



W&T OFFSHORE

July 18, 2014

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PRESIDENT

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Office of Natural Resources Revenue
Document Processing Section

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Lakewood, Colorado

Re: Comments to Proposed Rule to Amend Civil
Penalty Regulations, Regulation Identifier
Number (RIN) 1012-AA05

Submitted via: <http://www.regulations.gov> and Federal Express

Ladies and Gentlemen:

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

W&T Offshore, Inc. (“W&T”) appreciates the opportunity to submit comments on this Proposed Rule, as we see that the Proposed Rule is highly problematic for lessees, legally indefensible and denies due process, and, at a minimum, must be revised and re-proposed to accomplish ONRR’s stated goal to “clarify and simplify” its existing civil penalty regulations. Upon request, W&T is willing to assist ONRR, in any way, on valid efforts to improve and strengthen its production and royalty reporting and appeals process.

W&T’s comments are provided hereinbelow (the section cites correspond to those in the proposed amendment). We understand that the Independent Petroleum Association of America (“IPAA”), National Ocean Industries Association (“NOIA”) and the American Petroleum Institute (“API”), among others, are separately providing comments to the proposed amendment. W&T incorporates the IPAA, NOIA and API comments herein.

§1241.3 What definitions apply to this part?

The proposed definition of “Information” references a number of specific types of information but also includes broad, non-specific references to “any documents you provide to us in response to our request, and any other written information you provide to us.” This definition is vague and circular (i.e., “and any other written information you provide to us”) and is overbroad in that it includes virtually any type of information without regard to its relevance or importance. As a result, the definition should be revised to be more specific and tailored to relevant, essential information.

ONRR proposes to define “knowing or willful” as acting “with gross negligence.” This definition is overbroad and is inconsistent with the definition applied in case law and in other existing regulations. See, e.g., 43 C.F.R. 3160.0-5 (BLM regulation relating to onshore oil and gas operations, which provides that “knowingly or willfully means a violation that constitutes the voluntary or conscious performance of an act that is prohibited or the voluntary or conscious failure to perform an act or duty that is required. **It does not include performances or failures to perform that are honest mistakes or merely inadvertent.** It includes, but does not require, performances or failures to perform that result from a criminal or evil intent or from a specific intent to violate the law. The knowing or willful nature of conduct may be established by plain indifference to or reckless disregard of the requirements of the law, regulations, orders, or terms of the lease. A consistent pattern of performance or failure to perform also may be sufficient to establish the knowing or willful nature of the conduct, **where such consistent pattern is neither the result of honest mistakes or mere inadvertency.**”) ONRR’s proposed definition, and ONRR’s current application of the “knowing or willful” standard, are contrary to the BLM regulation and existing case law. ONRR seeks to equate an honest mistake or mere inadvertence to a “knowing or willful” act and, as discussed below, does so without regard to the severity or amount of the underlying violation or payment. The proposed definition should be omitted.

ONRR’s proposed definition of “maintenance of false, inaccurate, or misleading information” should be revised to specify that the company, after learning that its information was false, inaccurate, or misleading, has a “reasonable period of time under the circumstances” to correct it. As written, the definition does not provide the company with a period of time to correct the information. The definition should be revised accordingly.

ONRR’s proposed definition of “submission of false, inaccurate, or misleading information” refers to information the payor “knew, or should have known” was false, inaccurate, or misleading at the time the information was provided. The reference to “should have known” should be omitted because it is inconsistent with the requirement that such action be “knowing or willful.” Alternatively, a reasonableness component should be added to the “should have known” aspect of the definition (i.e., “...and you knew, or **reasonably** should have known,...”).

§1241.4 How will ONRR serve notices?

Subpart (b) of this proposed section should be revised to state that ONRR will consider the notice served on the date it was “received by” the addressee of record, not on delivery to the addressee. Basing service on receipt, rather than on delivery, will ensure that the company or payor has the full period within which to appeal the civil penalty assessment or to take other permitted actions in response to the assessment. The current version of Part 1241 bases service and the running of deadlines on receipt of the notice, not delivery. See, e.g., 30 CFR §§1241.52 through 1241.56; §§1241.62 through 1241.64.

§1241.5 How do I request a hearing on the record on a notice?

Subpart (a)(1) provides for a \$300 non-refundable processing fee. The proposed amendment should be revised to state that the fee will be refunded to the company in the event its appeal is successful.

Subpart (a)(3)(iii) provides for a bond or other surety instrument or demonstration of financial solvency under 30 CFR Part 1243. It goes on to state that the bond, surety instrument, or demonstration of financial solvency must include, along with principal and interest, “any additional penalties that have accrued since ONRR issued the FCCP or ILCP.” In many cases, the amount of additional penalties may be unclear or difficult to determine. While §1241.12 of the proposed amendments provides that ONRR may send courtesy notices informing the payor of additional royalties that have accrued, there is no requirement that ONRR do so. As a result, payors may not have specific guidance from ONRR concerning the additional royalties that have accrued. Accordingly, the amendment should be revised to provide that this will not be a basis for ONRR to find that the bond, surety instrument, or demonstration of financial solvency is deficient and that the Request for Hearing will not be considered.

Subpart (b)(1) of this section should be revised to provide that in the event ONRR determines that any bond, surety instrument, or demonstration of financial insolvency submitted with a Request for Hearing is incorrect or insufficient for any reason, the company or payor will be given a reasonable period or opportunity to correct or amend the bond, surety instrument, or demonstration of financial solvency, and the incorrect or insufficient bond, instrument, or demonstration of financial solvency will not be a basis for ONRR to deny consideration of the Request for Hearing.

Subpart (d) of this section should be revised such that when a party does not specify whether it is contesting liability, the penalties assessed, or both, the party should be deemed to contest both liability and the penalties assessed. This is necessary to protect the rights of the company/payor and to avoid prejudice where it fails to explicitly state the basis for its challenge. This revision will not prejudice the rights or position of ONRR. A similar revision should be made to apply this subpart to FCCP notices.

§1241.8 What procedures apply to my hearing request?

This section addresses motions for summary decisions and provides that such motions will be filed and considered prior to discovery. This revised structure is inefficient and will lead to a waste of time and resources on the part of the parties and the ALJ. Discovery should be permitted in advance of the filing of motions for summary decision. Such discovery, including oral depositions of ONRR and State witnesses, is necessary to clarify the issues and to establish the existence or non-existence of genuine issues of material fact. Requiring the filing of motions for summary decision prior to discovery will inevitably lead to a waste of time and resources. Moreover, the notion that discovery should not be conducted prior to the filing of motions for summary decision and rulings thereon is inconsistent with the requirements of proposed §1241.9, which require that such motions and responses be based on more than mere allegations and be accompanied by supporting affidavits, declarations, and evidence.

Subpart (f) of this section states if there is no summary decision, then the ALJ will, “to the extent necessary, authorize discovery, conduct a hearing, and issue a decision.” As discussed above, discovery, including oral depositions of ONRR and State witnesses, should be permitted as a matter of course.

Subpart (h) of this section impermissibly limits the authority and discretion of the ALJ to reduce penalties and to consider ONRR’s assessment of penalties, including the amount assessed. This should not be permitted, as the ALJ should have the discretion and authority to fully review ONRR’s assessment and to reduce or not assess penalties. Accordingly, subpart (h) should be stricken from the amendment.

§1241.9 What are the requirements and standards for a motion for summary decision and response?

As noted above, this proposed subpart runs contrary to the requirement in proposed §1241.8 that summary judgment motions are to be filed prior to and without the benefit of discovery. Specifically, subparts (a)(1), (a)(3), (a)(4), (b)(1), (b)(1)(ii), (b)(1)(iii), and (c)(1) of proposed §1241.9 require that motions for summary judgment and responses be based on more than mere allegations and that they be supported by affidavits, declarations, and other evidence in the record. Discovery will be necessary to develop or to rebut the evidence needed on summary judgment and to develop a record on summary judgment. Subpart 1241.8 and §1241.9 should be revised accordingly

§1241.12 Does my hearing request affect the penalties?

Subpart (b) of this section removes any discretion on the part of the ALJ or the IBLA to stay the accrual of penalties pending the appeal. Under the current regulations, ALJs and the IBLA can grant or deny a request to stay the accrual of civil penalties pursuant to 43 CFR §4.21. There is no basis or authority for ONRR to remove this discretion on the part of the ALJs or the IBLA.

§1241.51 What if I correct the violation(s) identified in an NONC?

This proposed subpart provides that even if a company or payor corrects the violation(s) identified in the NONC within the period provided in the NONC, ONRR may nevertheless consider the violations as part of the company or payor's history of noncompliance for future penalty assessments. This additional language should be stricken. To the extent a company timely corrects the violations in the NONC, those violations should not negatively impact any future penalty assessments.

§1241.52 What if I do not correct the violation(s) identified in an NONC?

Subparts (a)(2) and (b) propose to increase the maximum daily penalty amounts to \$550 and \$5,500. There is no reasonable basis or justification provided for this increase.

§1241.60 Am I subject to penalties without prior notice and an opportunity to correct?

Subparts (b)(1) and (b)(2) propose to increase the maximum daily penalty amounts to \$11,000 and \$27,500. There is no reasonable basis or justification provided for this increase.

In addition, ONRR proposes to add language in subparts (b)(1) and (b)(2) concerning what can be considered a knowing or willful failure or refusal to permit an audit ((b)(1)) or a knowing or willful preparation, maintenance, or submission of false, inaccurate, or misleading reports or other written information ((b)(2)). Each of these additions is overbroad and should be omitted.

The notion in proposed subpart (b)(1) that a "failure to keep, maintain, or produce documents [can] be a knowing or willful failure or refusal to permit an audit" is objectionable for several reasons. First, changes or variation in the documents that payors and companies are required to keep or provide to ONRR in the course of audits

improperly expose companies to penalties under this proposed addition. For example, requests by ONRR or State auditors for documents that are not in the company's possession, custody, or control (e.g., in the case of ONRR unbundling requests) would arguably be a basis for penalties under this new language. That should not be permitted. Second, the fact that a company, due to an honest mistake or inadvertence, did not maintain or cannot produce documents does not rise to the level of a "knowing or willful" violation. Yet ONRR's proposed amendment would provide for penalties in that case. In fact, recent assessments by ONRR indicate that ONRR is looking to increase its assessments in this area and will use this amendment to support its position. Again, that should not be allowed, and ONRR must be required to adhere to the recognized definition of "knowing or willful."

The same applies to the proposed language added to subpart (b)(2). The new language provides that a company "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 other written communication identifying a violation, and you (i) fail to correct that violation; or (ii) correct that violation but commit substantially the same violation in the future." There are several problems with this proposed language. First, the reference to any "email, preliminary determination letter, order...or any other written communication identifying a violation" is overbroad and would include letters or communications that are non-binding and non-appealable (e.g., course of business emails with ONRR or State auditors, Dear Reporter or Dear Payor letters, non-appealable guidance letters, etc.). ONRR should not be allowed to penalize a company for failing to comply with these types of non-appealable, non-binding communications. Including this language in the regulation will result in the filing of numerous unnecessary appeals, as companies will be forced to file an appeal of any communication that could potentially subject it to civil penalties at a later time.

Moreover, this new language in (b)(2) – like other provisions discussed above – would allow ONRR to penalize conduct that does not meet the recognized "knowing or willful" standard. For example, if a company corrects a violation in response to an initial order but later, through an honest mistake or inadvertence, makes the same mistake again, ONRR's proposed amendment subjects that company to penalties. That is patently unfair and directly contrary to the recognized "knowing or willful" standard. ONRR's current practices, including a penalty assessment against W&T under this very type of situation, are a clear signal that ONRR is looking to increase its penalty power and to dilute the "knowing or willful" requirement of Part 1241. The proposed language should be stricken from the amendment.

§1241.70 How does ONRR decide the amount of the penalty to assess?

The language in subpart (a)(3) that allows ONRR to consider the number of employees in a parent company, subsidiaries, and contractors is overbroad and would allow ONRR to increase the penalty amount based on factors that may have little or nothing to do with the payor or company at issue. The language in the current regulation on this issue should remain in place.

The language in subpart (b) is objectionable for several reasons and should be stricken from the amendment. First, the notion that the value or amount of the underlying royalty underpayment should not be considered in deciding whether to assess penalties and in what amount is contrary to existing law, including the U.S. Constitution and its Excessive Fines Clause. Penalties that are grossly disproportionate to the underlying offense are prohibited. This is a hotly contested issue that is currently before the Office of Hearings and Appeals. ONRR cannot be allowed to circumvent this by simply amending its regulations to say otherwise.

In many cases, ONRR has assessed millions of dollars in penalties for a very small royalty underpayment that was due to an honest mistake. When one considers the amount of royalties that many companies remit to ONRR over an audit period of several years (which often total in the hundreds of millions of dollars), an underpayment of \$20,000 or \$30,000 over that same period is a very small mistake. For ONRR to use its penalty regulations to turn this into a multi-million dollar penalty claim, or to use this proposed amendment to enhance its ability to do so, is patently unfair. Many regulations and statutes provide for a concept of materiality or recognize exceptions for *de minimis* mistakes. ONRR's penalty regulations should do the same.

The problem is further exacerbated by ONRR's view of what constitutes a "violation." ONRR views each line of a Form 2014 as a separate violation. By doing so, ONRR is able to exponentially increase the penalties it assesses. For example, in the case of a unit, where the payor is required to report royalties by lease on its Form 2014, ONRR treats each line for each lease as a separate violation (even though the lease-by-lease reporting is required by ONRR's own regulations). ONRR, through its "line-by-line" approach and its broad, unsupported view of what constitutes a "knowing or willful" violation, has gone too far in the area of assessing civil penalties and penalizing conduct that does not meet the recognized "knowing or willful" standard.

W&T recognizes that situations will arise in which a company commits a true knowing or willful violation that supports the imposition of civil penalties. We are not seeking to curtail ONRR's ability to assess penalties in those situations. However, ONRR's current approach and the approach signaled in the proposed amendment seek to dilute the "knowing or willful" requirement and to open the door to penalties for

honest, inadvertent mistakes. Moreover, ONRR seeks to impose millions of dollars in penalties where an honest mistake or inadvertence leads to a very small underpayment. This should not be permitted.

Subpart (c) of this section states that ONRR will post its penalty assessment matrix on the ONRR website. ONRR has not disclosed the penalty matrix referred to in subpart (c). ONRR should disclose the penalty matrix and allow a period for comments on the matrix.

Thank you for your consideration of these comments, please do not hesitate to contact me if you should have any questions.

Respectfully submitted,



Jamie L. Vazquez
President