No. 14-459

IN THE

SUPREME COURT OF THE UNITED STATES

CENTURY EXPLORATION NEW ORLEANS, LLC,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

BRADLEY A. BENBROOK
Counsel of Record
STEPHEN M. DUVERNAY
BENBROOK LAW GROUP, PC
400 Capitol Mall, Ste. 1610
Sacramento, CA 95814
(916) 447-4900
brad@benbrooklawgroup.com

ILYA SHAPIRO
CATO INSTITUTE
1000 Mass. Ave., N.W.
Washington, D.C. 20001
(202) 842-0200
ishapiro@cato.org

Counsel for Amicus Curiae

QUESTION PRESENTED

Where the government leases property to a private individual subject only to the laws and regulations in existence at the time of the lease's execution and "any regulations issued pursuant to Statute X in the future," does the government breach that contract by seeking to subject the leaseholder to post-lease informal guidance issued under Statute Y?

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to promote the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato conducts conferences, publishes books, studies, and the annual *Cato Supreme Court Review*, and files *amicus* briefs. This case is important to Cato because it concerns the scope of the government's power when contracting with private parties.

BACKGROUND

In 2008, the petitioners paid the Government $23 million to lease the right to drill exploratory oil wells in the Gulf of Mexico. Pet. 3. The lease they signed contained the Department of the Interior's (DOI) standard terms, and it obligated them to comply with all applicable statutes and regulations that were then in existence. DOI's standard terms also limited the petitioners' risk, by providing that the only subsequent regulations their lease would be subject to would be those promulgated under a single, specific statute, the Outer Continental Shelf Lands Act (OCSLA), relating to the prevention of waste and preservation of natural resources. *Id.*

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[1] Rule 37 statement: All parties were timely notified of and have consented to the filing of this brief. Counsel affirms that no counsel for any party authored this brief in whole or in part and that no person or entity other than *amicus* made a monetary contribution to its preparation or submission.

This sort of assurance was necessary because virtually every aspect of exploratory drilling is subject to substantial regulatory requirements. While the petitioners could account for existing regulations when considering whether or not to purchase the leasehold, the continued viability of the project depended on regulatory stability

As an extreme example, absent this limitation, the government could have taken the petitioners' money and subsequently passed a new law forbidding oil companies from drilling in the Gulf of Mexico—rendering petitioners' lease worthless. While the government was not so brazen as to completely outlaw drilling, the effect of the post-lease policy changes had *the exact same effect on the petitioners' business as an absolute ban*.

At the time the lease was executed, the Oil Pollution Act (OPA) required companies drilling in the Gulf to create and submit an emergency preparedness plan detailing how they would respond to an oil spill involving their facilities. As part of that plan, leaseholders are required to calculate the volume of oil that would be released in a "worst case scenario." Pet. 5. Based on that predicted volume, leaseholders are required prove that they have the financial resources to fund the clean-up efforts for the hypothetical spill and to post a bond.

Regulations issued pursuant to the OPA set out the methodology used to calculate the volume of oil released in a worst-case scenario spill. At the time the lease was executed, OPA regulations allowed leaseholders to assume that the spill would last 30 days and that the release of oil would be retarded by the presence of certain commonly used equipment

partially clogging the bore. Under those regulations, the petitioners calculated that their worst possible spill would result in the release of 45,000 barrels of oil, an amount which would cost $4.5 million to clean up, requiring petitioners to post a $35 million bond.

Following the DeepWater Horizon disaster, the petitioners received an email from a DOI employee informing them that they would have to recalculate the outcome of the hypothetical worst-case scenario using a new methodology which assumed that the spill would last for 120 days with an entirely unblocked borehole. *Id.* at 4. Using the new methodology, the predicted volume of oil spilled in a hypothetical disaster increased to 17 million barrels. That entirely speculative number required the petitioners to prove they had the financial resources to fund a $1.8 billion dollar clean-up, and to post a $150 million dollar bond before drilling commenced. *Id* at 5. Those costs made it impossible for the petitioners to continue operating, so they were forced to surrender the lease.

The petitioners sued, claiming *inter alia* that the government committed a breach of contract when it sought to subject them to new regulatory requirements that were not formally promulgated under OSCLA. The Federal Circuit rejected this claim on the ground that the agency employee's emails were not only regulations, they were regulations authorized by OSCLA.

SUMMARY OF ARGUMENT

The court below erred when it held that the government may do by informal email what this Court in *Mobil Oil* said it cannot do by congressional act. *Mobil Oil Exploration & Producing Se., Inc. v.*

United States, 530 U.S. 604, 614-20 (2000). This holding threatens the government's ability to efficiently conduct its business by undermining its credibility as an honest broker.

In addition to the petitioners' arguments, the petition should be granted for two reasons. First, the central holding of *Mobil Oil*—that the government cannot legislate its way out of a breach of contract—is crucial to the viability of government contracts, which are in turn vital to the smooth operation of the government and the health of the American economy. In light of the Federal Circuit's opinion below, that central principle should be reaffirmed.

Second, the government and the court below have defined "regulation" in a frighteningly expansive and unorthodox manner that includes emails sent by agency employees which contain policy guidance that contradicts regulations codified in the C.F.R. Whether or not that definition of "regulation" is substantively correct, its adoption merits this Court's attention because it presents a reversal of the government's historical position on the matter and conflicts with several of this Court's opinions.

This Court has recognized that when the government induces private parties to invest substantial resources through a contractual promise—subject to change only by formal rule-making—the government cannot evade that promise without committing a material breach of contract. *Id.* If day-to-day policy adjustments are to count as contract-adjusting "regulations" for these purposes, countless billions of dollars' worth of investments—including government contracts using form language identical to that used here—are in jeopardy.

ARGUMENT

I. THE DECISION BELOW THREATENS THE FEDERAL GOVERNMENT'S CREDIBILITY AS A CONTRACTING PARTNER

This Court recognizes that the government's sovereign power "to enter contracts that confer vested rights" on private parties carries with it "the concomitant duty to honor those rights." *Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986). Further "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Mobil Oil,* 530 U.S. at 607 (quoting *United States v. Winstar Corp.*, 518 U.S. 839, 895 (1996) (plurality opinion)); *Lynch v. United States*, 292 U.S. 571, 579 (1934) (stating rule). It then follows that when the government "repudiate[s its] obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen." *Perry v. United States*, 294 U.S. 330, 351 (1936).

Holding the government to the same standards as private parties not only protects the bargained-for expectations of its contracting partners, it is also essential to the maintenance of the government's credibility in the marketplace. As Justice Souter's principal opinion in *Winstar* emphasized, the power to make contracts is "'the essence of sovereignty' itself," and permitting the government to avoid its contractual obligations "compromis[es] the Government's practical capacity to make contracts" because it "undermin[es] the Government's credibility at the bargaining table and increase[es]

the cost of its engagements." *Winstar*, 518 U.S. at 884 (citation omitted). "Punctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." *Id.* (quoting *Lynch*, 292 U.S. at 580). *See also id.* at 883 (noting "the Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies.").

In a similar context, the Ninth Circuit explained the risk of allowing the government to avoid its contractual commitments:

> [T]oo liberal an interpretation of the residual sovereign power of the government to override its contractual commitments would eviscerate the government's power to bind itself to contracts. In addition to the moral offensiveness of allowing the government to break its promises, too liberal a construction would have the paradoxical consequence of weakening the sovereign power to implement policy. If the government's commitments need not be honored, then it can induce responses to policies only by cash or coercion.

Madera Irrigation Dist. v. Hancock, 985 F.2d 1397, 1401 (9th Cir. 1993). *See also* Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 Mich. L. Rev. 1129, 1146 (1996) ("If we allowed the government to break its contractual promises without having to pay compensation, such a policy would come at a high cost in terms of increased default premiums in future government contracts and increased disenchantment with the government generally.") (citing Richard A. Posner, *Economic*

Analysis of Law 81 (3d ed.1986)) (cited in *Winstar*, 518 U.S. 885 n.29).

These cases recognize that in order to contract with the government for essential goods and services, businesses and private individuals need to be certain that the government cannot divest them of their contractual rights through subsequent legislation or regulation. In *Mobil Oil* and *Winstar*, this Court noted that clauses limiting the applicability of future legislative or regulatory action are often essential to government contracts. *Mobil Oil*, 530 U.S. at 616 ("Without some such contractual provision limiting the Government's power to impose new and different requirements, the companies would have spent $156 million to buy next to nothing."); *Winstar*, 518 U.S. at 869 ("Contracts [allocating the risk of regulatory change] are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained-for performance is always lurking in the shadows."); *see also id.* at 907-10 (discussing allocation of risk of regulatory change).

Ensuring that private businesses and individuals are willing to contract with the government is vital given the magnitude of federal contracting. Between 2008-2010, the federal government spent more than half a trillion dollars each year on contracts. Federal contract spending for the current fiscal year (2014) will amount to approximately $385 billion (roughly equivalent to the GDP of Michigan), representing just over 15% of total federal spending in 2014.[2]

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[2] *See* OMB, USASpending.gov, *Prime Award Spending Data*, online at http://www.usaspending.gov/?q=explore&fromfiscal=yes&typeofview=detailsummary&fiscal_year=2014;

While the implications of the decision below reach far beyond the specific lease at issue here, it is worth noting that offshore energy and mineral exploration on the outer continental shelf is a lucrative source of revenue for the government and a central component of the national economy. According to the Bureau of Ocean Energy Management, "[i]n Fiscal Year 2012, federal leasing revenues for the [Outer Continental Shelf] exceeded $8 billion. The sales value of the oil and gas resources amounted to about $60 billion, and generated about $120 billion in total spending in the economy. These expenditures supported about 700,000 domestic jobs." DOI, *BOEM Fact Sheet*, online at http://www.boem.gov/uploadedFiles/BOEMfactsheet.pdf.

In short, this Court's consistent position has been that, while no contract can prevent the government from exercising its sovereign powers to legislate or give effect to new policy, where doing so breaches an explicit contractual promise, the government must compensate the harmed party.

That was this Court's conclusion in *Mobil Oil*, and, in light of that precedent, the only the way that the government's position (and the decision of the Federal Circuit) can be defended is if the changes to the methodology used to calculate the volume of the worst-case-scenario oil spill were made through regulations issued under the authority of OCSLA.

They plainly were not.

Bureau of Economic Analysis, *Widespread but Slower Growth in 2013*, online at http://www.bea.gov/newsreleases/regional/gdp_state/2014/pdf/gsp0614.pdf

II. EMAILS ARE NOT REGULATIONS

The government entered into a contractual lease that explicitly allocated the risk of subsequent legislative and regulatory development between the parties. Those provisions were as crucial to the lease as the right to drill for oil. The petitioners agreed to bear the risk of "regulations issued pursuant to [OCSLA]"; the government, in turn, would assume the risk of other changes to governing law. *Century Exploration New Orleans, LLC v. United States*, Pet. App. 58a. "In short, [petitioners are] entitled to a stable statutory regime under section 1 of the lease, but [they] assumed the risk of future regulatory changes within the context of that statutory regime." *Id.* at 60a-61a.

The decision below is incorrect, because, in addition to not being issued under OSCLA as the petitioners argue, Pet. 17-21, the documents purporting to effect the change in policy *cannot* be considered "regulations." Because the petitioners only accepted the risk of subsequent policy changes that took the form of formal regulations—not informal "guidance" from agency employees, or an FAQ circulated by email—the government committed a material breach of contract when it insisted that the petitioners recalculate their "worst case scenario" spill-volume using the new methodology—a methodology that explicitly contradicts the OPA regulations that were in existence at the time of the lease's execution. Pet. 16.

A. The Lease's Plain Text Specified That the Petitioners Would Only Be Subject to Formally Issued Regulations

The parties' use of the phrase "regulations issued pursuant to the statute" evidences an intent that the lease would be subject to regulations adopted through formal rulemaking. *See* Pet. 26-30; *see also, e.g., Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 100 (1995) (positions that contradict current regulations must be adopted through notice-and-comment provisions of the Administrative Procedure Act).

Such formal rulemaking would have allowed all interested parties to argue about the competing interests at stake in the light of day, where political capital must be put on the line. This process is vital to allowing citizens and affected parties to assess political accountability for agency action, particularly when the potential loss of massive private resources is at stake. *See Erringer v. Thompson*, 371 F.3d 625, 629 (9th Cir. 2004) ("Generally, '[t]he procedural safeguards of the APA help ensure that government agencies are accountable and their decisions are reasoned.'") (citation omitted); *Time Warner Cable Inc. v. F.C.C.*, 729 F.3d 137, 168 (2d Cir. 2013) (notice-and-comment rulemaking "'serve[s] the need for public participation in agency decisionmaking and to ensure the agency has all pertinent information before it when making a decision.'") (citation omitted); *cf. Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2167 (2012) (noting the importance of APA in preventing "unfair surprise" to regulated parties).

Put simply, the sort of formal agency rulemaking required by the lease cannot be accomplished with the informality of an intra-office memo or newsletter. But that's precisely what the petitioners received. Instead of issuing regulations, the government relied on an agency email and "FAQs" to materially alter the terms of the contract. And, rather than follow the clearly established meaning of the language in the contract, the Federal Circuit deferred to the government and condoned its use of informal guidance as an end-run around the petitioners' contractually defined protections.

B. The Government Itself Has Previously Represented That Informal Guidance Created and Disseminated By Agency Employees Is Not the Legal Equivalent of Regulations

The government's position in this case—where it asks the Court to agree that informal guidance has the same legal character as a formally issued regulation—conflicts with its repeated reliance on the distinction between the two in cases where private parties have sought to hold the government to positions taken in informal guidance documents. For example, in *Devon Energy Corp. v. Kempthorne*, 551 F.3d 1030 (D.C. Cir. 2008), the plaintiff energy company argued that a "Dear Operator" policy letter distributed by a senior DOI official should be vacated because the agency failed to follow the APA before promulgating the policy embodied in the letter. (Similar to the email and FAQs in this case, the policy letter interpreted an existing agency rule and detailed how the energy companies should calculate the royalty value of methane gas. *Id.* at 1035.)

When DOI renounced its prior guidance and issued a new interpretation of the royalty calculation rule, plaintiff argued that it should not have to retroactively recalculate royalties after having relied for years on the Department's guidance. *Id.* at 1038. The D.C. Circuit instead accepted the government's argument, holding that such informal "guidance documents" issued by the agency did not amount to "authoritative and binding interpretations" of the rule. *Id.* at 1039-40, citing *Amoco Prod. Co. v. Watson*, 410 F.3d 722, 732 (D.C. Cir. 2005) ("workaday advice letters" sent by agencies do not constitute agency rules and lack force of law) and *Ass'n of Am. R.Rs. v. Dep't of Transp.*, 198 F.3d 944, 948 (D.C.Cir.1999) (holding a letter and two emails from lower level officials did not amount to an authoritative agency interpretation). In essence, the court said that the energy company should have known better than to assume the government would stand by its guidance. *See also OPM v. Richmond*, 496 U.S. 414 (1990) (holding that the government is not bound by its employees informal statements or interpretations of policy and law)

If informal guidance documents (like the email and FAQs here) lack the force of law when the government is acting as a regulator, then they must also lack the force of law when the government contracts on equal footing with private parties. The sort of "heads I win, tails you lose" regime ratified by the lower court here threatens to destabilize the relationship between the government and private parties who are both regulated by and contracting with the government.

CONCLUSION

This Court's intervention is necessary to reaffirm that the government is bound by its contractual commitments, just as the Federal Circuit is bound by this Court's precedent. As this Court said long ago, "[t]he United States does business on business terms." *United States v. Nat'l Exch. Bank of Baltimore*, 270 U.S. 527, 534 (1926).

The government made the petitioners a promise. It should be made to keep it. Accordingly, the petition for writ of certiorari should be granted.

Respectfully submitted,

BRADLEY A. BENBROOK
Counsel of Record
STEPHEN M. DUVERNAY
BENBROOK LAW GROUP, PC
400 Capitol Mall, Ste. 1610
Sacramento, CA 95814
(916) 447-4900
brad@benbrooklawgroup.com

ILYA SHAPIRO
CATO INSTITUTE
1000 Mass. Ave., N.W.
Washington, D.C. 20001
(202) 842-0200
ishapiro@cato.org

Counsel for Amicus Curiae

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