July 21, 2014

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Re: American Petroleum Institute, Council of Petroleum Accountants Societies, and Western Energy Alliance Comments on Proposed Rule to Amend Civil Penalty Regulations, RIN-1012-AA05

Submitted via: http://www.regulations.gov and U.S. mail

Dear Mr. Southall:

On May 20, 2014, the Office of Natural Resources Revenue ("ONRR") issued a Proposed Rule entitled "Amendments to Civil Penalty Regulations."[1] This rule would establish a comprehensive set of new civil penalty regulations applicable to royalty reporting and payment by oil and gas lessees (and other lessees) on federal lands onshore and on the Outer Continental Shelf, and on Indian leases.

The American Petroleum Institute ("API") is a national trade association that represents over 600 members involved in all aspects of the oil and natural gas industry, including the exploration and production of both onshore and offshore resources. The U.S. oil and natural gas industry supports 9.8 million U.S. jobs and more than 8 percent of the U.S. economy. The industry has paid more than $150 billion in royalty revenues to the federal treasury.

The Council of Petroleum Accountants Societies ("COPAS") is a professional organization comprised of the oil and gas industry's most knowledgeable and influential accounting professionals. COPAS has operated as a non-profit entity for 50 years and has over 4,000 members with 24 societies in the United States and Canada. The societies have developed standardized documents in areas such as joint interest accounting, auditing, production volume and revenue accounting, and financial reporting and tax matters. Additionally, many COPAS members are responsible for the filing of the Federal royalty reports to the ONRR.

Western Energy Alliance ("the Alliance") represents over 480 companies engaged in all aspects of environmentally responsible exploration and production of oil and natural gas in the West.

[1] 79 Fed. Reg. 28,862 (May 20, 2014).

The Alliance represents independents, the majority of which are small businesses with an average of fifteen employees.

API, COPAS, and the Alliance appreciate the opportunity to submit comments on this Proposed Rule, which is highly problematic for the industry, legally indefensible, and, at a minimum, must be revised and re-proposed.

Introduction and Summary of API, COPAS, and the Alliance Comments

API, COPAS, and the Alliance share ONRR's commitment to compliance with royalty reporting and payment requirements consistent with their lease obligations and the applicable regulations, guidance, and mineral leasing statutes. This is no straightforward task, however, as Congress recognized more than 30 years ago when it enacted the Federal Oil and Gas Royalty Management Act ("FOGRMA").[2] Each month, lessees and other payors gather information and perform a host of intricate calculations for thousands of leases pertaining to production volumes, transportation and processing allowances, and valuation for royalty payment purposes. This information is even more difficult to determine and report where a lessee is dependent on data from independent outside sources (*e.g.*, third-party gas processing plant operators). The agency's 490-page Handbook on royalty reporting exemplifies the inherent complexity of the reporting requirements.[3] Even today, reporting procedures remain unresolved and differing views may arise – in some instances, there is no single objectively "correct" answer. As a result, "errors" inevitably occur, not only by lessees but also by ONRR. To resolve these issues, a back-and-forth dialogue between lessees and ONRR is common. Where legally and factually warranted, ONRR may pursue appropriate civil penalties under applicable statutory provisions to promote compliance. In turn, recipients possess the statutory right to appeal proposed civil penalty assessments via a "hearing on the record."[4] API, COPAS, and the Alliance remain committed to working with the Department of the Interior on valid efforts to improve and strengthen its production and royalty reporting and appeals processes.

ONRR's Proposed Rule unfortunately is not one of those valid efforts. Rather, this extreme proposal unlawfully exceeds the bounds of FOGRMA, departs from any semblance of reasonableness, and denies due process. While it purports to merely "clarify and simplify" ONRR's existing civil penalty regulations, ONRR's proposal in reality effects a sea change and constitutes unprecedented agency overreach inconsistent with FOGRMA. ONRR proposes to eviscerate the statutory hierarchy of civil penalty provisions for oil and gas leases and replace it with unfettered administrative enforcement discretion that Congress denied the agency 30 years ago. Specifically, ONRR would strain beyond recognition FOGRMA's most limited and severe category of "knowing or willful" civil penalties under 30 U.S.C. § 1719(d) – and the associated criminal exposure under § 1720 – to encompass potentially all forms of reporting errors. ONRR's interpretation contradicts decades of agency practice under FOGRMA. ONRR's allusions to "current ONRR practice" refer only to relatively recent orders to individual

[2] 30 U.S.C. § 1701 *et seq.*; *see* S. REP. NO. 97-512 (1982), at 17 (referring to "necessarily complex regulations" under FOGRMA).
[3] *See* MINERALS MANAGEMENT SERVICE, MINERALS REVENUE REPORTER HANDBOOK (2003), *available at* www.onrr.gov/ReportPay/PDFDocs/RevenueHandbook.pdf.
[4] 30 U.S.C. § 1719(e).

companies that are currently being challenged before the Interior Board of Land Appeals ("IBLA"). Despite ONRR's post-hoc attempt to now bolster its litigation position, ONRR's interpretation of the statute remains insupportable, as is ONRR's simultaneous attempt to deny critical protections to lessees that may now need to defend themselves against ONRR's efforts to substantially expand its enforcement discretion.

FOGRMA's Civil Penalty Hierarchy

Congress enacted FOGRMA as a response to allegations in the late 1970s and early 1980s that federal and Indian oil and gas lessees effectively were on an "honor system," and that there existed significant underpayment of royalties and theft of production.[5] The Linowes Commission, which was created to assess the status of royalty payment and accounting, recognized that "[f]urther possibilities exist for 'paper theft.'"[6]

FOGRMA provided the Secretary of the Interior with new civil penalty authority – where *no* civil penalty system previously existed – to address the concerns identified by the Linowes Commission. But the system crafted by Congress did not allow the agency to impose broad-ranging "knowing or willful" civil penalties entirely at its discretion. Rather, Congress established a purposeful hierarchy of civil penalties:

- In 30 U.S.C. § 1719(a), Congress granted the Secretary comprehensive new authority to impose civil penalties of up to $500 per violation per day on federal and Indian oil and gas lessees who commit and fail to correct within 20 days violations of lease terms, regulations, and orders following notice from ONRR and a prescribed period to correct.
- In 30 U.S.C. § 1719(b), Congress permitted a tenfold increase in daily civil penalties for violations not corrected within 40 days or more.
- Under 30 U.S.C. § 1719(c), substantially higher penalty amounts of $10,000 per violation per day are provided for lessees who "knowingly or willfully" fail to pay their royalties by the date they are due, or who fail to respond to or refuse to allow an ONRR audit. No advance notice or opportunity to correct is provided under § 1719(c).
- Finally, at the pinnacle, 30 U.S.C. § 1719(d) imposes "knowing or willful" civil penalties of up to $25,000 per violation per day (50 times the maximum daily penalty under § 1719(a)) on any person who commits criminal-type acts and steals oil or gas or "prepares, maintains, or submits false, inaccurate, or misleading" reports, records, or other data – the "paper theft" to which the Linowes Commission referred.[7] Under 30 U.S.C. § 1720, these violations, and *only* these violations, are also subject to criminal penalties.

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[5] *See* DAVID F. LINOWES ET AL., REPORT OF THE COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES 15 (1982) [hereinafter Linowes Commission], *available at* www.onrr.gov/laws_R_D/FRNotices/PDFDocs/linowesrpt1-5.pdf.

[6] *Id.* at 32.

[7] *See* H. REP. NO. 97-859, at 24, 35 (1982) (highest civil penalty provision applies to "knowingly or willfully committing *certain acts*," and acts subject to highest civil penalties "*usually considered to be acts for which criminal sanctions are warranted*.") (emphasis added); S. REP. NO. 97-512, at 23 (higher penalties for "*certain more serious violations* which are committed knowingly or willfully") (emphasis added); *cf. id*. at 45 (containing Interior's rejected proposal to fine up to $25,000 and criminally penalize any "knowing or willful" violation).

ONRR's Subversion of the FOGRMA Civil Penalty Hierarchy

ONRR's current Proposed Rule subverts Congress' carefully designed civil penalty hierarchy by extensively and improperly broadening applicability of the most serious "knowing or willful" civil penalty provision to relatively routine reporting and recordkeeping violations, not just those rare acts of intentional theft or fraud against federal and Indian lessors entitled to royalties.

ONRR proposes novel and overbroad definitions for statutory terms to yield its desired result. Most notably, ONRR proposes to equate the "maintenance of false, inaccurate, or misleading information" under § 1719(d) with a "failure to correct" an alleged reporting violation. But other provisions of FOGRMA, § 1719(a) and (b), already address failures to correct after notice from ONRR, as evidenced even in the Proposed Rule. Nowhere does ONRR contend that there is any deficiency in this existing scheme that the agency has applied for decades.

Rather than using the provisions of § 1719(a) & (b), ONRR instead seeks to invent new "knowing or willful" violations predicated on minimal standards of prior agency notification of alleged errors. "Maintains" in § 1719(d), however, is not intended to address all reporting errors or the contents of ONRR's databases, but rather internally keeping company records in a way that is intended to defraud the government of oil and gas production or associated royalties and rises to the level of an intentional criminal-type violation – i.e., "cooking the books." Likewise, "submits" does not paradoxically apply to submitted information that a lessee "knowingly or willfully" "should have known" was inaccurate. Under the Proposed Rule, ONRR even could communicate with a lessee via "email" or other informal means and then assess knowing or willful penalties for failure to immediately take corrective action based on that notice.

ONRR's Proposed Rule also fails to acknowledge that the "knowing or willful" standard in § 1719(d) is unique and must also warrant criminal liability under § 1720. Consequently, "gross negligence," or any other inapposite standard that ONRR's preamble attempts to import from a legal dictionary or the False Claims Act ("FCA"), is insufficient for a "knowing or willful" violation under FOGRMA; specific intent is required. Moreover, in its definition of "knowing or willful," ONRR proposes to impose "strict vicarious liability on corporations for the knowledge of their employees and agents." Incredibly, this would allow ONRR to provide notice in any form to any one person at a company and the next day deem the entire company to have committed knowing or willful violations.

ONRR also summarily seeks to expand FOGRMA § 1719(c), the second-most severe civil penalty provision. ONRR is proposing to equate lessee recordkeeping deficiencies under FOGRMA with a knowing or willful refusal to permit an agency audit. This reading finds no support in the statute, and in fact contravenes its strict requirements for ordering a restructured accounting and evaluating compliance with such an order. Moreover, ONRR's use of "maintain" in this section to reference internal ONRR recordkeeping highlights the agency's inconsistent and incorrect use of that same term for purposes of § 1719(d).

ONRR's Denial of Due Process

Furthermore, ONRR's Proposed Rule would impermissibly deprive lessees of basic due process, including their statutory right to a full "hearing on the record" before an Administrative Law Judge ("ALJ"). That is, while ONRR is attempting to significantly expand "knowing or willful" civil penalty liability, it is simultaneously limiting lessees' procedural protections to contest that liability. For example, the Proposed Rule effectively negates the lessee's right to a hearing on the record by insulating from administrative review ONRR's "discretion" to issue a civil penalty. This is of particular concern where the premise for the penalty is a prior non-appealable non-order (*i.e.*, an email from an ONRR staff person). In addition, no rational basis exists for ONRR's proposal to deny the option for a lessee to seek, or an ALJ to grant, a stay of penalty accrual pending appeal of a civil penalty notice. This denial would force the lessee, in order to exercise its basic appeal rights, to incur either additional penalties or costs (up to hundreds of thousands of dollars) to comply with an order that the lessee believes is unfounded. These and other proposed procedural changes unfairly shift the adjudicatory role from an independent arbiter (the ALJ) to the agency that issued the contested civil penalty in the first instance, as well as create a greater burden on the federal judiciary.

Finally, ONRR's proposal to divorce the penalty amount from the extent of any actual royalty underpayment resulting from reporting errors is irrational and violates the basic tenet of proportionality to the underlying violation. The core concern of FOGRMA, and particularly its most severe civil penalty category, is the payment of royalty owed to the royalty owner; as ONRR itself has conceded, "ensuring that royalties are accurately accounted for and that royalties are fully paid is the central purpose of FOGRMA."

ONRR may be frustrated that Congress was unwilling to accept the agency's request for broad-ranging discretion to impose knowing or willful civil penalties for royalty reporting or payment. But ONRR cannot redraft the statute to accomplish its preferred result. ONRR cannot overcome the constraints imposed by Congress through a rulemaking that converts minor reporting violations, which may not even have significantly negative royalty payment implications (or, indeed, no negative implications whatsoever) into "knowing or willful" violations subject to the most severe civil and criminal liability.

In the comments below, API, COPAS, and the Alliance present in greater detail the legal and policy flaws in ONRR's proposed amendments to the agency's existing civil penalty regulations. API, COPAS, and the Alliance cite particular provisions of the Proposed Rule where applicable, though several of API, COPAS, and the Alliance's concerns apply to multiple aspects of the proposal. API, COPAS, and the Alliance reserve the right to amend or supplement these comments as warranted.

1. <u>ONRR Already Possesses Sufficient Civil Penalty Tools to Address Reporting Errors and Failures to Correct. [§§ 1241.50-.52, 1241.60(b)(2)]</u>

In the first instance, ONRR does not explain why it is proposing wholesale changes to current civil penalty regulations, given its existing clear and adequate enforcement path to address the conduct it now seeks to shoehorn under 30 U.S.C. § 1719(c) & (d). Specifically, 30 U.S.C. § 1719(a) & (b), and ONRR's existing implementing regulations at 30 C.F.R. §§ 1241.51-.56,

prescribe substantial and rapidly escalating civil penalties for various violations, including the failures to correct after notice that ONRR is apparently seeking to include in § 1719(c) & (d). The Proposed Rule largely retains this readily available option at new 30 C.F.R. §§ 1241.50-.52, but nowhere squares it with ONRR's attempt to expand § 1719(c) & (d) to reach the same conduct.[8]

ONRR lacks the authority to erase the graduated, proportionate, and strictly defined hierarchy of ascending civil penalties that Congress prescribed. In fact, 30 years ago, Congress expressly denied the agency the same level of administrative discretion that ONRR seeks to create now.[9] Instead, Congress carefully constructed an ascending hierarchy of civil penalties, and limited the pinnacle of that scheme, § 1719(d), to certain narrowly circumscribed, criminal-type "knowing or willful" violations. Congress explained this choice as intended to fashion a "balance" ensuring both correction of violations and fairness of enforcement, particularly given the context of "necessarily complex regulations."[10] It was through this comprehensive *system* of penalties where *no* civil penalty authority had previously existed, rather than through only the most severe category, that Congress achieved its goal to ensure acceptable accounting and payment of royalties. The Proposed Rule entirely ignores this critical legislative history.[11]

Congress' four-tier hierarchy specifies civil penalty limits and procedural requirements for, on the low end of the hierarchy, "failure[s] to take corrective action" upon "notice of violation," which are set forth in § 1719(a) & (b). These provisions, and ONRR's implementing regulations, enable ONRR to assess up to $500 per day per violation beginning a mere 20 days after a Notice of Noncompliance ("NONC") is issued and remains uncorrected. If corrections remain outstanding after another 20 days, under § 1719(b) ONRR may increase the civil penalties up to tenfold, or $5,000 per day per violation.[12] These rapidly escalating penalty provisions, for which a lessee has limited defense following its receipt of the formal NONC, provide a strong incentive for royalty reporters and payors to promptly correct violations, including errors ONRR identifies in previously submitted reports.

FOGRMA distinguishes failures to correct, penalized under § 1719(a) & (b), from separate civil penalties under § 1719(d)(1) for certain limited recordkeeping violations – "knowingly or

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[8] Elsewhere in its preamble, the Proposed Rule admits that Congress "established different penalties for different violations." 79 Fed. Reg. at 28,870.

[9] As the Senate Report explained, "the Committee feels strongly that administrative discretion should not be the principal mechanism through which the severity of punishment is matched to the seriousness of the offense." S. REP. NO. 97-512, at 17. The House Report similarly rejected ONRR's proposed approach and instead provided "lesser penalties for failure to comply with a term of an oil and gas lease, . . . regulations or orders" other than a narrow set of articulated violations. H. REP. NO. 97-859, at 34.

[10] "Therefore, the Committee amendment attempts to distinguish between those violations which ought to lead to a very large civil penalty and those for which liability should be reduced. In making this distinction, a balance must be struck between the need to deter violations of the Act and the need to avoid a situation in which exposure to very severe penalty liability for relatively minor or inadvertent violations of necessarily complex regulations becomes a major disincentive to produce oil or gas from lease sites on federal or Indian lands. The Committee attempted to achieve this balance by providing a requirement of notice of violation and a lower civil penalty for certain violations of the Act and a steeply rising civil penalty liability for serious violations knowingly or willfully committed." S. REP. NO. 97-512, at 17.

[11] *See, e.g.*, 79 Fed. Reg. at 28,870 ("Secretary Watt agreed with all the recommendations [of the Linowes Commission Report], and Congress ultimately enacted FOGRMA.")

[12] API offers no comment on the adjustments for inflation in the Proposed Rule.

willfully ... maintain[ing] … false, inaccurate, or misleading reports," i.e., intentionally retaining internal false or inaccurate documents to mislead auditors and deprive an unknowing lessor of financial benefits from oil and gas production on federal and Indian leases. This conduct is a form of stealing, akin to the other provisions of § 1719(d), which Congress made subject to the most severe civil penalties under 30 U.S.C. § 1719(d)(1) as well as potential criminal liability under § 1720. Such violations and civil penalties require no prior notice or opportunity to correct.

Despite this clear legislative distinction, ONRR now would merge FOGRMA's civil penalty provisions, thus eliminating the various grades of violation that FOGRMA clearly established. Indeed, in proposed § 1241.60 implementing the most severe of the civil penalties, § 1719(d), ONRR inserts a new violation for which a lessee is "also" subject to the harshest civil penalties, based merely on any prior "communication" of an alleged reporting error and a "fail[ure] to correct." Meanwhile, in proposed § 1241.52 implementing the lower end of the hierarchy at § 1719(a) & (b), the Proposed Rule retains lesser civil penalties if a lessee "do[es] not correct," and even provides for a "Failure to Correct Civil Penalty" or FCCP. Under ONRR's preferred formulation, ONRR could sweep into § 1719(d) any reporting violation, however alleged, that is not immediately corrected. Indeed, ONRR would have no incentive to *ever* use a FCCP to pursue lesser, non-knowing or willful penalties because in ONRR's view the same "failure to correct" after notification would suffice for an Immediate Liability Civil Penalty ("ILCP") notice. Simply put, FOGRMA provides no escalation pathway for ONRR to jump from § 1719(b) to § 1719(d) for the conduct identified in the Proposed Rule. ONRR cannot claim a need to rely on an inapplicable provision by ignoring the specifically available remedy afforded to it by Congress.

2. ONRR's Expansion of § 1719(d)(1) is Contrary to Law. [§§ 1241.3, 1241.60]

A plain reading of 30 U.S.C. § 1719(d)(1), particularly within its statutory context, reveals that it does not apply to mere delays in correcting alleged errors not knowingly or willfully made when originally submitted. In attempting to rationalize a different result, ONRR parses out individual statutory terms and separately assigns them new "definitions" created out of thin air. ONRR then uses these "definitions" as the basis to manufacture new violations under § 1719(d)(1). Individually and collectively, ONRR's "definitions" find no support in the provisions of FOGRMA and contravene well-established principles of law. Indeed, the Proposed Rule does not faithfully interpret the governing statute, but instead impermissibly seeks to re-draft it.

A. *The Proposed Definition of "Maintenance" Is Invalid. [§§ 1241.3, 1241.60]*

One of the most extreme examples of ONRR's misapplication of FOGRMA is the Proposed Rule's definition of "maintenance of false, inaccurate, or misleading information." New § 1241.3 defines this term as: "you *provided information to an ONRR data system*, or otherwise to us for our official records, and *you later learn* the information you provided was false, inaccurate and misleading, and *you do not correct* that information *or other information* you provided to us that you *know* contains the *same* false, inaccurate, or misleading information."[13]

[13] 79 Fed. Reg. at 28,873 (emphasis added).

As also stated in the preamble, this "maintenance" becomes a "failure to correct errors," whenever and wherever they might exist, after "ONRR informs you" that you have an error and you fail to search out and correct all other information that ONRR may deem contains the "same" errors. This definition, changing an affirmative act to a passive one, violates basic rules of statutory construction for a number of reasons, as described below. Further, it exposes lessees to potentially limitless "knowing or willful" liability under § 1719(d) for potential errors based solely on assumed knowledge of what the agency may deem "the same."[14] This is legally insupportable.

"Maintain" (the actual word used in FOGRMA) in § 1719(d) is not synonymous with "fail to correct." Simply put, the statutory context does not allow it. As the Supreme Court has held:

> [t]he definition of words in isolation . . . is not necessarily controlling in statutory construction. A word in a statute may or may not extend to the outer limits of its definitional possibilities. Interpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis.[15]

In addition, "a word is known by the company it keeps" – a rule that is "often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress."[16] Yet, the Proposed Rule defines "maintain" in isolation without any consideration of FOGRMA's other terms and consequently produces an illogical result.

While FOGRMA does not expressly define "maintain," the surrounding text of FOGRMA clarifies that "maintain," and § 1719(d)(1) overall, address actions equivalent to intentionally defrauding the lessor out of oil and gas production or revenues through internally-managed records – not mere delay in correcting unintentional reporting errors of which ONRR is already aware and has notified the lessee. For example, § 1719(d)(2) and (d)(3), the only violations equal in degree to § 1719(d)(1), address the physical theft of oil and gas. To consistently fit within that context, § 1719(d)(1) must only apply to similarly egregious defrauding of the lessor – what the Linowes Commission referred to as "paper theft." Likewise, conduct within § 1719(d)(1) must rise to the level of being criminally punishable because § 1720 covers precisely the same conduct. By contrast, as discussed above, FOGRMA already contains an express enforcement provision to address "failure to take corrective action," namely § 1719(b). Sections 1719(a) & (b) are ONRR's proper recourse for the sorts of unexceptional violations it instead is attempting to bring within § 1719(d).

ONRR is stretching "maintain" to cover passive, external conduct, or non-action, after information has been "provided" to ONRR. To "maintain information" means affirmative, internal conduct, i.e., that a lessee must keep that information internally within its control. The order of the statutory terms "prepares, maintains, or submits" in § 1719(d) further confirms this meaning, as preparing and maintaining logically precede the submitting of information to

[14] *Id.* at 28,864.
[15] *Dolan v. U.S. Postal Serv.*, 546 U.S. 481, 486 (2006).
[16] *Id.* at 486-87 (quoting *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961)) (internal quotation marks omitted).

ONRR; Congress did *not* write "prepares, submits, or maintains" as ONRR appears to presume. ONRR effectively changes the order of the statutory terms to support its meaning of "maintenance." "Maintain" is consistently used throughout FOGRMA to apply only to a lessee's internal preservation of its own records to facilitate agency review, investigations, and audits, and thus requires the same meaning here.[17] Even the Proposed Rule uses "maintain" in this way.[18] This makes sense, as only ONRR "maintains" reports on ONRR's "data system"; externally, lessees merely "submit" reports to ONRR.

The Proposed Rule's definition also creates internal inconsistencies and absurd results. For example, an alleged violation predicated entirely on prior notice of inadvertent errors cannot fall under the most severe category of "knowing or willful" civil penalties reserved for violations punishable *without notice*. ONRR cannot manufacture a § 1719(d) "knowing or willful" violation simply by providing notice that a violation exists. Ironically, ONRR's proposed definition writes out of the FOGRMA enforcement scheme the plain meaning of "maintain" in § 1719(d), such that a company's retention of "cooked books" would no longer be a violation under that provision – further demonstrating that ONRR's proposed definition is inconsistent with the statute.

Furthermore, proposed § 1241.3 and the preamble introduce critical operative terms that remain undefined. For example, what is the "same" false, inaccurate, or misleading information that could trigger § 1719(d) beyond information identified in ONRR's "communication"? Obviously this could not be the same data figures, which vary for each month and each lease. If "same" remains undefined, and ONRR's civil penalty discretion becomes unreviewable, what prevents ONRR from applying "same" to cover any other error later discovered on any other lease for any other year? Other unresolved ambiguities involve timing. How long does a lessee have to "correct" an error before § 1719(d) penalties begin to accrue? The preamble introduces the term "in a timely manner."[19] But it offers no guidance on what this means, and the "timely" term does not appear in the rule itself. Separately, how long may ONRR wait to inform the lessee that penalties have been accruing? There is no rational basis for ONRR to have the ability on the one hand to provide notice of a violation and issue a penalty notice in a matter of days, or alternately to wait as long as years and then retroactively notify lessees of penalties that have been accruing on a daily basis without the lessee's knowledge.

ONRR's proposed § 1241.60(b)(2) expands the scope of "maintenance" even further.[20] Beyond the definition of "maintenance" in § 1241.3, the second sentence of § 1241.60(b)(2) adds yet another ground for § 1719(d) civil penalties based on "maintained" incorrect information. ONRR problematically suggests that it may pursue § 1719(d) penalties if a lessee has "received an email, preliminary determination letter, … or any other written communication identifying a violation." This precursor for a § 1719(d) maintenance violation is patently overbroad because it encompasses agency communications which the lessee has no opportunity to appeal. Elsewhere in its Proposed Rule, ONRR seeks to now require lessees to appeal an underlying alleged

[17] *See, e.g.*, 30 U.S.C. § 1713. Terms presumably have the same meaning within a statute unless expressly indicated otherwise. *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (applying "normal rule of statutory construction" that "identical words used in different parts of the same Act are intended to have the same meaning").
[18] 79 Fed. Reg. at 28,875 (in context of § 1719(c)).
[19] 79 Fed. Reg. at 28,864.
[20] *Id.* at 28,875

violation prior to appealing an associated civil penalty notice, and also seeks to assert unreviewable discretion to impose civil penalties. But lessees cannot appeal anything that does not constitute an "order" under 30 C.F.R. Part 1290. As a result, a lessee may have no opportunity to challenge an agency communication that underlies its § 1719(d) civil penalty, violating basic tenets of due process and the statutory entitlement to a hearing on the record. Moreover, to the extent that § 1241.60(b)(2)(ii) applies to "maintain," it is unclear how the "substantially the same" violation term in that provision relates to the "same" violation term in § 1241.3. Both proposed §§ 1241.3 and 1241.60(b)(2) rewrite the statutory word "maintain" in § 1719(d) to engineer an outcome not contemplated by FOGRMA, and thus are unlawful.

B. *The Proposed Definition of "Submission" Is Invalid. [§§ 1241.3, 1241.60]*

As with "maintenance," the Proposed Rule overreaches in its definition of "submission of false, inaccurate, or misleading information." Proposed § 1241.3 defines "submission" as: "you provide information to an ONRR data system, or otherwise to us for our official records, and you knew, or should have known, the information that you provided was false, inaccurate, or misleading at the time you provided the information."[21] A "should have known" standard directly contradicts the knowing or willful standard within § 1719(d) and is unlawful. In essence, ONRR is nonsensically seeking to penalize submission of "errors that a lessee knowingly or willfully should have known." Proposed § 1241.60(b)(2) introduces further problems regarding "submission," akin to those described above for "maintenance." It is again unclear what ONRR means when it says committing "substantially the same violation in the future" will trigger § 1719(d). What types of violations are "substantially the same," and where and when will they come into play? The hypothetical posed in the preamble offers no sideboards, as it appears to suggest that ONRR's notice to a lessee of any product code error on a Form ONRR-2014 would subsequently trigger § 1719(d) knowing or willful civil penalties for any future product code error on any Form ONRR-2014 for any lease at any time. Further, it is unreasonable for ONRR to invoke § 1719(d) absent immediate compliance with communications that do not even rise to the level of an appealable order. Such limitless discretion and liability are clearly not what Congress intended in FOGRMA.

C. *The Proposed Definition of "Knowing or Willful" Is Invalid.*

i. The Proposed *Mens Rea* Standard Is Insufficient. [§1241.3]

Section 1719(d) applies only to specifically enumerated acts committed "knowingly and willfully." The Proposed Rule defines "knowing or willful" to mean "gross negligence."[22] The preamble further articulates gross negligence as only requiring ONRR to show that a person has "failed to exercise even that care which a careless person would use."[23] But this *mens rea* does not legally suffice for knowing or willful civil penalties (let alone for a provision like § 1719(d) that also imputes criminal liability). ONRR cites no legal authority for equating "knowing or willful" under FOGRMA with "gross negligence." Even case law interpreting the FCA, to which ONRR erroneously analogizes throughout its Proposed Rule, has explicitly stated that

[21] *Id.* at 28,873.
[22] *Id.*
[23] *Id.* at 28,863.

gross negligence by itself is not enough to give rise to "knowing" civil liability for submitting false information.[24] Instead, courts have required proof of at least "gross negligence plus" or "aggravated gross negligence" regarding the falsity of statements or omissions for "knowing" liability.[25] Consequently, ONRR's proposal to set the standard as "gross negligence" misinterprets the necessary *mens rea,* even in the solely civil context.

While the Proposed Rule would define "knowing or willful" only as "gross negligence," the preamble further explains that this is the "lowest standard."[26] The preamble states that the FOGRMA § 1719(d) standard would also be met in "situations in which a corporation or an individual in a corporation acts with actual knowledge, as well as situations in which the corporation acts with deliberate indifference or reckless disregard." *Id.* The preamble further declares that "it does not require specific intent."[27] While these additional standards are not included in the proposed regulatory language, they evidence ONRR's intent. However, these standards also are inapplicable to FOGRMA, particularly § 1719(d), because they would improperly impose criminal liability based on a distinct civil standard.

ONRR again imports the above additional suggested standards wholesale from the FCA, which *civilly* penalizes any person who "knowingly…uses…a false record or statement material to an obligation to pay…the Government, or knowingly conceals,…avoids[,] or decreases an obligation to pay…the Government."[28] But this definition of "knowingly" in the FCA, a civil statute, cannot define "knowingly or willfully" in FOGRMA § 1719(d), a statute that imposes *both civil and criminal liability for the very same conduct*. As described above, § 1720 of FOGRMA imputes criminal liability upon conviction to any person who committed an act in violation of § 1719(d), based on the same "knowing or willful" *mens rea*. That is, no other element is required under § 1720

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[24] *See, e.g., U.S. ex rel. Ervin & Assocs. v. Hamilton Sec. Group, Inc.*, 298 F. Supp. 2d 91, 101 (D.D.C. 2004) ("innocent mistakes, mere negligence, or *even gross negligence* (without more) are not actionable under the [FCA]") (emphasis added); *U.S. ex rel. Longhi v. Lithium Power Techs., Inc*., 513 F. Supp. 2d 866, 876 (S.D. Tex. 2007) ("Courts have consistently found that innocently-made faulty calculations, flawed reasoning, and disputed legal issues arising from vague provisions or regulations cannot support liability under the FCA."); *Hindo v. Univ. of Health Scis.*, 65 F.3d 608, 613 (7th Cir. 1995) (to violate the FCA, the "requisite intent is knowing presentation of what is known to be false"); *Hagood v. Sonoma Cnty. Water Agency*, 81 F.3d 1465, 1478 (9th Cir. 1996) ("[FCA]…requires a showing of knowing fraud….Bad math is no fraud, proof of mistakes is not evidence that one is a cheat, and the common failings of engineers and other scientists are not culpable under the Act.") (citations and internal quotation marks omitted); *U.S. ex rel. Wright v. Comstock Res. Inc.*, 456 Fed. App'x 347, 351 (5th Cir. 2011) (to prove knowledge under the FCA, in the context of federal mineral leases and royalty payments, means that "the evidence must demonstrate guilty knowledge of a purpose on the part of the defendant to cheat the government or knowledge or guilty intent") (original alterations and internal citations and quotations omitted).

[25] *See, e.g., Hamilton Sec. Group*, 298 F. Supp. 2d at 101; *Lithium Power Techs.*, 513 F. Supp. 2d at 876; *see also U.S. ex rel. Burlbaw v. Orenduff*, 548 F.3d 931, 945 n.12 (10th Cir. 2008) ("[A]n aggravated form of gross negligence (*i.e.*, reckless disregard) will satisfy the scienter requirement for an FCA violation.").

[26] 79 Fed. Reg. at 28,863.

[27] *Id.*

[28] 31 U.S.C. § 3729(b)(1)(A) ("Knowingly" is defined in the FCA as "(i) ha[ving] actual knowledge of the information; (ii) act[ing] in deliberate ignorance of the truth or falsity of the information; (iii) or act[ing] in reckless disregard of the truth or falsity of the information; and requir[ing] no proof of specific intent to defraud" – i.e., the same three additional standards in the preamble.) . The FCA also specifically provides that for liability under that statute "no proof of specific intent to defraud is required." § 3729(b)(1)(B).

other than committing an act under § 1719(d). The Supreme Court has indicated that the standard for application of criminal and civil penalties for the same conduct must be interpreted consistently.[29] Courts have also explained that the "knowing or willful" *mens rea* imposes different scienter requirements in contexts that are purely civil and those where criminal liability may follow.[30] In the latter criminal context, courts *do* require specific intent.

ONRR's attempt to attach a single definition of "knowing or willful" to § 1719(d) (which attaches criminal liability under § 1720) *and* to the separate set of less egregious violations in § 1719(c) (which has no statutory linkage to § 1720) ignores these important distinctions. Moreover, that proposed definition, and ONRR's additional preamble musings invoking the FCA and jettisoning "specific intent," improperly create criminal exposure for individuals who do not have the requisite *mens rea* associated with "knowing or willful" criminal conduct. Contrary to being "largely self-explanatory" as ONRR suggests,[31] the proposed "knowing or willful" standard would undercut Congress' intent in its hierarchical penalty system, and contravene decades-old principles of law. It is simply not credible for ONRR to suggest that Congress intended to impose criminal-level sanctions on a company accountant who did not, in ONRR's view, promptly correct previously filed royalty reports after receiving an email from ONRR advising of the potentially erroneous report.

ii. Strict Vicarious Liability of Lessees for the Acts and Knowledge of its Employees and Agents is Untenable. [§§ 1241.3, 1241.60(b)(2)]

ONRR's proposed definition of "knowing or willful" means "that a person, including its employee or agent, with respect to the prohibited act, acts with gross negligence."[32] ONRR would go so far as to hold a lessee strictly and vicariously liable – possibly even criminally – for the "knowledge" of all of its employees, charging it with instantaneous knowledge of everything its employees know.[33] Such liability apparently would attach even if the royalty matters at issue are beyond the scope of the employee's employment, experience, or responsibility. ONRR further seeks to convert all employees into de facto "designated agents," legally responsible for handling official correspondence from ONRR on behalf of the company. These proposals are inconsistent both with FOGRMA and the fundamental tenets of the law of agency.

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[29] *Maracich v. Spears*, 133 S. Ct. 2191, 2221 (2013) (Ginsburg, J., dissenting) (quoting *Leocal v. Ashcroft*, 543 U.S. 1, 12 n.8 (2004) ("'[W]e must interpret the statute consistently, whether we encounter its application in a criminal or noncriminal context.'"); *Scheidler v. Nat'l Org. for Women, Inc.*, 537 U.S. 393, 408-09 (2003); *United States v. Thompson/Center Arms Co*., 504 U.S. 505, 518 (1992) (plurality opinion).

[30] *E.g.*, *United States v. Murdock*, 290 U.S. 389, 394 (1933) ("'Willful'] often denotes an act which is intentional, or knowing, or voluntary, as distinguished from accidental. But when used in a criminal statute it generally means an act done with bad purpose.").

[31] 79 Fed. Reg. at 28,863.

[32] *See id.* at 28,873.

[33] *Id.* at 28,863 ("the proposed rule is guided by judicial precedent…which imposes strict vicarious liability on corporations for the knowledge of their employees and agents."); *see also id.* at 28,875 ("You also may be deemed to have knowingly or willfully prepared maintained, or submitted false, inaccurate, or misleading information if you have received an email, preliminary determination letter, order, NONC, ILCP, or any written communication or violation….").

In the context of FOGRMA, "knowing or willful" cannot lawfully be defined to mean the mere act of "an employee or agent" or "gross negligence." Under the law of agency, the act or knowledge of an employee who is not acting within the scope of his responsibilities and without apparent authority cannot impute liability to the corporation under any standard, let alone impute the requisite elements of a specific intent criminal-type standard such as "knowing or willful" under § 1719(d). Consequently, ONRR cannot legally support its proposed definition of "knowing or willful" in § 1241.3(b). ONRR should also strike the second half of proposed § 1241.60(b)(2).

ONRR claims support for its strict vicarious liability scheme in "judicial precedent, primarily interpreting the FCA, which imposes strict vicarious liability on corporations for the knowledge of their employees and agents."[34] Not only is this a mischaracterization of the case law, but also it is entirely beside the point.[35] FCA precedent cannot be used to interpret the language of an entirely different statute like FOGRMA. Before ONRR can impose its unique brand of strict vicarious liability on lessees, ONRR must show that such a rule is compatible with FOGRMA's controlling statutory scheme. ONRR cannot do so.

Unlike the FCA, which defines "knowingly," FOGRMA contains no such Congressional definition.[36] Because Congress did not expressly define "knowing or willful" in FOGRMA, it is clear that it intended that term's customary usage as described above. Moreover, unlike in the FCA, under FOGRMA Congress made no mention of alternate, lesser standards like "reckless disregard," and included no provision relieving the government from its obligation to demonstrate the criminal-like *mens rea* necessary to establish liability under a "knowing or willful" standard.[37] As a result, the FCA cannot be used as justification for interpreting the term

[34] *Id.* at 28,863.

[35] The line of FCA cases cited by ONRR does not interpret the FCA to simply and automatically impose "strict vicarious liability on corporations for the knowledge of their employees and agents." *See* 79 Fed. Reg. at 28,863. Those cases unremarkably hold a principal generally is vicariously liable when its agent acts within the scope of employment or with apparent authority and commits an FCA violation. *E.g., U.S. ex rel. Shackelford v. American Mgmt.,* 484 F. Supp. 2d 669, 677 (E.D. Mich. 2007) ("the [FCA should] not punish honest mistakes or incorrect claims submitted through mere negligence") (internal quotations omitted).

[36] Under the FCA, a company is liable for civil penalties when it "knowingly" submits a false or fraudulent claim or makes or uses a false record in support of such a claim. 31 U.S.C. § 3729(a). In the FCA, the *statute* defines "knowingly" to encompass "actual knowledge," "deliberate ignorance," or "reckless disregard" for the truth, and specifically provides that "no proof of specific intent to defraud is required" to establish liability. *Id.* § 3729(b). As a result, "knowing" employee violations of the FCA may be imputed to companies that are grossly negligent in their oversight because *Congress* said they could. The 1986 FCA amendments created the current definition of "knowingly" and inserted the language relieving the government from the obligation to show specific intent on the part of the employer. This act *by Congress* "decreased the level of scienter required for a violation of the FCA," opening the door for vicarious liability of employers under the FCA for the actions of their agents. *Shackelford*, 484 F. Supp. 2d at 675, 677.

[37] For § 1719(d) purposes, FOGRMA includes companion *criminal* sanctions for certain "knowing or willful" acts. Because criminal prosecution could be the consequence of a violation, the requisite mental state should be heightened and further constrain attribution of intent to others. *See Shackelford*, 484 F. Supp. 2d at 675 (discussing *United States v. Ridgela State Bank*, 357 F.2d 495, 498-99 (5th Cir. 1966), where court refused to impute to employers the requisite "knowledge" or "guilty intent" of an employee because the civil penalty provisions of pre-1986 FCA were punitive in nature, and the criminal scienter requirements must be applied independently to the employer).

"knowing or willful" to somehow mean "gross negligence." Instead, to vicariously impute "knowing or willful" intent to employers, ONRR must conduct case-by-case evaluations of relevant factors to discern the employer's actual culpability for the prohibited act committed by the employee, rather than establishing automatic liability by fiat.[38]

Additionally, there is no legal principle – under FOGRMA or the FCA – by which all actions, omissions, and knowledge of all employees can at all times be imputed to a company regardless of the scope of the employees' responsibilities. Yet ONRR's "knowing or willful" definition, in conjunction with proposed § 1241.60(b)(2), would do just that. ONRR's definition is inconsistent with the basic rule that notice to or knowledge of an agent may be imputed to the company *only* if the fact is *material to the agent's duties to the company.*[39]

ONRR's attempt to hold a lessee responsible for the knowledge of all of its employees also ignores the regulatory system currently in place for delegating actual authority, notifying ONRR of delegations of authority, serving official notices to lessees, and assigning liability. As ONRR recognizes in § 1241.3 of its Proposed Rule defining "agent," under FOGRMA, lessees may officially designate agents for the purpose of making royalty payments to the agency.[40] The existing regulations require lessees to notify ONRR of such designations by filing Form ONRR-4425, which ensures that the agency is aware of the identity of the designee, where and how to contact the designee, and that the designee has authority to legally bind the lessee.[41] The lessee also submits to the agency Form ONRR-4444, identifying the "addressee of record" on whom ONRR is to serve all correspondence.[42] If, for some reason, the lessee has not identified an addressee of record on Form ONRR-4444, the regulations specify how ONRR will serve correspondence. This may include selection of a corporate officer, or an addressee of record filed with a state government, as the person responsible for receiving official ONRR correspondence.[43] The current regulations also provide for three methods of service to the addressee(s) of record: U.S. mail, personal delivery, or private mailing service (e.g., FedEx).[44] This simple regulatory scheme moots any need to divine imputed knowledge.

ONRR's proposed regulation would short-circuit this otherwise orderly system, replacing it with unfettered agency discretion to hold the lessee responsible for complying with any communication sent by any ONRR employee to any employee or ONRR-identified "agent" of the lessee, regardless of that person's role, duties, or area of expertise. Under proposed § 1241.60(b)(2), a lessee that fails to comply with any communication ONRR sends to any company employee could be subject to the most severe civil penalties even if ONRR fails to

[38] *See, e.g., Kolstad v. Am. Dental Ass'n*, 527 U.S. 526, 541-42 (1999). Per FOGRMA and consistent ONRR regulations, such vicarious liability determinations also must be appealable.
[39] *See, e.g., Gutter v. E.I. DuPont de Nemours*, 124 F. Supp. 2d 1291, 1309 (S.D. Fla. 2000) ("The best test for determining whether notice to or knowledge of an agent, such as an attorney, is imputed to his or her principal or client is whether the condition and facts known by the agent were within the sphere of authority of that particular agent.").
[40] 30 U.S.C. § 1712(a).
[41] *See* 30 C.F.R. § 1218.52.
[42] *See id.* §§ 1218.540, 1241.51, 1241.61.
[43] *Id.* § 1218.540(b).
[44] *Id.* § 1218.540(a). NONCs and civil penalty notices may only be sent by registered mail or personal service. *Id.* §§ 1241.51(b), 1241.61.

include the company's duly designated agent or addressee of record in the communication. It would be unfair for ONRR to strictly and vicariously impose potentially enormous civil liability on a lessee in cases where ONRR fails to serve official correspondence on the designated person and instead sends an email "identifying a violation" to any of potentially thousands of employees. The recipient of the ONRR communication may not know what to do with it or what it means, and might even be temporarily unavailable (e.g., on vacation or sick leave) without reason to alert others to monitor for communications from an unexpected source. This highlights the importance of ONRR correspondence being received in the normal course by the proper recipient and through the company's mailroom. In any given case, particularly those where ONRR invokes the most severe FOGRMA penalties, ONRR must use the appropriate outlet for dissemination of information and attribute corporate responsibility for such information on that basis alone.

D. *ONRR's Proposed Rule Contravenes the Federal Oil and Gas Royalty Simplification and Fairness Act.*

If FOGRMA were not already sufficiently clear, in the 30 years since FOGRMA's enactment Congress has reinforced that ONRR's proposed expansion of § 1719(d) does not fit within the statutory royalty enforcement scheme. FOGRMA amendments enacted in the Federal Oil and Gas Royalty Simplification and Fairness Act ("RSFA"), Pub. L. 104-185 (1996), reflect Congress' fairer and more moderate approach to enforcing accurate royalty reporting. ONRR's proposal is antithetical to multiple provisions of RSFA, as now codified in FOGRMA.

For example, RSFA demonstrated Congress' intent that even "chronically submit[ted] erroneous reports," let alone minor reporting errors, do not warrant knowing or willful civil penalties under § 1719(d). That RSFA section added a new provision to FOGRMA:

> Beginning eighteen months after the date of enactment of this section, to encourage proper royalty payment the Secretary or the delegated State shall impose assessments on a person who chronically submits erroneous reports under this Act.

30 U.S.C. § 1725. This provision emphasizes that Congress considered assessments, which may be imposed by ONRR without notice or an opportunity to correct, as an adequate enforcement tool for chronic reporting errors. At the same time, as the agency acknowledged in subsequent rulemaking implementing RSFA, ONRR has no discretion to impose assessments on federal oil and gas lessees for "incorrect or late reports" that are not chronic.[45] It is incoherent for ONRR to now infer that it may shoehorn into § 1719(d) – the most severe FOGRMA penalty provision – various alleged reporting errors, even those for which ONRR may not even issue an assessment. This RSFA provision is further Congressional affirmation that the knowing or willful civil penalty provision in § 1719(d) is limited in scope and reserved for the most severe violations akin to criminal behavior.

RSFA also undercuts ONRR's proposal to impute an alleged reporting error on one lease to a lessee's other reports or leaseholdings and impose § 1719(d) knowing or willful penalties on that

[45] *See* 30 C.F.R. § 1218.40; 71 Fed. Reg. 38545, 38550 (July 7, 1996) (proposed rule amending same)

basis. As explained above, ONRR would penalize as "maintenance" (or "submission") under § 1719(d) not only uncorrected information on the specific reports for which ONRR notifies a lessee, but also other information elsewhere that might not be correct. That is, ONRR would authorize itself to penalize a lessee for not performing what is in effect a "restructured accounting" upon receiving any communication from ONRR alleging a single violation. But ONRR has no statutory authority to proceed in this manner for federal oil and gas leases.

Under 30 U.S.C. § 1724(d)(4)(B), ONRR may issue an order to perform a restructured accounting ("RSO") when ONRR or a delegated state determines during an audit that a lessee:

> has made identified underpayments or overpayments which are demonstrated . . . to be based upon repeated, systemic reporting errors for a significant number of leases or a single lease for a significant number of reporting months with the same type of error which constitutes a pattern of violations and which are likely to result in either significant underpayments or overpayments. . . .

The statute also imposes strict procedural requirements that ONRR must follow before it may issue a RSO for federal oil and gas leases. Only the senior career official responsible for royalty management (now the ONRR Director), or the equivalent state official, may issue an RSO. Moreover, the remedy for failure to comply with and perform the RSO, and amend production or royalty reports accordingly, is expressly *not* a civil penalty. Rather, § 1724(d)(4)(D) requires that an Assistant Secretary of the Interior (or similar level state official) provide "notice" to the lessee that it has not substantially complied and a "reasonable time within which to perform the restructured accounting." ONRR's Proposed Rule impermissibly would do away with these statutory RSO requirements, effectively superimpose a constant RSO requirement on all lessees across their holdings, and define failure to comply with a RSO (explicit or implicit) as knowing or willful maintenance of inaccurate reports. Also contrary to the Proposed Rule, FOGRMA § 1724(d)(4) requires that the RSO be issued "within a reasonable period of time" after ONRR identifies "systemic" reporting errors (not at any time), affords lessees "not less" than 60 days to perform the RSO (not a 20-day or non-extendable period), and permits the filing of an administrative appeal within 60 days (not 30 days). Consequently, ONRR's proposed penalty scheme is patently flawed. Congress' treatment of failure to comply with an RSO also further demonstrates that ONRR's proposed definition of maintaining records is not the meaning that Congress intended in § 1719(d).

The RSFA amendments enacted in 1996 collectively demonstrate that Congress did not contemplate that reporting errors, even chronic reporting errors, were routinely within the scope of § 1719(d) knowing or willful civil penalties. As § 1719's hierarchical scheme, the legislative history, and ONRR's implementation of that section for decades all demonstrate, § 1719(d) and the companion criminal sanctions under § 1720 only may be applied in those limited circumstances where bad intent and a concerted effort to avoid royalty payment obligations are alleged and supported by the record.

3. ONRR's Expansion of § 1719(c) Is Contrary to Law. [§ 1241.60(b)(1)(ii)]

In addition to expanding 30 U.S.C. § 1719(d), the Proposed Rule would broaden civil penalties under 30 U.S.C. § 1719(c). That statutory provision encompasses a knowing or willful failure to pay royalties at all, or a failure or refusal to permit lawful entry, inspection, or audit. As currently written, ONRR's regulations simply mirror § 1719(c).[46] ONRR now proposes to renumber and supplement this provision by adding a new sentence: "[w]e may consider your failure to keep, maintain, or produce documents to be a knowing or willful failure or refusal to permit an audit."[47] In so doing, ONRR essentially would convert any internal recordkeeping issue into an impediment of a hypothetical audit and thereby trigger greater penalties without notice.

The Proposed Rule, including the preamble, offers no explanation for this significant deviation from the existing regulation and the statute. Highlighting its arbitrariness, ONRR asserts that for the same violation it may freely choose between issuing a NONC with notice under FOGRMA's least severe civil penalty provision, § 1719(a), or jumping to "an ILCP instead of an NONC" without notice under § 1719(c).[48] Most problematically, as written, proposed § 1241.60(b)(1)(ii) potentially could allow knowing or willful civil penalties based on an audit *not even occurring.*

The Proposed Rule's treatment of § 1719(c) also suffers from some of the same issues identified above for § 1719(d). For example, the Proposed Rule tries to impose a uniform "knowing or willful" definition for both § 1719(c) & (d), when the applicable standard for § 1719(d) must be considerably more strict. Likewise, ONRR cannot automatically impute any alleged impediment of an audit by any employee so as to create § 1719(c) liability for an entire company. ONRR should not amend its regulations implementing § 1719(c).

4. The Proposed Rule Unduly Curtails Due Process and the Statutory Right to a Hearing on the Record.

While the Proposed Rule would increase lessees' exposure to civil penalty liability, at the same time it would decrease lessees' ability to defend themselves against such liability. This runs afoul of basic due process, as well as of FOGRMA's express terms which guarantee that "[n]o penalty under this section shall be assessed until the person charged with a violation has been given the opportunity for a hearing on the record."[49]

The statutory right to a "hearing on the record" entitles the recipient of a civil penalty to the full administrative review protections provided under §§ 554 and 556 of the Administrative Procedure Act ("APA").[50] With respect to civil penalties assessed under FOGRMA, lessees

[46] 30 C.F.R. § 1241.60(a).
[47] 79 Fed. Reg. at 28,869-70, 28,875 (proposed § 1241.60(b)(1)(ii)).
[48] *Id.* at 28,869.
[49] 30 U.S.C. § 1719(e).
[50] 5 U.S.C. §§ 554 & 556; *Duquesne Light Co. v. EPA*, 698 F.2d 456, 480-81 (D.C. Cir. 1982); *United States v. Cheramie Bo-Truc # 5, Inc*., 538 F.2d 696, 698-99 (5th Cir. 1977). The statutory right to an administrative hearing on the record comports with the constitutional right to due process under the Fifth Amendment. *See Gardner v. United States*, 239 F.2d 234, 238 (5th Cir. 1956); *cf. Mathews v. Eldridge*, 424 U.S. 319, 332 (1976) (due process requires the right to be heard "'at a meaningful time and in a meaningful manner.'") (quoting *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965)).

should have the full opportunity to appeal an underlying violation and the amount of the penalty. Lessees similarly should have the right to full discovery of the facts underlying the agency's orders, and the right to do so before an independent arbiter.[51]

ONRR now seeks to erect myriad administrative barriers that severely limit – if not totally abrogate – lessees' statutory right to a hearing on the record and meaningful relief even if the agency is wrong. Individually, these restrictions are problematic; collectively, they would so "stack the deck" in favor of the agency as to deter or seriously compromise the lessee's exercise of its administrative appeal rights, thereby severely impairing the lessee's due process rights.[52]

A. *Unreviewable Discretion of the Agency to Issue Civil Penalties. [§ 1241.8(h)(2)]*

One of the most significant proposed appeal restrictions would be that an ALJ could not "review the exercise of discretion by ONRR to impose a civil penalty" whenever the ALJ finds that the alleged "factual basis" exists.[53] As a result, lessees may not be able to challenge, and the ALJ may not be able to review, the threshold issue of whether the agency's decision to impose a civil penalty was appropriate in the first place. This restriction is particularly troubling given that the Proposed Rule also would premise civil penalty liability on agency communications (e.g., an email) that are not appealable orders. As a result, a lessee that receives such an agency communication may *never* have the opportunity to challenge either the underlying informal directive for which ONRR claims a factual basis exists, or a subsequent penalty based on failing to comply with that non-appealable notification. A lessee also would have no means to hold ONRR to its obligation to treat similar civil penalty cases in a similar manner; the aggrieved lessee would be foreclosed from ever questioning the agency's rationale for disparate treatment, and ONRR would have no obligation to provide one.[54]

B. *Inability of ALJ or Board to Stay the Accrual of Penalties Pending Review. [§ 1241.12(b)]*

The Proposed Rule would preclude any stay of accrual of penalties pending administrative appeal. No rational basis exists to deny the option for a lessee to seek a stay, or an ALJ or the IBLA to grant one, even where all of the well-established factors are met. As higher-level reviewers of subordinate bureau actions, ALJs/IBLA and courts alike generally possess the discretion to stay the effectiveness of certain agency actions pending appeal in order to maintain the status quo. The primary purpose of a stay is to prevent a party's claim from becoming moot through interim performance and to preserve the parties' original positions pending the

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[51] 5 U.S.C. §§ 554 & 556; *see, e.g.*, *Cheramie Bo-Truc # 5*, 538 F.2d at 698-99; *In re John A. Biewer Co. of Ohio, Inc.*, 2009 EPA ALJ LEXIS 20 (Dec. 23, 2009).

[52] As a threshold matter, 43 C.F.R. part 4 delegates the Secretary's authority to review the actions of subordinate bureaus, including ONRR, to the Office of Hearings and Appeals ("OHA"). As the following comments illustrate, ONRR proposes in this rule to severely constrain OHA's traditional role as an appellate tribunal acting on behalf of the Secretary. Nowhere does ONRR provide any justification for depriving lessees of their traditional rights to administrative review of ONRR decisions, or for interfering with OHA's ability to determine which cases it hears.

[53] 79 Fed. Reg. at 28,874.

[54] *See Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996) (DOI must treat similarly situated royalty payors in similar circumstances alike).

adjudication of their legal rights.[55] A given party might never seek a stay, or a stay petition may be denied when the facts and legal claims do not warrant a stay. But the critical point is that the appellant – and arbiter – have the ability to effectuate a stay where it *is* warranted.

By denying any stay opportunity, ONRR is attempting to derogate a lessee's basic appeal right. In order to exercise its appeal rights, the lessee would be forced to either (i) subject itself to additional penalties (up to $27,500 per day per violation) plus accumulating interest (now dating back from the due date specified in the original penalty notice per newly proposed § 1241.71(b)), or (ii) comply with a directive (possibly informal) that the lessee may believe is incorrect (at a cost of potentially hundreds of thousands of dollars). This unenviable choice would impermissibly "chill" the exercise of a lessee's statutory right to a hearing on the record. Depriving lessees of an administrative stay option also would needlessly burden the federal judiciary with otherwise premature federal court lawsuits to obtain preliminary injunctive relief (utilizing nearly the same standard as the ALJ or IBLA would use).

C. *ONRR as Sole Gatekeeper to a Hearing on the Record. [§ 1241.5]*

ONRR's proposed regulations would permit ONRR alone to decide whether ALJ jurisdiction has been timely triggered to review either a NONC or a civil penalty notice. ONRR then claims unreviewable discretion to determine whether the appeal request is satisfactory, and imposes a blanket ban on extensions of the original 30-day period to provide that information, even for resubmission of an appeal request returned for any reason. That is, if ONRR alleges on day 30 that there is a defect in any portion of the lessee's appeal request, the right to a hearing on the record is forever lost. This unwavering hard-line proposal lacks any justification.[56]

The burdensome and ambiguous suite of prerequisites for would-be petitioners in the first 30 days only heightens the concerns of members of API, COPAS, and the Alliance regarding the proposed new rigid 30-day appeal period with ONRR as the exclusive judge of the sufficiency of the appeal filing. For example, new § 1241.5 would require that the appeal request "explains your reasons for challenging the notice."[57] It is unclear whether this provision means a summary paragraph, or prematurely requires a full-blown statement of reasons before the appeal and administrative record are even filed – with ONRR as the sole arbiter of that question in each case. Separately, for an appeal to be deemed timely filed, the same provision would require that the applicant submit a bond, letter of credit, or demonstration of financial solvency, including for "interest" and "additional" penalties that have accrued since issuance of the order or notice being appealed. What is more, that amount may be uncertain, particularly where ONRR has elected not to send a "courtesy notice" or otherwise informed the lessee of the total amount ONRR then believes is due. As the Proposed Rule is currently written, ONRR could utilize that moving target to find the submitted security insufficient and deny a hearing on the record on that ground. ONRR must withdraw or revise and re-propose these proposed appeal requirements.

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[55] *See, e.g., Neely v. Bankers Trust Co. of Tex*., 848 F.2d 658, 661 (5th Cir. 1988).
[56] *E.g., Duquesne Light Co.*, 698 F.2d at480-81 (D.C. Cir. 1982) (where statute requires "hearing on the record," agency cannot by regulation create circumstance where a hearing timely and reasonably requested does not in fact occur); *Cheramie Bo-Truc # 5, Inc.*, 538 F.2d at 698-99.
[57] 79 Fed. Reg. at 28,874.

D. *"Motion for Summary Decision." [§§ 1241.8, 1241.9]*

The Proposed Rule would allow the agency to move for "summary decision" based on alleged facts before the appellant can initiate discovery to contravene those facts. No appellant should have to face a dispositive motion before having an opportunity to review and assess the administrative record. IBLA's standard practice is to grant a request for extension of time to submit a Statement of Reasons until after the agency submits its administrative record. Likewise, Section 556 of the APA, governing hearings on the record, requires that a party have an opportunity for factual development before final adjudication.[58] Compounding the problem, ONRR also seeks to reverse the black-letter rule that on a motion for summary judgment disputed facts should be construed in favor of the *non-movant*.[59] Under ONRR's formulation in proposed § 1241.9(c)(1), all facts set forth by the "moving party" must be "taken as true and considered undisputed for the purpose of a summary decision…." This provision also deprives the lessee of its right to a hearing on the record as provided by FOGRMA. Proposed § 1241.9 cannot stand.

E. *Fixed Period to Correct. [§ 1241.50(c)]*

Under proposed § 1241.50(c), the period to correct a violation identified in a NONC cannot be extended "for any reason." This absolute barrier to an extension is patently unreasonable. A NONC may require the lessee to perform a scope of work that is impossible to complete within the default 20-day period, e.g., a systemic fix in the royalty reporting procedures or software that could include several years of production, multiple leases, and thousands of lines of royalty reports. ONRR should not arbitrarily disavow its inherent discretion to extend the period to correct errors identified in a NONC as appropriate in the circumstances of each case.

F. *Unreviewable Enforcement Actions. [§ 1241.7(b)]*

For any ONRR communication to form the basis for liability or civil penalties, that communication must be appealable. Alternately, no appeal clock or civil penalties should run until ONRR issues an "order" recognized under its regulations at 30 C.F.R. Part 1290. ONRR cannot deny this proposition and simultaneously insist on appeals of earlier violation notices in order to later contest liability for a civil penalty. Yet, the Proposed Rule creates unreviewable enforcement actions exempt from a hearing on the record, which could apply even where no opportunity existed to appeal the earlier communication. For example, the Proposed Rule refers to emails as adequate to notify a lessee of a reporting error. In addition, "courtesy notices" informing lessees that "additional penalties have accrued" are made enforceable under proposed § 1241.12, but are exempt from appeal under § 1241.7(b). These "notices" are really civil penalty communications that impose additional liability yet are unreviewable. ONRR cannot have it both ways.

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[58] *See* 5 U.S.C. § 556(d) ("A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence…. A party is entitled to present his case or defense by oral or documentary evidence…and to conduct such cross-examination as may be required for a full and true disclosure of the facts.").

[59] *See, e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

G. *Inability of ALJ to Reduce Civil Penalty Amounts. [§ 1241.8(h)(1)]*

ONRR proposes that wherever ONRR can show facts underlying an imposed penalty, the ALJ may not, under any circumstance, reduce a penalty by more than half. This could result in extreme injustice. For example, if a lessee committed a "knowing or willful" violation subjecting it to a penalty under FOGRMA § 1719(d), that penalty could begin to run on the day the violation occurred. It is entirely feasible that the agency would wait years before issuing the lessee an ILCP, thereby assessing multiple years' worth of daily penalties against the lessee. It also could take several more months to complete the hearing on the record before the ALJ. All the while, these daily penalties would be piling up without the possibility for a stay, and under ONRR's proposed §1241.8(h)(1), the ALJ would be powerless to reduce the accrued amount of the penalties below 50 percent of the amount ONRR assessed. It is plainly unreasonable to bar the ALJ from substantially reducing the penalty in such a circumstance, or for example in a circumstance where the amount of the penalty ONRR seeks to obtain is wildly disproportionate to the harm caused by the lessee's violation. Consequently, ONRR must eliminate proposed § 1241.8(h)(1) from this rule.

H. *ONRR's "Stacked Deck."*

Though each of the above proposed provisions is problematic, their collective operation best illustrates ONRR's interference with due process and the statutory right to a hearing on the record. For example, consider the following scenario an oil and gas lessee might face under the Proposed Rule.

- ONRR sends an email to a lessee's employee alleging an existing reporting inaccuracy, and at any time afterward may send an ILCP based merely on that ONRR informal communication.
- The company has no opportunity to contest the basis of the civil penalty because (i) ONRR's informal communication was not an appealable order and (ii) the Proposed Rule would not permit a merits challenge in the civil penalty appeal.
- Even if the company were provided notice and an opportunity to correct under § 1719(a), it could have a fixed total of 20 days to "correct" the alleged violation regardless of the accuracy or the feasibility of ONRR's demands.
- If the lessee appeals the civil penalty notice within 30 days, ONRR could at any time unilaterally reject the appeal for perceived insufficiency, avoid any review of that rejection, and force the lessee to permanently forfeit its right to a hearing on the record.
- If the lessee makes it to an ALJ, the lessee would have no means to stay the continued accrual of penalties, even if the lessee otherwise meets the established criteria for a stay.
- ONRR could preempt the hearing on the record by filing an immediate motion for summary decision based on an incomplete and undisclosed administrative record, and the ALJ would be compelled to construe all of ONRR's alleged facts in ONRR's favor.
- If ONRR establishes its underlying alleged "facts," regardless of their sufficiency, the ALJ would lose jurisdiction to review ONRR's discretion in issuing the civil penalty.
- The ALJ would lose authority to significantly reduce the amount of the penalty even if (i) ONRR delayed in issuing the civil penalty notice and demanded significant retroactive

penalties, or (ii) the civil penalty amount is wildly disproportionate to underlying royalty underpayments.

Any and all of these steps foreclose a meaningful appeal or recourse for ONRR civil penalties, and thus constitute a denial of due process.[60]

5. Refusal to Consider Royalty Implications in Determining the Royalty Amount is Arbitrary. [§ 1241.70(b)]

The Proposed Rule purports to amend 30 C.F.R. § 1241.70(b) to explicitly disregard the "royalty consequences of the underlying violation when determining the amount of the civil penalty for violations."[61] Contrary to ONRR's representations, Congress did not intend to place standalone paperwork errors in the same tier as royalty underpayment. Indeed, ONRR itself has represented to the IBLA that "ensuring that royalties are accurately accounted for and that royalties are fully paid is the central purpose of FOGRMA." ONRR's citation to the many recommendations of the Linowes Commission and general statements in the legislative history regarding the problematic state of royalty reporting pre-1982 likewise do not change the basic fact that Congress' enactment of FOGRMA was motivated by *royalty collection*.[62] ONRR's focus on paperwork rings particularly hollow given that, under ONRR's theory of a § 1719(d)(1) violation, ONRR may already possess information to notify a lessee of an alleged error, and thus would not be at risk of being defrauded by the lessee's erroneous report.[63]

Further refuting ONRR's position, when enacting FOGRMA, Congress was keenly aware of the need to preserve basic principles of proportionality between the amount of the penalty and the severity of the underlying offense.[64] Indeed, the proposed amendment to § 1241.70(b) neglects the prohibition on imposition of "excessive fines" established by the Eighth Amendment to the U.S. Constitution and case law. ONRR must consider: (1) "the degree of the defendant's reprehensibility or culpability;" (2) "the relationship between the penalty and the harm to the victim caused by the defendant's actions;" and (3) "the sanctions imposed in other cases for comparable misconduct."[65] Specifically, under the second prong, the loss suffered by the lessor is a determining factor in judging the penalty.[66]

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[60] ONRR also must revise proposed §§ 1241.3 and 1241.60 which state that ONRR may "assess" penalties without an opportunity to correct. FOGRMA does not authorize "assessment" of penalties by issuance of an "immediate liability" notice before the opportunity for a hearing on the record. The proper term is "accrue."

[61] 79 Fed. Reg. at 28,870, 28,875.

[62] *See also* 30 U.S.C. § 1724(g) (to "maximize the collection of oil and gas receipts from lease obligations," ONRR "should not perform or require accounting, reporting, or audit activities if . . . the cost of conducting or requiring the activity exceeds the expected amount to be collected by the activity, based on the most current 12 months of activity") (as added by RSFA).

[63] *Id.* at 28,870.

[64] For example, FOGRMA's House sponsor made clear upon its introduction that it will "establish reasonable civil penalties for compliance violations without forcing USGS to shut-in a lease to insure compliance by the lessee." 127 CONG. REC. 5,627 (daily ed. Dec. 7, 1981) (statement of Rep. Markey); *see also* S. REP. NO. 97-512, at 17 (discussing the "balance" sought in FOGRMA enforcement).

[65] *Cooper Indus. v. Leatherman Tool Grp., Inc.*, 532 U.S. 424, 435 (2001).

[66] *United States v. Bajakajian*, 524 U.S. 321, 328 (1998). This consideration likewise applies in the royalty reporting context under the FCA. *U.S. ex rel. Maxwell v. Kerr-McGee Oil & Gas Corp.*, No. 04-cv-01224, 2010 U.S. Dist. LEXIS 97018 (D. Colo. Sept. 16, 2010) (finding a penalty of approximately $23 million for $7 million of oil and gas royalty reporting violations to be an "excessive fine" under the Eighth Amendment); *U.S. ex rel. Presley*

ONRR's Proposed Rule not only ignores this basic tenet of proportionality but also explicitly calls for the agency to disregard it in imposing civil penalties. This concern is heightened by ONRR's new proposed § 1719(d) definitions of "maintenance" and "submission" under which ONRR could impose civil and criminal penalties for inadvertent reporting errors that even result in a net *overpayment* to the government. ONRR's disregard of the royalty consequences of alleged reporting errors ignores Congressional intent to impose penalties that will deter violators but not jeopardize future leasing and operations.

Some of the factors that ONRR states it does intend to consider in setting penalty amounts also may result in unjust outcomes under ONRR's Proposed Rule. Most significantly, even where a NONC is corrected, under proposed § 1241.51 ONRR "will consider the violations as part of your history of noncompliance for future penalty assessments." There is no rational basis for ONRR to consider merely alleged violations in its analysis of a lessee's "history of noncompliance." A NONC is not a conclusive statement of liability and does not itself implicate penalties. It is unreasonable under the Proposed Rule that the recipient of a NONC must appeal the merits of the notice to protect itself from incurring heightened penalties for future, unrelated "violations" even if it decides to "correct" the alleged violation to most efficiently close the matter. In addition, consistent with existing regulations, the "size of your business" should only be a mitigating factor for a small business, and not an arbitrary multiplier for larger entities, particularly as defined to include even non-employee contractors in proposed § 1241.71(b).

6. The Proposed Rule Understates Its Economic Impacts.

ONRR's suggestion that adoption of the proposed rule would only have a $163,594 annual impact on the entire industry of approximately 2,000 royalty payors is simply not credible. The allowable daily civil penalties that could now accrue under ONRR's expanded use of § 1719(c) & (d) are several times greater than penalties properly assessed under § 1719(a) & (b). Moreover, since ONRR could accumulate those penalties without notice, there would be little to prevent ONRR from running up civil penalties before issuing an ILCP. Also under the Proposed Rule, penalty accrual could no longer be stayed and steep penalties could be pursued even when the lessor has not been deprived of substantial royalty. ONRR also relies on outdated gas penalty assessment data from 2007-2011. More recently, ONRR has sought, and in some cases has obtained, millions of dollars from individual lessees based on theories now articulated in the Proposed Rule.[67] It should also be noted that what ONRR reports as "collected" does not reflect any higher demands it may have made initially. ONRR now seeks to bootstrap its ad hoc "initiative" and apply more severe penalties on a widespread basis, even absent to date any final Departmental or judicial determination of ONRR's novel interpretation of FOGRMA.

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v. Koch Indus., 57 F. Supp. 2d 1122, 1145 (N.D. Okla. 1999) (stating that "the 'excessiveness' of a penalty must be assessed in light of the actual damages involved and in light of the defendant's overall culpability").

[67] *Civil Penalties*, OFFICE OF NATURAL RESOURCES REVENUE (Apr. 16, 2014), *available at* http://www.onrr.gov/compliance/civil-penalties.htm.

ONRR's finding of insignificant economic effects on small businesses under the Regulatory Flexibility Act is similarly suspect.[68] Indeed, a "knowing or willful" civil penalty with inexorably accruing daily penalties levied against a smaller lessee could threaten its business.

ONRR also fails to consider the royalty impacts that might accrue to Indian Tribes and individual owners. Although ONRR opines that its proposed changes would "not affect" Indian Tribes and "are only technical in nature,"[69] in reality the hugely increased potential liability may discourage oil and gas development on Indian lands, and thereby have a substantial impact on Indian land revenues.

7. ONRR's Proposed Rule May Have Unintended Consequences.

Beyond its legal and procedural infirmities, the Proposed Rule should not be adopted because it would not accomplish its intended result of full accounting and payment of royalty. Rather, it may foster the opposite result. For over three decades, companies have engaged in constructive dialogue with ONRR and its predecessor agencies to obtain guidance and implement proper reporting and payment. This need for interaction has only grown over time as operations, contractual arrangements, valuation methodologies, and paperwork have become more numerous, varied, and complex. The Proposed Rule, however, would chill communication with ONRR out of fear that any agency feedback or guidance would be construed as notice forming the basis for potential knowing or willful civil penalties if that informal guidance is not strictly followed. In addition, total royalty collections may decrease as ONRR's significant expansion of the most egregious civil penalty provision provides a disincentive to lessees, particularly smaller entities, from producing on federal lands, Indian lands, and the Outer Continental Shelf in the first instance. Congress specifically warned against this result.[70] This Proposed Rule is not the way royalty reporting, or government, is supposed to function. The needlessly draconian penalty provisions proposed by ONRR are not only unwarranted and unlawful, but also counterproductive.

Thank you for your time and attention to API, COPAS, and the Alliance's comments on ONRR's Proposed Rule. Please do not hesitate to contact Erik Milito (militoe@api.org, 202-682-8273), Pam Williams (pam.williams@shell.com, 832-337-2592), or Kathleen Sgamma (ksgamma@westernenergyalliance.org, 303-501-1059) if you have any questions.

Sincerely,

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[68] 79 Fed. Reg. at 28,872.
[69] *Id.*
[70] Congress was concerned about "the need to avoid a situation in which exposure to very severe penalty liability for relatively minor or inadvertent violations of necessarily complex regulations becomes a major disincentive to produce oil or gas from lease sites on federal or Indian lands." S. REP. NO. 97-512, at 17.

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