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Mr. Armand Southall
Regulatory Specialist
Office of Natural Resources Revenue
Department of the Interior
Post Office Box 25165, MS 61030A
Denver, Colorado 80225

By Email: Regulations.gov

**Re: IPANM COMMENTS to ONRR
Amendments to Civil Penalty Regulations, 79
Fed. Reg. 28,862, May 20, 2014 (RIN 1012-AA05)**

Dear Mr. Southall,

The member companies of the Independent Petroleum Association of New Mexico ('IPANM') appreciate the opportunity to comment to the Office of Natural Resources Revenue (hereinafter 'ONRR') proposed amendments to 30 CFR Part 1241, subparts A through C, filed in the federal register on May 20, 2014. In addition, IPANM is a cooperating association with the Independent Petroleum Association of America and we fully adopt their comments filed on this matter.

Difficulty with interpreting ONRR regulations is not a new problem for oil and gas producers¹, particularly smaller operators. The manner in which the ONRR has proceeded over the past three years in auditing small New Mexico producers has been extremely harsh. There have been threats to run companies into the ground by excessive fines and a general attitude that small oil and gas producers, by their very nature, are trying to cheat the government. Industry's attempts to work with the agency to achieve reasonable regulations and even an understanding of what the agency may want have been met with sarcasm. Indeed, at a June 2013 workshop held by

¹ The terms 'producer', 'operator' and 'reporter' are use interchangeably in this document. In each instance

IPANM in Albuquerque, the lead enforcement agent for the ONRR gave a presentation stating, “we could fine you \$25,000 per day per violation and if you don’t like how we do this, just get out of the business.” This proposed regulation would create a regulatory scheme to give all ‘guidance’ documents the force of law, limit the operator’s ability to contest the agency’s overly aggressive penalty assessments and would limit appellate review of the agency action. This proposed regulation is just another example of the ONRR’s intent to ignore existing law and basic tenants of administrative law and constitutional due process.

The Independent Petroleum Association of New Mexico, IPANM, represents several hundred independent oil and gas producers who live, work and employ New Mexicans. Our member companies provide enough revenue to the State of New Mexico to support 31% of the state General Fund² in a state where nearly 41.8% of the land is federally owned. According to the Office of Natural Resources Revenue, in FY 2013 the Federal Government disbursed \$478,732,193.90 in revenues to New Mexico³, which is only 48% of the total royalty revenues collected for oil and gas operations on NM federal lands. There are currently 30,561 active wells on federal lands,⁴ managed by the Bureau of Land Management that controls 13.4 million acres of surface and 26 million acres of subsurface minerals in New Mexico.

Specific points:

In addition to the excellent points made in the Independent Petroleum Association of America comments, IPANM is extremely concerned about the knowing and willful and adjudicative provisions amended in this proposal. Currently, there are several dozen IPANM member companies who are under audit review because of varying interpretations of existing regulations. However, the ONRR states in the preamble to the amendments that ‘knowing and willful’ shall accrue for “delays in providing documents and outright refusal to provide documents ”⁵ ONRR then states that even if a delay results in a ‘curable NONC’ under §1241.5 that the agency still believes it may seek penalties for the delay “as a knowing or willful failure to

² “Fiscal Impacts of Oil and Natural Gas Production in New Mexico: Preliminary report”, New Mexico Tax Research Institute, Jan 2014.

³ <http://statistics.onrr.gov/ReportTool.aspx>

⁴ <http://www.emnrd.state.nm.us/OCD/documents/OCD%20Well%20Statistics03272014.pdf>

⁵ 79 Fed. Reg. 28,862 at 28,869 (May 20, 2014)

permit an audit under this paragraph, resulting in an Immediate Liability for Civil Penalty (ILCP)” which does not give an operator the opportunity to correct a violation.

ONRR further points to situations where a reporter unknowingly reports an royalty calculation using the wrong code to the agency, and then is told by the agency that the wrong code was used. The operator is required to then amend all the reports using that erroneous code going back for a seven year period since that is how far back the agency can audit a company. Not amending the reports for the required period could result in a ‘knowing and willful violation’ according to this new ONRR proposal⁶. Using this example to equate a lack of busywork in amending several years of reports to the legal standard of ‘knowing and willful’ demonstrates how unreasonably aggressive the ONRR is being towards the oil and gas industry.

The proposed knowing and willful provisions do not work with the unbundling issues

The newly proposed vicarious liability standard cannot stand in light of the agency’s application of the ‘unbundling’ issue. In June 2013, IPANM conducted an extensive two day workshop featuring several staff members from the ONRR Denver office. The subject matter of the workshop was the ‘unbundling’ concept wherein the ONRR is now requiring all natural gas producers to use specific formulae for each processing plant when calculating royalty payments to the federal government. In essence, the question is a complex one involving expense calculations associated with the transportation and processing of conventional gas sources and determining which sources are deductible from federal royalty. The answer that came from the industry experts and ONRR at the workshop was that the amount of allowable deductions depended on the unique stream of molecules coming from each well through each processing plant. Thus, under the unbundling requirements, in order to arrive at a ‘defensible’ deduction, the producer/reporter is to calculate the capital costs for each section of pipeline, gathering and each piece of equipment in the processing plant and deduct a certain percentage from the value stream of the gas. But, by definition, an independent producer does not own pipeline, gathering lines or processing plants, thus the cost of capital expenditures are not available. At the IPANM workshop, the ONRR staff admitted that even with their regulatory power, they could not get that information from the midstream assets and acknowledged that it would be even more difficult for producers to obtain

⁶ 79 Fed. Reg. 28,864.

that information. Thus, the ONRR has opted to publish figures on their website as to the allowable percentages for each plant after they have ‘unbundled’ the gathering system and the plant. However, the agency will only release figures for past years, is forcing operators to amend part reports and will not release figures for current years. This perverse system effectively requires independent operators who do not have complete information to make ‘best guesses’ for their deductibility figures, or use the government figures and then change them when the ONRR reports the figures for those years. For example, in January 2014 the ONRR published on its website information for the San Juan Conventional transportation system and Ignacio plant with allocation figures for 2006 to 2010. With the publication of the figures, an operator is expected to go back and amend all the monthly reports from 2006 through 2010 with the new figures. But amending all those reports raises a few issues: 1) will amending the reports be considered ‘knowing and willful’ misreporting? 2) what figures should be used for 2011 to present? 3) will amending those figures impact other royalty obligations? 4) If an operator uses the 2010 numbers for reporting in 2014 can the agency deem him to be knowing and willfully misreporting under these proposed amendments? 5) The audit period for the ONRR is seven years. At the IPANM workshop, the ONRR chief enforcement officer made very clear that not amending figures seven years back when the agency informed you of new allocation figures would be considered a ‘knowing and willful’ violation. But if you look at the ONRR website today, you will see an example on how to report that is very different from the way the ONRR has been auditing companies for the past several years⁷. ONRR never issued guidance or information to operators to report differently than how they had presented at the IPANM meeting and at several COPAS meetings prior. So what is the rule?? IPANM would respectfully request that unbundling figures cannot be retroactively applied. If an agency publishes a cost allocation figure for a plant and expects the operators to use that number in their royalty calculations, that the figure must be prospective. Much like the federal mileage rate or the federal tax rate, when changes are made, the government does not expect citizens to amend their tax records going back seven years or face

⁷ <http://onrr.gov/unbundling/default.htm>

How to use the published Unbundling Cost Allocations (UCAs) Example:

1. ONRR publishes UCAs for 2010.
2. You use 2010 UCAs to estimate 2011, 2012, and 2013.
3. ONRR publishes UCAs for 2011 and 2012.
4. You replace estimated values for 2011 and 2012 (there is no change for 2013).
You use 2012 (most current) UCAs for future reporting period estimates.

civil and possibly criminal penalties and interest for those seven years. In the unbundling scenario, the ONRR should post figures for various plants and gathering systems since independent operators do not have that information, but the ONRR data must be for the current year and until additional data is posted. As currently enforced coupled with the proposed changes to ‘knowing and willful’, the unbundling process will unfairly impose liability on operators that would clearly be violative of due process rights.

The proposed limitation on time periods for hearing requests is unreasonable and punitive

Next, we would note that historically, there has been a significant problem working with the ONRR in the interpretation of their regulations. The issue of interpretation of ONRR regulations and enforcement and the need for open lines to communicate different interpretations of the complex regulatory mechanisms is one that cannot be stressed enough. Federal royalty accounting is a very specialized area of expertise that requires a detailed understanding of a specific area of law and accounting. Often, there are questions as to an agency’s demand for information and, thus, several proposed provisions of this ONRR amendment must not stand.

For example, IPANM represents one company who received a notice of non-compliance (NONC) in February 2012 for issues that had been the subject of communications between the ONRR reporting officer and the company since 2009. The issues in question included the ONRR’s erroneous contention that this particular company owned several wells. Other questions pertained to applying allowable exemptions and whether there had been prior reporting errors. The assigned ONRR representative had been non-responsive to questions and did not provide requested information as to what information existed on those wells for nearly two and half years. The NONC gave the company 20 days to fix all reporting errors. Two days after receipt of the NONC, the company emailed the supervisor of their assigned ONRR representative questioning why there was a NONC filed. However, without contacting the company, and the ONRR promptly forwarded that email back to the non-responsive ONRR representative. The ONRR representative was not happy that the company’s production clerk had gone over her head but she told the company that she needed to research the questions and committed to getting back to the company. She also indicated, that since she was busy, that she would provide the company ‘cover’ and would request a time extension in the event she did not respond to the company prior

to the 20-day deadline. However, the 20-day NONC period expired by the time the ONRR representative ultimately got back to the company. Because the current rules do not allow for an extension request once the NONC period has expired, the company's rights to contest the underlying liabilities was therefore, waived.

At the subsequent hearing before an Administrative Law Judge, the company argued that the ONRR verbally indicated that they would grant an extension of time. While the ONRR insisted that the company's ONRR representative did not have the authority to grant an extension and only her supervisor had that authority, but this fact had never been communicated nor is it written in any ONRR regulation. It is also concerning to note that the company's contact with the supervisor was within the 20 day time period and yet made no effort to assist either the company or her employee to timely resolve the pending issues. IPANM would contend that if an operator is making a good faith effort to comply with an ONRR information request and the ONRR is being unresponsive, the only alternative with a strict 30 day limit on hearing requests in the proposed regulation is to file a request for hearing in order to protect his rights. The purpose of a hearing should be to contest liability claims, but if an operator is simply attempting to correct erred reports then this is an unnecessary waste of the federal government's time.

Limiting ALJ authority removes due process protections

Under the proposed rule, "if the ALJ finds that the factual basis for imposing a civil penalty exists," the ALJ may not: (i) reduce the penalty below half the amount ONRR assessed; (ii) review ONRR's decision to impose a civil penalty; or (iii) consider any factors to reduce the penalty amount other than those specified in 30 CFR part 1241.70. However, the basic tenants of administrative law and due process require a fair and impartial review of an agency action to ensure there are no arbitrary or capricious decisions. Again referring to the actual case adjudicated with an IPANM member company, at the hearing, the ALJ found that"

"...ONRR's lack of responsiveness and [the company's] efforts to comply are mitigating factors warranting a reduction in the civil penalty amount ... The circumstances surrounding ONRR's lack of responsiveness directly affected The company's reporting efforts...the record does demonstrate that ONRR failed to give adequate consideration to ONRR's lack of responsiveness during the 20-day period allotted for reporting and the companys good faith efforts to comply. The company acted in good faith initially by requesting information necessary to

report, ...but a preponderance of the evidence also demonstrated the presence of mitigating factors warranting a reduction in the penalty amount.”

Without the requisite review by an ALJ to question the underlying penalty assessment, this operator would not have had any recourse. Further, if an ALJ finds mitigating factors including a lack of good faith on the part of the agency to fairly communicate with an operator, the reduction of a penalty amount must be afforded an operator. IPANM strongly contests the ONRR’s position in these amendments that an ALJ’s authority to reduce or eliminate ONRR penalties may be significantly reduced.

The elimination of ALJ discretion to stay accrual of penalties violates due process

In the company’s particular incident, after receiving the Civil Penalty Notice (Now called an FCCP, Failure to Correct Civil Penalty Notice), within the 10-days allowed in the FCCP, the company alerted the Office of Hearings and Appeals of its request for a hearing. After the company received notice that an ALJ was assigned to the case, the company contacted the ALJ and was told that the judge encouraged the parties to settle. The company contacted the Office of the Solicitor General, who had been assigned to adjudicate the ONRR’s case. Upon receiving confirmation from both parties that they were in settlement negotiations, the ALJ rescheduled the Pre Trial Scheduling conference for several months later. A few days prior to the rescheduled Pre Trial Scheduling conference, the company still had not heard from the government’s attorney. After reestablishing communications with the attorney, the government’s attorney then indicated that they did not have the authority from the ONRR to engage in settlement talks. IPANM strongly believes that this was a delay tactic used by the agency. If additional interest and penalties could have accrued during that time frame, as proposed in these amendments, there will be no incentive for the government to communicate, negotiate or settle in a timely manner.

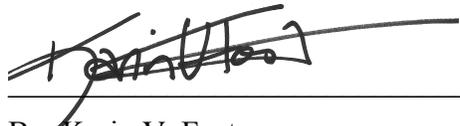
In addition, during the discovery process for the hearing with this company, the ONRR refused to comply with several discovery requests for the production of documents. The company was forced to file a motion with the ALJ to compel the ONRR to release these vital documents. Similar to the situation above, if an ALJ is not able to stay accrual of penalties when delays are due to ONRR non-responsiveness, the government is incentivized to delay the adjudication of their claims.

IPANM has heard from many operators that the non-responsiveness and unwillingness to communicate is an issue that is common with ONRR. In all reported instances the ONRR took no responsibility for their lack of professionalism, nor are there any standards to which they must be held accountable. The burden to comply with the unreasonable standards and requirements posed in these amendments is fully on the shoulders of the operator/reporters. As drafted, the proposed amendments will result in all operators who receive a NONC or ILCP to contest the underlying liability and penalties by requesting a hearing, whether they intend to comply or not and whether or not they contest the underlying liability. Under the current and proposed regulations this is the only way a reporter can maintain their right to due process. Unfortunately, this will have the effect of clogging the ONRR with requests for hearings on even the most mundane matters.

IPANM thanks the ONRR for the opportunity to comment on the amendments to the civil penalties provisions. Please feel free to contact me at Karin@ipanm.org or at (505) 238-8385 if you have any questions regarding our comments.

Respectfully submitted,

INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO



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