



July 18, 2014

Submitted via [www.regulations.gov](http://www.regulations.gov)

Armand Southall  
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Denver, CO 80225

Re: Comments on Proposed Rule to Amend Civil Penalty Regulations, RIN 1012-AA05

Dear Mr. Southall:

The Office of Natural Resources Revenue's (ONRR) Proposed Rule entitled *Amendments to Civil Penalty Regulations* would establish new civil penalty regulations applicable to royalty reporting and payment by oil and natural gas lessees on federal and Indian lands. We believe the proposed rule on civil penalties would cause a series of disruptions and problems throughout the industry and within the ONRR that will not be productive for advancing the shared goal of ensuring that oil and natural gas royalties are equitably paid.

Western Energy Alliance represents over 480 companies engaged in all aspects of environmentally responsible exploration and production of oil and natural gas in the West. The Alliance represents independent producers, the majority of which are small businesses with an average of fifteen employees.

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

Small companies are particularly vulnerable to penalties from differing interpretations, as they lack the extensive staff and legal resources of larger firms. In fact, we have seen very small companies in New Mexico subject to disproportionately large penalties for honest errors. The proposed rule would exacerbate the situation further.

Yet ONRR is now proposing to treat these honest differences of interpretation, caused by its own lack of clarity in regulations, as willful mistakes subject to civil penalties. The proposed regulations will create a more adversarial relationship that is not productive to

ensuring open and honest dialogue toward the goal we all share—that of ensuring royalties are fairly paid.

The proposed rulemaking on civil penalties is going to cause a series of disruptions and problems throughout the industry and even within the federal government. This rule as written will create hesitancy on the part of industry to seek ONRR feedback and approval for reporting problems and scenarios that may arise as a result of normal business operations. This will serve to breakdown communication between industry and ONRR and thereby make the ultimate goal of the Federal Oil and Gas Royalty Management Act (FOGRMA) and the stated function of ONRR unattainable.

The industry changes regularly as do business practices, as a result we must have an open line of communication with ONRR. Threat of penalties and fines outside ONRR's legal authority will reduce the willingness of industry to work with ONRR in ensuring proper reporting and payment.

Additionally, the proposal seeks to greatly increase the penalties allowed while simultaneously reducing due process of those accused of “knowing or willful” violations. Simply sending an e-mail to an individual working at an organization does NOT constitute “notice” as proposed under this rule. Secondly, setting the “knowing or willful” bar at the lowest possible standard goes against the intent of Congress in passing FOGRMA.

### **Penalty and Assessment**

FOGRMA lays out several penalty tiers up to the most serious which is the “knowing and willful” violation of FOGRMA. The knowing and willful tier is supposed to be reserved for theft and purposeful misreporting designed to defraud the government of royalty due. It was never intended to include incidental or accidental misreporting. Furthermore, the rule introduces this concept of “maintenance” which seems incorrectly applied throughout portions of the proposed rule and now attempt to tie “maintenance” of “false” information to knowing and willful violations.

Knowing and willful should be reserved for those instances when an organization had an intent to commit fraud or deceive ONRR. Arbitrary application creates a situation of distrust between ONRR and industry and will impede the overall goal of accurate payment and reporting of royalty due.

In addition, ONRR cannot take away the due process that industry was given under FOGRMA. Yet this is precisely what it is attempting to do by proposing to limit the power of administrative law judges (ALJ) and attempting to codify that they may not reduce assessed penalties by more than 50%. This gives ONRR not only the ability but an incentive to perversely manipulate the civil penalty system by allowing penalties to accrue unknown to the lessee and to move slowly on all administrative proceedings related to a specific penalty.

Finally, the proposals would remove consideration of actual damages as part of the penalty calculation. For example, if a company under or over reports \$10 or \$10,000,000,

the rule would equate these as bearing the same penalty. FOGRMA makes it clear that the number one priority is proper collection of royalty, and that assessments should be based at least in part on the damages caused by the reporting party.

### **Notification and Liability**

The proposed rule would redefine when a lessee is “notified” of erroneous reporting. The proposal says written communication officially puts lessee on notice, but this could include an e-mail, audit determination letter, or any other written communication identifying a supposed violation.

This proposal creates an obvious problem of whether ONRR has notified the correct, responsible person within an organization of a violation. Notification must be to the primary contact for an area responsible for reporting as designated on form 4444. ONRR must ensure that 4444s are updated in the system in a timely manner, which is certainly not the experience of our member companies.

Furthermore, just because an accountant has been notified of a reporting error it does not mean that the organization or individual was attempting to defraud the government. Nor does it mean that the organization as a whole had knowledge of the alleged error.

The proposed rule also does not account for situations when ONRR is erroneous in its assessment of wrongdoing or misreporting. Our member companies can attest to numerous situations in which ONRR auditors have advised taking particular actions that are not supported by regulation. Companies then must escalate the situations to audit managers and in some cases to ONRR’s Lakewood, CO office and valuation group. Under the proposed rule, ONRR could have begun running the penalty clock from the time the alleged error occurred.

The attempt in the rule to place criminal liability on individuals and/or companies that submit erroneous reports lies well outside the intent of FOGRMA. The explicit escalation of the penalty up to “knowing and willful” under 1719(d) is an overreach of authority not supported by statute. In order to assess and levee penalties under 1719(d), the office of enforcement is supposed to conduct an investigation into the facts surrounding the allegations made by ONRR. Jumping straight to the most severe penalty under the law and then limiting the ability of an ALJ to limit the size and scope of penalties based on the facts of the situation is arbitrary and capricious.

### **Penalties and Economic Impact**

We believe the impact of the proposed rules is woefully understated and based on poor assumptions. The proposed rule states that from 2007 to 2011 ONRR collected an average of \$1 million per year in civil penalties, and uses this as the basis for the cost estimates. Yet ONRR has been publicly stating that since 2010 it has increased civil penalties collections. It is on pace this year to exceed \$3 million in penalties. By choosing an average based on data that does not reflect current practice does not provide a correct baseline

from which to assess the cost of this proposed rule. The cost estimate should therefore use a more recent year such as 2013 as the baseline.

### **Summary**

The proposed rule would greatly expand the scope of ONRR's powers beyond what Congress has given it. The rule as written attempts to bypass congressional authority and intent while simultaneously making it more difficult and onerous for industry to comply with timely reporting and collection of royalties.

Sincerely,



Kathleen M. Sgamma  
VP, Government & Public Affairs