires that Defendants “receive fair market value of the
27 use of the public lands and their resources.” 43 U.S.C. § 1701(a)(9).
28

- 1 2. Vacate the Final Repeal;
- 2 3. Issue a mandatory injunction compelling Defendants to reinstate the Rule;
- 3 4. Award Plaintiffs their costs, expenses, and reasonable attorneys' fees; and
- 4 5. Award such other relief as the Court deems just and proper.

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Dated: October 17, 2017

Respectfully Submitted,

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