W&T OFFSHORE, INC.

184 IBLA 272 Decided February 11, 2014

United States Department of the Interior
Office of Hearings and Appeals
Interior Board of Land Appeals
801 N. Quincy St., Suite 300
Arlington, VA 22203

W&T OFFSHORE, INC.

IBLA 2012-266 Decided February 11, 2014

Appeal from a decision of the Director, Office of Natural Resources Revenue, denying appeal from orders requiring payment of additional royalties for production from Outer Continental Shelf oil and gas leases. MMS-10-0020-OCS & ONRR-11-0001-OCS.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

   ONRR's original election to take royalty in kind for production from an offshore oil and gas lease does not preclude it from later requiring a cash payment for additional royalties properly deemed to be due.

2. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

   Dear Operator Letters issued by ONRR to outline procedures for resolving production imbalances upon termination of the Royalty-in-Kind Program are statements of policy rather than the creation of substantive law, and are not subject to the notice and opportunity for comment provisions of the Administrative Procedure Act, 5 U.S.C. § 553 (2012).

3. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

   Requiring a cash payment for additional royalties calculated on the basis of the applicable price the United States received upon the resale of gas originally delivered as royalty in kind does not constitute a violation of any contractual provision or implied duty of good faith and fair dealing.

4. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

An appellant who is the current designated payor of an offshore oil and gas lessee is a proper recipient of an order to pay additional royalties due on production from the lease.

5. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

The statute of limitations in 30 U.S.C. § 1724(b)(1) (2006) precludes any action or relief regarding a royalty obligation that became due more than 7 years prior to the order at issue.

6. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

In requiring the payment of additional royalties due on production from an offshore oil and gas lease, ONRR properly calculated the additional royalty due for each month of production and correctly computed interest from the end of the month following each month of production.

7. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

In requiring the payment of additional royalties due on production from an offshore oil and gas lease, ONRR did not abruptly depart from a well-established practice, to the prejudice of an affected party, rendering collection of the royalties unfair.

8. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

   In calculating the additional royalties on production from an offshore oil and gas lease for each month of production, ONRR properly relied on the contract sales price originally received by the United States on the resale of gas delivered as royalty in kind.

9. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Oil and Gas Leases

   When additional royalty in kind is owed for a specific month of production, or if the royalty payor has over-delivered royalty in kind that was due for a specific month, interest properly accrues in favor of the United States or the royalty payor, respectively, from the end of the month following the month of production forward until the royalties for each month of production are paid to the United States or credited to the payor.

APPEARANCES: Jonathan A. Hunter, Esq., Katie S. Roth, Esq., and Sarah Y. Dicharry, Esq., Liskow & Lewis, New Orleans, Louisiana, for W&T Offshore, Inc.; John R. Kunz, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Lakewood, Colorado, for the Office of Natural Resources Revenue.

OPINION BY ACTING CHIEF ADMINISTRATIVE JUDGE ROBERTS

W&T Offshore, Inc. (W&T), has appealed from a July 20, 2012, Decision of the Director (Director's Decision), Office of Natural Resources Revenue (ONRR), denying its appeal from two Orders to Report and Pay Additional Royalties (Orders) issued by ONRR on March 16, and December 7, 2010 (March 2010 Order and December 2010 Order, respectively),[1] requiring it to pay additional royalties for

---

[1] W&T's appeals from the Orders were docketed by the ONRR Director as MMS-10-0020-OCS and ONRR-11-0001-OCS, respectively. By Orders dated May 19, June 18, and Oct. 1, 2010, the Secretary of the Interior transferred authority over offshore oil and gas royalty from the Minerals Management Service (MMS) to ONRR. *See* 75 Fed. Reg. 61051, 61052 (Oct. 4, 2010); *Anadarko Prod. Corp.*, 181 IBLA 388, 389 n.1 (2012). For the sake of clarity, all references herein to ONRR refer, as (continued...)

natural gas produced and sold from nine Outer Continental Shelf (OCS) oil and gas leases and units (Leases) situated in the Gulf of Mexico, off the coast of Louisiana.[2] All of the Leases participated in the Royalty-In-Kind (RIK) Program.[3] The Director agreed with ONRR's determination that W&T owed the additional royalties because of a "production imbalance" in the volume of natural gas delivered to the United States as RIK, *i.e.*, during the months at issue, production fell below the volumes of natural gas production to which the United States was entitled as RIK.[4] He specifically found that W&T was "acting on behalf of all parties"[5] as their designee

---

[1] (...continued)
appropriate, to ONRR and its constituent agencies, and to its predecessor MMS and its constituent agencies.

[2] All of the OCS leases and units were entered into pursuant to the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1331-1356a (2006). They are 054-014391-0, 054-015838-0, 054-015841-0, 054-015852-0, 054-015860-0, 054-021586-0, 054-021587-0, 754-303001-A, and 754-398017-A. Units 754-303001-A and 754-398017-A encompassed, respectively, unitized leases 054-015852-0 and 054-017307-0, and unitized leases 054-014391-0, 054-014208-0, and 054-014209-0.

[3] The RIK Program was a pilot program designed "to assess the feasibility of taking royalties in kind and selling the production under a competitive bid process in the open marketplace." Minerals Revenue Reporter Handbook, MMS/MRM Release 2.0 (07/01/03) (2003 Handbook), at 8-1. The Secretary terminated the Program beginning in September 2009, following issuance by the U.S. Government Accountability Office (GAO) of an Aug. 14, 2009, Report to Congressional Requesters (GAO-09-744) (GAO Report), entitled *Royalty-in-Kind Program, MMS Does Not Provide Reasonable Assurance It Receives Its Share of Gas, Resulting in Millions in Forgone Revenue*. *See* Answer at 3. The GAO noted deficiencies in the Program. *See* GAO Report at 6.

[4] ONRR refers to production delivered to the United States that falls either above or below the production required to be delivered to the United States as a "production imbalance." *See* Decision at 1; Answer at 5.

[5] In footnote (a) of Enclosure 1 to the March 2010 Order, ONRR explained: "The gas mcf volumes up to 04/2006 are provided by Kerr McGee, Energy Resources and Hess as lease/unit reporting operators until all agreed to have W&T report. W&T provides statements beginning 05/2006. MMS understands that all parties have agreed that W&T will cash out with MMS for all operators." The fact that W&T may not be liable for all of the royalty due on RIK production imbalances is not material to ONRR's authority to issue its demands for payment to W&T as designee of the lessees, with copies to the lessees. *See* sections 3(23) and 102(a) of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C.
(continued...)

in paying additional royalties required under the Orders; that while W&T may not be liable for any payment obligation under the Leases, ONRR properly made its demand for payment to W&T as the designee of the lessees, with written notice to the lessees; and that since "no lessee [had] separately appealed the Orders or joined W&T's appeals," any decision regarding production imbalances under the RIK Program "will be binding on the lessees of the leases covered by the Orders." Director's Decision at 21, 22, 23. For the following reasons, we affirm the Director's Decision in all respects.

BACKGROUND

Royalty payment in the case of Federal offshore oil and gas leases is governed by OCSLA; FOGRMA, 30 U.S.C. §§ 1701-1759 (2006); and the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (FOGRSFA), Pub. L. No. 104-185, 110 Stat. 1700, which amended FOGRMA. These statutes provide for the accurate and timely assessment, accounting, and collection of royalties owed, either in value or in kind, for oil and gas produced from such leases. *See, e.g.*, 30 U.S.C. §§ 1701, 1702 ("royalty"), 1711(a), and 1712(a) (2006); 43 U.S.C. §§ 1331 ("production") and 1337(a)(1) (2006); *Anadarko Petroleum Corp.*, 181 IBLA at 390-93, 404-11.

The RIK Program was in effect from September 2000 to September 2009, when the Secretary announced that the Program was to be phased out. On December 8, 2009, he established that (1) ONRR would allow all existing RIK contracts to expire by their own terms, and (2) ONRR would not initiate any new RIK contracts.[6] All RIK sales ceased to be effective September 30, 2010. When an existing RIK contract expired, the lease at issue reverted to royalty in value (RIV) status, and ONRR no longer had authority to take or receive royalties in kind. Decision at 4; *see* Answer at 3. However, upon termination of the RIK Program, existing RIK contracts left volume imbalances which ONRR had a duty to rectify. ONRR undertook to perform an accounting whereby it would determine, with respect to each lease that had been committed to the Program, whether royalties had been paid in full in each of the production months at issue. *See* 30 U.S.C. § 1711(c)(1) (2006) ("The Secretary shall audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted.").

---

[5] (...continued)
§§ 1702(23) and 1712(a) (2006).

[6] *See, e.g.,* http://www.doi.gov/news/presreleases/Interior-Completing-Close-Out-of-Royalty-in-Kind-Program.cfm (last visited Feb. 10, 2014).

ONRR refers to the process of resolving a production imbalance as "cashing out," which it did on a month-by-month basis. *See* Decision at 4. ONRR cashed out the volume imbalances each month there was an imbalance." *Id.* All of the imbalances for all of the production months at issue were "netted," arriving at an overall imbalance, either positive or negative, for the entire accounting period. Answer at 4. ONRR states that it "applied the same methodology to all cash out settlements at the end of the RIK Program[,] . . . receiv[ing] additional royalties in some circumstances and remitt[ing] refunds in others." Decision at 16; *see* Answer at 5 n.3.

ONRR does not contest W&T's assertion that it was not the lessee or the operating rights owner of all of the Leases throughout the entirety of the accounting period. *See* Statement of Reasons (SOR) at 8; Supplemental SOR (MMS-10-0020-OCS) at 1 n.1; Ex. D to Supplemental SOR (MMS-10-0020-OCS); Answer at 7. Nor does it dispute W&T's assertion that it "was not even a designated operator for the entire period covered by the Order[s]." Supplemental SOR (MMS-10-0020-OCS) at 1 n.1. However, there is no question that W&T is now the designee regarding resolution of the production imbalances, and any additional royalties and late-payment interest deemed to be owed as a consequence of such imbalances. *See id.* at 2 ("W&T cannot be liable for any royalty obligations *based solely on its status as designated operator.*") (emphasis added).

It is undisputed that during the *accounting period* from February 2003 through October 2008,[7] W&T "overdelivered [natural gas] in 26 months and underdelivered in 35 months." SOR at 6; *see* Gas Imbalance Settlement (Cash Out) for Royalty in Kind Monthly Volumetric Imbalances, Enclosure (Encl.) 1 to March 2010 Order; Multiple Royalty Rate FMP Entitlement Imbalance Cash Out February 2008 through September 2008, Encl. 1 to December 2010 Order. W&T asserts that, for the entire *RIK period*, it overdelivered natural gas in 34 months and underdelivered natural gas in 42 months, and that the net production imbalances favored W&T prior to February 2003, and favored the United States for the period after February 2003. *See* SOR at 6, 24; Answer at 5, 6. W&T states: "Based on cumulative RIK deliveries over th[e] [entire 7-year RIK] period, the . . . Leases were 'undelivered' as of October 31, 2008, meaning that *W&T Offshore . . . had not delivered, and DOI [Department of the Interior] had not taken, the entire royalty volume of natural gas produced during the seven-year period*." SOR at 1 (emphasis added).

[7] We denote the period of time from February 2003 through October 2008 as the "accounting period." We distinguish this accounting period from W&T's "RIK period," which covers the entire period of time that the Leases were subject to the RIK Program (November 2001 through October 2008). SOR at 1.

In its March 2010 Order, ONRR computed a cash out value of $1,649,529.51 for the net production imbalance during the accounting period owed to the United States, which it required W&T to pay by April 19, 2010. W&T paid the additional royalties under protest. In its June 28, 2010, Invoice (June 2010 Invoice),[8] ONRR determined that a total of $673,516.99 in late-payment interest was owed, and required payment of that interest by August 2, 2010. Upon later determining that it had miscalculated the net production imbalance for the period from February 2008 through September 2008, ONRR issued its December 2010 Order, requiring payment for that time period of $74,049.01 in additional royalties, with payment to be made by January 10, 2011. ONRR has yet to calculate or require payment of late-payment interest with respect to those additional royalties.

On April 12, 2010, W&T appealed to the Director from ONRR's March 2010 Order and June 2010 Invoice, and on January 6, 2011, W&T appealed to the Director from ONRR's December 2010 Order, pursuant to 30 C.F.R. § 1290.103 (formerly, 30 C.F.R. § 290.103 (2009)). As stated, the parties agree that there was a net production imbalance for the Leases for the entire RIK period that the Leases had been subject to the RIK Program (November 2001 through October 2008). W&T challenged ONRR's determination to resolve the production imbalance for only the shorter accounting period from February 2003 through October 2008, instead of resolving it for the RIK period. W&T questioned whether ONRR was entitled to require the payment of additional royalties in value, given its prior election to accept RIK, and whether the requirement to pay additional royalties and late-payment interest otherwise comported with the facts and the law.

The Director denied W&T's appeals. He required W&T to pay, within 30 days of receipt of his Decision, the $74,049.01 in additional royalties demanded in the December 2010 Order, as W&T had already paid the additional royalties and late-payment interest owed under the March 2010 Order and June 2010 Invoice.

W&T appealed timely from the Director's July 2012 decision to the Board.

DISCUSSION

In challenging ONRR's requirement to pay additional royalties attributable to production imbalances, W&T bears the burden of showing, by a preponderance of the evidence, that ONRR "committed a material error in its factual analysis or that the decision generally is not supported by a record showing that [the agency] gave due consideration to all relevant factors and acted on the basis of a rational connection between the facts found and the choice made." *Shooters-Edge, Inc.*,

---

[8] The appeal from the June 2010 Invoice was docketed as part of MMS-10-0020-OCS.

178 IBLA 366, 370 (2010). Thus, we have stated that "[t]he burden is on the payor . . . to show error in determining the amount of RIK that was due and/or that the volume of oil [or gas] actually received by MMS' purchaser . . . satisfied its royalty obligation." *Citation Oil & Gas Corp.*, 179 IBLA 390, 404 (2010). ONRR's 2010 Orders, as upheld by the Director's Decision, will not be overcome by "mere expressions of disagreement"; rather, "[t]here must a showing of clear error of law or demonstrable error of fact." *California Wilderness Coal.*, 176 IBLA 93, 101-02 (2008).

In accordance with section 8(a) of OCSLA, 43 U.S.C. § 1337(a) (2006), the holders of the Leases at issue are required to pay royalty to the United States at not less than 12-1/2 percent of the "amount or value of the production saved, removed, or sold" from the leases. *See* 30 U.S.C. § 1702 (2006); 30 C.F.R. §§ 1202.52(a), 1202.100(a) and (b)(1), 1202.150(a) and (b)(1), and 1218.150(a); *Amerada Hess Corp. v. Dep't of the Interior*, 170 F.3d 1032, 1033 (10th Cir. 1999); *Little v. Eni Petroleum Co., Inc.*, No. CIV-06-120-M, 2009 WL 2424215, at *1 (W.D. Okla. July 31, 2009); Lease OCS-G 14391, dated June 1, 1994 (Ex. 1 to SOR), § 6(a), at 2; 2003 Handbook at 8-1; *see also* Answer at 10.

Under section 27(a)(1) of OCSLA, 43 U.S.C. § 1353(a)(1) (2006), the Secretary has the discretionary authority to demand that royalty be paid in oil or gas produced from the lease (RIK) rather than in the value of the oil or gas produced from the lease (RIV). Section 27(a)(1) provides, in relevant part, that "all royalties . . . accruing to the United States under any oil and gas lease issued [under OCSLA] . . . shall, on demand of the Secretary, be paid in oil or gas." *Id.* When royalty is paid in kind, "Lessees fulfill their obligations by delivering the proper amount of RIK oil [or gas]. *See Texaco, Inc.*, 129 IBLA 46, 50 (1994)." *U.S. Oil & Refin. Co.*, 137 IBLA 223, 231 (1996). Upon receipt of the oil or gas, the Secretary may sell the oil or gas "by competitive bidding for not more than its regulated price, or, if no regulated price applies, not less than its fair market value[.]" 43 U.S.C. § 1353(b)(1) and (c)(1) (2006).

Section 101(c)(1) of FOGRMA directs the Secretary to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted." 30 U.S.C. § 1711(c)(1) (2006). ONRR is the agency in the Department charged with the audit and collection/refund authority under the statute. *See* 30 C.F.R. §§ 1201.100 and 1217.50.

W&T and ONRR agree that "the termination of the RIK Program required an accounting to address the outstanding [production] imbalances" that had arisen during implementation of the Program. Answer at 32. What is at issue here is the manner of accounting for imbalances. We find nothing in OCSLA or FOGRMA, as amended by FOGRSFA, or their implementing regulations, that specifically dictates how ONRR is to account for such imbalances. Rather, ONRR selected an accounting method that was neither prohibited by, nor inconsistent with, statutory and regulatory authorities, and provided guidance regarding the resolution of imbalances in its 2003 Handbook and notified those affected by issuing Dear Operator Letters.

The 2003 Handbook provides, with respect to "*RIK Imbalance Cash-Outs*," as follows:

> When a gas RIK lease is no longer taken in kind[,] . . . the cumulative imbalance will be *cashed out*. The cash out value will be based on instructions in the current Dear Operator letter.
>
> When an oil RIK lease is no longer taken in kind[,] . . . the cumulative imbalance will be *cashed out* based on the MMS contract price (at the delivery point) for the last month the lease is taken in kind.

2003 Handbook at 8-4 (emphasis added). In both cases, "[i]nterest will accrue from 60 days after the final month of delivery." *Id.*

ONRR issued two Dear Operator Letters over the course of the RIK Program.[9] *See* GAO Report at 7. The first Dear Operator Letter, dated September 28, 2000 (2000 Dear Operator Letter), stated, under the heading *Balancing Account and Imbalances (Lease Level Imbalances)*, that "[i]mbalances will be determined on the basis of the difference between the royalty share of production and the actual volumes delivered." 2000 Dear Operator Letter at 3. It further provided that, following each month of production, the operator "must provide the lease imbalance statement to the Lessor . . . no later than 45 days after the end of the month of production, unless MMS approves an alternative timeframe for submission of the statement." *Id.* The letter provided for resolving imbalances, initially, by having "[d]eliveries for the month following the month when the imbalance statement is due . . . adjusted to provide for volumetric makeup of the monthly imbalances," which adjustment "will be made in equal amounts each day of the month, prorated to resolve the identified imbalance." *Id.* at 3, 4. However, it also instructed the operator, in "extraordinary imbalance situations," to "work . . . with the Lessor to reach mutually acceptable methods of imbalance resolution." *Id.* at 4.

[9] W&T provides copies of the two Dear Operator Letters as part of Ex. 2 to its SOR in IBLA 2012-266 and as Ex. B to its SOR in MMS-10-0020-OCS.

The second Dear Operator letter, dated September 2005 (2005 Dear Operator Letter) superceded the 2000 Dear Operator Letter and stated, under the heading *Balancing Account and Imbalances (Lease Level Imbalances)*, that "[i]mbalances will be determined on the basis of the difference between the royalty share of production and the actual volumes delivered." 2005 Dear Operator Letter at 4. It provided that, following each month of production, the operator must provide a lease imbalance statement that would "specify total production, MMS' entitled share, volumes delivered, . . . the monthly imbalance, and the cumulative imbalance," and that the deadline for doing so was "no later than 60 days after the end of the month of production." *Id.* The letter provided for resolving imbalances by having RIK deliveries made "in the production month following the month that the imbalance is identified." *Id.* It thus allowed monthly imbalances to be made up by subsequent deliveries. However, the letter added that, if not resolved within 120 days of the end of the production month, imbalances were to be resolved by having the operator either adhere to a "[m]utually agreed upon make-up delivery schedule," or, if mutual agreement is not reached, make a "cash out payment based on the Lessor's sales price net of transportation costs from the lease for each month of production." *Id.* at 4, 5. The letter provided that, in the case of a cash out payment, "[i]nterest will accrue from the end of the month following the month of production." *Id.* at 5. The letter recognized the possibility of "extraordinary imbalance situations," when ONRR could require a cash out payment based on the "Lessor's sales price . . . for each month of the imbalance," noting that "[i]nterest will accrue from the end of the month following the month of production." *Id.* Finally, the letter stated that any "[i]mbalances remaining upon cessation of the royalty-in-kind term . . . will be settled on the basis of the Lessor's sales price net of transportation costs from the lease for the final month of in-kind delivery," and that, absent settlement, "[i]nterest will accrue from the end of the month following the month of production." *Id.*

W&T asserts that because deliveries are generally made contemporaneously with production, before the end of the month of production, underdeliveries and overdeliveries of RIK are inherent in the RIK Program and occur before the royalty payor knows the precise amount of RIK that ultimately will be owed for that month. *See* SOR at 3-4. W&T recognizes that, in the case of RIV payments, the amount of any underpayment or overpayment becomes fixed at the end of the last day of the month following the month of production, when whether the payor has paid more or less than the royalty value owed for the production month becomes clear. However, W&T states that such amount is not clear for RIK payments, since such payments "generate a constantly fluctuating 'total delivery' imbalance that changes each day, month, and year that a lease is in RIK status." *Id.* at 4. Thus, according to W&T, the status of the overall imbalance in RIK payments does not become fixed until the end of the RIK period. We cannot accept W&T's reasoning.

Under the terms of the OCS lease, "[w]hen paid in amount, . . . royalties *shall be delivered* at pipeline connections or in tanks provided by the Lessee . . . at reasonable times and intervals and, at the Lessor's option, . . . either (i) on or immediately adjacent to the leased area . . . or (ii) at a more convenient point closer to shore or on shore[.]" Lease OCS-G 14391, dated June 1, 1994, § 6(b), at 2 (emphasis added). This provision addresses the manner of delivery of RIK, which is a matter that is separate and distinct from the overriding obligation to "pay" RIK. *Id.*, § 6(a), at 2. In other words, if the royalty payor is required to "pay" RIK, it is required to deliver the in-kind natural gas as specified in the Lease.

Under section 8(a) of OCSLA, the amount of production for any particular month is fixed and finite, as it is simply the quantity of natural gas produced during the month. Thus, the RIK for the month, which is a percentage of the amount of production, is also fixed and finite. The ultimate deadline for payment of RIK, just like payment of RIV, is definite, established by statute and regulation, *i.e.*, the last day of the month following the month of production. *See* 30 U.S.C. § 1724(c) (2006); 30 C.F.R. § 1218.50(a); *Phillips Petroleum Co. v. Lujan*, 4 F.3d 858, 861, n.3 (10th Cir. 1993); Sol. Op., *Applicability of Sec. 10 of the Outer Continental Shelf Lands Act*, M-36977, 100 I.D. 418, 420, 426 (1993). When RIK is not paid in full on or before the deadline, interest begins to accrue on the amount of the unpaid royalty, and continues to accrue until the unpaid royalty is paid.[10] We conclude that W&T's argument that overall imbalances in RIK payments could not be fixed before the end of the RIK period is without merit.

A. ONRR is not Barred by Prior Election of RIK from Requiring Cash Payment in Satisfaction of Royalty Deficiency

W&T does not dispute ONRR's right to demand the payment of RIK, or its "right to receive the entire RIK volume that was owed." SOR at 10. However, it argues that ONRR was barred from subsequently requiring the resolution of production imbalances in the form of cash when it had previously elected to take RIK. W&T argues as follows: "[H]aving elected to take its royalties 'in amount' (in-kind), W&T does not owe, and the United States has no right to demand, payment of any royalties that may still be due for the RIK period 'in value' (in cash)." *Id.* at 2. In

[10] W&T appears to concede this point in stating that it "either underdelivered or overdelivered the royalty volume of natural gas *in each month of the RIK period*." SOR at 6 (emphasis added). In her Declaration dated Dec. 13, 2012 (Ex. 4 to SOR), Gayle Cheatham, Marketing Coordinator, W&T, states that W&T reported the "Monthly Imbalance" for each month from November 2001 through January 2003, just as ONRR reported, in Encl. 1 to the March 2010 Order, the "Monthly Gas Imbalance" for each month from February 2003 through October 2008.

doing so, W&T argues, ONRR "has exceeded its statutory, regulatory, and contractual authority." *Id.* at 11.

W&T indicates its willingness to resolve the imbalances at issue by delivering additional natural gas to the United States. According to W&T, what is owed, "if anything, is the completion of the performance that was owed during the RIK period—*i.e.*, one final delivery of RIK gas volumes that were not delivered to ONRR." SOR at 2; *see id.* at 10. Without citing any authority, lease provision, or policy, W&T states that "the United States' election to take royalties 'in amount' is binding for all royalties owed on production from the RIK period (including make-up volumes needed to resolve underdeliveries)[.]" *Id.* at 18. We reject W&T's conclusion.

[1] Nothing in FOGRMA or its implementing regulations provides that once ONRR elects to take RIK, it is barred from electing RIV to satisfy a royalty deficiency later determined to be due on that production. Nor do they contain a prohibition against changing the form of the royalty due on OCS production. Section 101(c)(1) of FOGRMA, which specifically directs ONRR to audit and reconcile lease accounts, authorizes ONRR to "take appropriate actions to make additional collections or refunds as warranted." 30 U.S.C. § 1711(c)(1) (2006). Nothing in that provision constrains or purports to constrain ONRR's discretionary authority to determine the actions that are appropriate in the circumstances. The Director thus correctly stated that "[n]o statutory or regulatory impediment precludes the Secretary from requiring that corrections or adjustments of production imbalances be remitted in value (cash) rather than volumes of production (in kind)." Decision at 8.

W&T argued before the Director that, since the royalty obligation "'accrues on a *monthly* basis,'" ONRR's election to take RIK fixed W&T's royalty obligation such that any future adjustment must be made in kind for the specific month for which there is a deficiency. *See* SOR (MMS-10-0020-OCS) at 5 (quoting *Union Texas Petroleum Energy Corp.*, 153 IBLA 170, 180 n.12 (2000)). It is true that the obligation to pay royalty, whether in value or in kind, accrues on a monthly basis, in accordance with section 115(c) of FOGRMA, and that royalty must be paid on or before the last day of the calendar month following the month of production. *See* 30 C.F.R. § 1218.50(a); 2003 Handbook at 2-7; GAO Report at 8, 22, 38; Decision at 11. It does not follow, however, that ONRR's election regarding the original payment of royalties in kind precludes ONRR from requiring payment of additional royalties in value, or vice versa. The one does not compel the other. *See* 30 C.F.R. § 1218.150(b); Answer at 12-13 (citing 96 Stat. 2447 (1983)).

We begin by observing that W&T has not challenged the method of valuing production in value or in kind for royalty purposes or argued that the royalty obligation under one method inflicts a financial burden or other inequity on lessees that the other does not. Although W&T contends the Letters and Orders represent a departure from past practice, it has not identified or documented any such prior practice, or shown how it would affect or change the obligation to pay royalty on the accrued production imbalances that existed when the RIK term ended. In the absence of a viable claim that W&T or the lessees for whom it is the designated payor have been harmed or materially disadvantaged by using the RIV valuation, or evidence that the Lease, a RIK Program term, or a statute or regulation specifies that a royalty deficiency is payable only as RIK, W&T merely advocates a position and a preference.[11]

Nor can W&T plausibly claim surprise. The Payor Handbook expressly advised that production imbalances would be cashed out in the manner explained in the current Dear Operator Letter. The 2005 Dear Operator Letter was in effect when the RIK Program ended, and it unambiguously stated that imbalances would be cashed out and that interest would begin to accrue as of the end of the month following the month of production. Moreover, imbalances would have been cashed out under the 2000 Dear Operator Letter as well, because W&T neither corrected underdeliveries by paying RIK in subsequent months nor attempted to reach an agreement to develop a mutually acceptable alternate method before the cessation of the RIK term, the end of the RIK Program, or the last month of RIK delivery.

W&T nonetheless argues that ONRR was precluded by State law from requiring the payment of royalties both in kind (when initially calculated) and in value (when more was later determined to be owed). *See* SOR at 10-11. W&T asserts that Federal law is silent regarding the matter at hand, so that "[S]tate law applies" pursuant to section 4(a)(2)(A) of OCSLA, and is "'declared to be the law of the United States.'" *Id.* at 11 n.19 (quoting 43 U.S.C. § 1333(a)(2)(A) (2006)). W&T refers to provisions in the Louisiana civil code to the effect that its obligation to pay royalty in amount or value is "an 'alternative obligation,'" so that W&T "is prohibited from 'perform[ing] an alternative obligation by rendering as performance a part of one item and a part of another.'" *Id.* at 11 (quoting La. Civ. Code Ann. arts. 1808 and 1811 (West 2013)). W&T deduces that ONRR is prohibited from demanding payment "partially in-kind and partially in cash." *Id.* W&T supports its argument with *Hunt Oil Co. v. Batchelor*, 644 So.2d 191, 198 (La. 1994), in which the court, applying the Louisiana civil code, stated that "balancing in kind is the *preferred* method of correcting any imbalances which may arise between owners in a . . . lease."

---

[11] We again note that the staff and organizational component that supported and implemented the RIK Program no longer exists, nor would that capacity be re-constituted to accede to W&T's preference for satisfying the additional royalty obligation by paying RIK. W&T can have no reasonable expectation that the RIK term would persist after the RIK Program concluded in the absence of a lease or other provision specifying it would.

In rejecting W&T's State law argument, the Director of ONRR stated that Congress intended for "Federal law [to] occupy [the] . . . field of Federal royalty management," and that "Federal law was deemed to have preempted State law." Decision at 9 (quoting *California v. ARC Am. Corp.*, 490 U.S. 93, 100 (1989)). He stated further that "even if Congress has not occupied the field, [S]tate law is nevertheless pre-empted to the extent it actually conflicts with [F]ederal law, that is, when compliance with both [S]tate and [F]ederal law is impossible[.]"[12] *Id.* (quoting *California v. ARC Am. Corp.*, 490 U.S. at 100).

We need not venture into the preemption debate between W&T and ONRR because we do not agree with W&T's conclusion that State law constrains ONRR's discretion in this matter. *Hunt Oil* may support the proposition that balancing in kind is the preferred method of correcting imbalances, but that case does not establish that State law prohibits the correction of subsequent royalty deficiencies by payments in value. *Hunt Oil* does not concern royalty deficiencies, but rather the allocation of production between unit owners. Even in that situation, however, the court stated: "We also agree . . . that *balancing in kind is not the only method* which may be employed to correct any production imbalances which may arise, and that depending on the particular circumstances presented, the Commissioner has *the authority to order either balancing in kind or balancing in cash*." 644 So.2d at 198-99 (emphasis added); *cf. S. Oil Corp. v. Waggoner*, 276 F. 487, 488, 491 (5th Cir. 1921), *cert. denied*, 258 U.S. 626 (1922).

B. The Dear Operator Letters Are Statements of Policy Guiding the Resolution of RIK Royalty Deficiencies and Not Subject to the Notice and Comment Provisions of the APA

W&T argues that ONRR's requirement to pay additional royalties in cash to resolve production imbalances after electing RIK, as upheld in the Director's Decision, required rulemaking and violated the requirements of section 5(a) of OCSLA, 43 U.S.C. § 1334(a) (2006), which directs the Secretary to "prescribe such rules and regulations as may be necessary to carry out [OCSLA]"; section 301(a) of FOGRMA, 30 U.S.C. § 1751(a) (2006), which directs the Secretary to "prescribe such rules and regulations as he deems reasonably necessary to carry out [FOGRMA]"; and section 4 of the Administrative Procedure Act (APA), 5 U.S.C. § 553 (2006), which requires promulgation of a substantive rule after notice and opportunity for comment. *See* SOR at 12.

---

[12] We note that section 4(a)(2)(A) of OCSLA itself provides that the civil laws of each State adjacent to the OCS are declared to be the law of the United States with respect to that part of the OCS, but only "[t]o the extent that they are applicable and *not inconsistent with [OCSLA]*[.]" 43 U.S.C. § 1333(a)(2)(A) (2006) (emphasis added).

[2] While the cited provisions of OCSLA and FOGRMA direct the Secretary to promulgate regulations that are deemed “necessary” to carry out royalty accounting and collection duties with respect to offshore production, we do not agree that a regulation specifically authorizing ONRR to collect additional royalties in value or in kind is “necessary.” Rather, we conclude that the authority to do so is inherent in the basic statutory mandate to collect royalties in oil or gas, and also follows from the discretion to take appropriate actions to make additional collections or refunds as warranted by the circumstances. *See s*ection 27(a)(1) of OCSLA, 43 U.S.C. § 1353(a)(1) (2006), and section 101(c)(1) of FOGRMA, 30 U.S.C. § 1711(c)(1) (2006).

W&T argues that the methodology articulated in the Dear Operator Letters constitutes a substantive rule of law that should have been promulgated pursuant to the notice and comment procedures of the APA. *See* SOR at 12-13. It asserts that requiring resolution of volumetric imbalances by cash payments upon termination of the RIK Program, which was applied widely to W&T and all similarly-situated royalty payors subject to ONRR’s Dear Operator Letters, is “unquestionably a ‘rule’” within the meaning of the APA, 5 U.S.C. § 551(4) (2006), since it is “‘an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy[.]’” *Id.* at 13 n.21 (quoting 5 U.S.C. § 551(4) (2006)).

W&T contends that ONRR’s requirement did not “interpret an existing statute or regulation,” but rather established a new “mandatory method for settling imbalances remaining at the end of the RIK Program.” SOR at 15 (quoting *Phillips Petroleum Co. v. Johnson*, 22 F.3d 616, 619 (5th Cir. 1994), *cert. denied*, 514 U.S. 1092 (1995)). W&T states that the requirement embodied in the Dear Operator Letters constrained ONRR’s discretion, rendering it mandatory that ONRR require cash payments to resolve volumetric imbalances. *See id.*; *e.g.*, *Phillips Petroleum Co. v. Johnson*, 22 F.3d at 620 n.3; *Batterton v. Marshall*, 648 F.2d 694, 702 (D.C. Cir. 1980). W&T concludes that, since ONRR adopted a requirement to resolve volumetric imbalances with cash payments that was “firm, unwavering, and final,” it could be promulgated only by rulemaking with notice and opportunity for comment under the APA, and, absent such promulgation, could not be enforced against W&T. SOR at 15.

There is no question that when an agency adopts a substantive rule of law, it is required by the APA to promulgate the rule after notice and opportunity for comment. *See* 5 U.S.C. § 553(b) and (c) (2006); 30 U.S.C. § 1751(b) (2006); *Shell Offshore Inc. v. Babbitt (Shell Offshore)*, 238 F.3d 622, 626 (5th Cir. 2001); *Phillips Petroleum Co. v. Johnson*, 22 F.3d at 619. Rulemaking with notice and opportunity for comment is “‘designed to assure fairness and mature consideration of rules of general application,’” which have “‘a substantial impact on those regulated.’” *Phillips*

Petroleum Co. v. Johnson, 22 F.3d at 620 (quoting *Nat'l Labor Relations Bd. v. Wyman-Gordon Co.*, 394 U.S. 759, 764 (1969); and *Texaco, Inc. v. Fed. Power Comm'n*, 412 F.2d 740, 744 (3d Cir. 1969)).

We conclude that W&T places undue emphasis on *Shell Offshore* in arguing that the Dear Operator Letters amount to the promulgation of substantive law subject to notice and comment rulemaking under the APA. In *Shell Offshore*, the Fifth Circuit reviewed an MMS decision denying a lessee's request to use tariff rates published by the Federal Energy Regulatory Commission as a component in calculating royalties. The Court held that even though the Department had never set forth its interpretation of the applicable regulation in a written statement, there "was undeniably [a] long established and consistently followed practice," and that departure from that practice required notice and comment rulemaking. 238 F.3d at 629-30. In the present case, there is no long and consistently followed practice concerning the methodology to be utilized in resolving production imbalances at the end of the RIK Program.

The D.C. Circuit's opinion in *Devon Energy Corp. v. Kempthorne (Devon Energy)*, 551 F.3d 1030, 1040 (D.C. Cir. 2008), *cert. denied*, 558 U.S. 819 (2009), more aptly applies to the case at hand. In *Devon Energy*, the Court rejected a lessee's challenge to an Assistant Secretary's order to recalculate royalties due from a coalbed methane lease, and Devon Energy contended "that the regulatory interpretation it relied on was authoritatively adopted by the agency through the cumulative effect of a number of agency actions, including but not limited to, the issuance of the 1996 Dear Operator letter." 551 F.3d at 1039. The court rejected Devon Energy's argument that two internal memoranda addressed by the Deputy Director of MMS to the Associate Director for Royalty Management and the Associate Director for Policy and Management Improvement were final and binding agency interpretations of the marketable condition rule. *Id.* at 1040. It also rejected Devon Energy's assumption that the guidance documents have the force of law because Devon Energy followed the advice contained in the documents. *Id.* "At the very least, a definitive and binding statement on behalf of the agency must come from a source with the authority to bind the agency." *Id.*

In *Shell Offshore*, the Fifth circuit followed the D.C. Circuit's rationale in *Alaska Prof'l Hunters Ass'n v. Fed. Aviation Admin. (Alaska Professional)*, 177 F.3d 1030 (D.C. Cir. 1999). In that case, a regional office of the Federal Aviation Administration (FAA) had for many years been advised Alaska hunting and fishing guides that they were exempt from FAA regulations governing commercial pilots, but the agency later published a notice that Alaska guides who transport customers by aircraft were no longer considered exempt from the FAA's safety regulations. The court ruled that the FAA's action required notice and comment rulemaking, and that the new interpretation of their regulation was invalid without it. 177 F.3d at 1036. The court stated: "When an agency has given its regulation a definitive interpretation, and later significantly revises that interpretation, the agency has in effect amended its rule, something it may not accomplish without notice and comment." 177 F.3d at 1034.

However, in *Devon Energy*, the D.C. Circuit declined to extend its holding in *Alaska Professional* to the practices of MMS. The Court specifically rejected Devon's arguments that the *Alaska Professional* decision should control the disposition of the case:

> In *Alaska Professional*, the court found that thirty years of uniform advice by the Alaskan regional office of the FAA "became an authoritative departmental interpretation" binding on the agency. The case is plainly distinguishable, however, because the disputed agency advice in that case had been upheld in a formal adjudication by the Civil Aeronautics Board, FAA's predecessor agency. *See Alaska Prof'l*, 177 F.3d at 1034 (discussing *Administrator v. Marshall*, 39 C.A.B. 948 (1963)). Indeed, the decision in *Alaska Professional* acknowledges that an interpretation or advice by an official without authority to bind the agency alone would not amount to an authoritative interpretation. *Alaska Prof'l*, 177 F.3d at 1035; *see also Hudson v. FAA*, 192 F.3d 1031, 1036 (D.C. Cir. 1999) (distinguishing *Alaska Professional* as concerning a binding interpretation on the basis of the formal adjudication upon which the longstanding practice was based); *Ass'n of Am. R.Rs.*, 198 F.3d at 949 (same). In this case, by contrast, the guidance documents have never been upheld in an agency adjudication, nor have they ever been endorsed in any other agency action having the force of law.

551 F.3d at 1041.

We conclude that the Dear Operator Letters at issue herein should be viewed as guidance or policy documents, just as the D.C. Circuit viewed the Dear Operator Letter and related memoranda involved in *Devon Energy*. W&T argues that the Dear Operator Letters involve the creation of law, because "there are no RIK regulations to interpret[.]" SOR at 16. However, W&T forgets that conclusion of the RIK Program itself triggered RIV valuation, and that the statute has always authorized ONRR to require cash payments to resolve volumetric imbalances. *See* Answer at 24. In deciding to resolve volumetric imbalances with cash payments, ONRR merely applied the statute. The requirement that such imbalances be resolved by cash payments is expressly authorized by OCSLA and reflects "'what the administrative officer thinks the statute or regulation means.'" SOR at 16 (quoting *Phillips Petroleum Co. v. Johnson*, 22 F.3d at 619). As statements of policy issued to guide ONRR in resolving imbalances at the end of the RIK Program, the letters do not embody a substantive rule that must be promulgated in accordance with the APA, as W&T argues.

We reject W&T's argument that the Dear Operator Letters represent a significant departure "from a long established and consistent practice that substantially affects the regulated industry," and should have been promulgated pursuant to notice and opportunity for comment rulemaking. SOR at 17 n.22 (citing *Shell Offshore*, 238 F.3d at 630). W&T argues that it and others in the oil and gas industry have for years relied upon the Dear Operator Letters, and that the methodology contained in those letters amounted to rules binding on ONRR, even though they had not been promulgated as regulations in accordance with the APA. In W&T's view, the Dear Operator Letters either set a precedent from which ONRR could not depart in the absence of rulemaking, or the letters constituted binding rules, in either case precluding the Orders at issue. We disagree in both respects.

In both of its Dear Operator Letters, ONRR provided that monthly imbalances could initially be corrected through make-up deliveries of natural gas "for the month following the month when the imbalance statement is due," or "in the production month following the month that the imbalance is identified." 2000 Dear Operator Letter at 3; 2005 Dear Operator Letter at 4. But both letters also recognized the possibility of "extraordinary imbalance situations," with the September 2000 letter leaving it to the parties to resolve the imbalance by mutual agreement, and the September 2005 letter providing for a cash out payment based on the applicable sales price in effect at the time of production, with interest accruing after the end of the month following the month of production. *See* GAO Report at 6. We find no evidence that W&T invoked extraordinary circumstances or requested an opportunity to resolve production imbalances before or after the 2005 Dear Operator Letter was issued. W&T did not make any timely make-up deliveries of gas while the RIK Program operated. The 2005 Dear Operator Letter expressly provided that the imbalances remaining upon the termination of the RIK Program would be resolved by a cash out payment based on the applicable sales price in effect at that time, with interest accruing thereafter. *See* GAO Report at 6 ("[A]ny lease that . . . is terminated from the RIK program is required to be settled through a cash payment for any outstanding imbalances"). We see no basis for concluding that the methodology of requiring production imbalances to be remedied through cash rather than in kind, as reflected in the 2005 Dear Operator Letter, the Orders, and the Director's Decision, should have been promulgated as a regulation through notice and comment rulemaking. *See Devon Energy*, 551 F.3d at 1041.

The Director concluded that the Dear Operator Letters constituted "mere[] guidance," rather than a definitive interpretation of applicable law, and, in any event, were not promulgated by "agency sources having the authority to bind the agency." Decision at 15 (citing *Devon Energy*, 551 F.3d at 1040). ONRR correctly states that "the Dear Operator Letters were signed by a lower level official without authority to bind the agency," and "did not contemplate binding the agency," but instead represented ONRR's best opinion, at the time, regarding the resolution of imbalances. Answer at 22. First, the Dear Operator Letters were signed by or on behalf of the Associate Director for Royalty Management, MMS, or a lesser official, the Manager, Gas Marketing, Royalty in Kind, Minerals Revenue Management, MMS.[13] Second, the Dear Operator Letters provided ONRR's guidance regarding how W&T and other similarly-situated parties could resolve imbalances, and they contained nothing that stated or suggested that ONRR was limiting its authority to later modify that guidance, which ONRR clearly did in issuing the September 2005 letter to replace the September 2000 letter. In addition, ONRR correctly notes that the letters were inconsistent, and thus "there was no definitive interpretation [regarding the proper resolution of imbalances] in any correspondence prior to the Orders and Director's Decision." Answer at 31. Further, the letters facilitated the conduct of the Department's business, but without finally determining the legal ramifications of the actions of the affected parties. *See Devon Energy,* 551 F.3d at 1039-41, and cases cited. That only occurred with issuance of the 2010 Orders and July 2012 Director's Decision.

We conclude that ONRR's requirement to pay additional royalties in cash to resolve volumetric imbalances constitutes a reasonable and rational method of carrying out the statutory mandate to collect the additional royalty determined to be due at the end of the RIK term. ONRR is authorized by section 8(a) of OCSLA to collect additional royalties in cash or in kind, even in situations where it has previously originally collected royalties in the other manner. ONRR's decision did not change any existing statutory or regulatory provision. We reject W&T's argument

---

[13] The court in *Amoco Prod. Co. v. Baca*, 300 F. Supp. 2d 1 (D.D.C. 2003), *aff'd*, 410 F.3d 722 (D.C. Cir. 2005), *aff'd*, 549 U.S. 84 (2006), declined to set aside the Dear Operator Letter at issue in that case as violative of the notice and opportunity for comment rulemaking requirements of the APA, since it "is not a rule and it was therefore not subject to notice and comment," and because it was "issued by the Associate Director for Royalty Management, MMS, and therefore for the same reasons, it can no more bind the agency than the letter at issue in *Babbitt*." *Id.* at 8 (citing *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248 (D.C. Cir. 1996) ("The District Court held, and the Court of Appeals affirmed, that the letter itself did not constitute a rulemaking because 'nothing in the DOI's procedures vests authority in the Associate Director of the MMS[,] . . . or even the Director, to issue proclamations binding on the agency . . . [q]uite simply, the May 1993 letter is not an 'agency statement' with 'future effect' since it did not bind the agency in any way.' *Babbitt*, 92 F.3d at 1256 (affirming the District Court's unpublished decision in *Indep. Petroleum Ass'n of Am. v. Babbitt*, 1995 WL 431305 at *4 (D.D.C. June 14, 1995)).")).

that ONRR's decision to require that volumetric imbalances be resolved by cash payments, rather than in kind payments, created law. The Dear Operator Letters did not require, nor were intended to require, ONRR to resolve all future volumetric imbalances only with RIK, rather than RIV, payments. Thus, ONRR was not required to change or rescind the Dear Operator Letters by notice and opportunity for comment rulemaking, but rather properly provided for resolving volumetric imbalances with cash payments. The issuance of the Dear Operator Letters, and ONRR's Orders and Decision applying them, did not violate the APA.

C. ONRR Is Not Barred by Explicit or Implicit Covenant from Requiring Cash Payment in Satisfaction of Production Imbalance

W&T argues that ONRR breached the explicit covenant included in the Dear Operator Letters that the United States will take royalty gas in kind from offshore leases; that additional royalties for imbalances would be computed based on the value of production as of the end of the RIK period, rather than as of the royalty deadline for each production month at issue; and that interest would accrue from the earlier date. SOR at 21; 2005 Dear Operator Letter at 1. W&T contends that ONRR's Orders and Decision requiring the payment of production imbalances in cash violate an implicit covenant in the Leases to engage in good faith and fair dealing, and that ONRR's decision to compute additional royalties based on the value of production as of the royalty deadline for each production month, and to calculate interest from those dates, is contrary to the Dear Operator Letters. SOR at 24.

[3] We do not question the requirement that ONRR abide by its explicit contractual bargains. *See* SOR at 22 (citing *Mesa Air Group, Inc. v. Dep't of Transp.*, 87 F.3d 498, 503-04 (D.C. Cir. 1996)). However, the Dear Operator Letters do not set forth a contractual arrangement that expressly limited the timing of ONRR's valuation of the production imbalances for purposes of calculating additional royalties, or for setting a starting date for computing the interest owed on unpaid royalty. The Dear Operator Letters represented ONRR's reasoned judgment as to the methodology that would most fairly and accurately bring W&T into conformity with the applicable statutes and regulations. *See* Answer at 39.

Further, ONRR is no doubt required to abide by the implied covenant to engage in good faith and fair dealing under the Leases. W&T asserts that, by later repudiating the methodology set forth in the Dear Operator Letters, ONRR "failed to cooperate with W&T, impeded W&T's ability to perform, and acted evasively," since W&T would "have had the chance to change its method of performance."[14] *Id.* at 23

[14] W&T also argues that ONRR acted evasively by failing to properly respond to its pending requests under the Freedom of Information Act (FOIA), 5 U.S.C. § 552 (continued...)

(citing, *e.g.*, *Centex Corp. v. U.S.*, 395 F.3d 1283, 1304 (Fed. Cir. 2005)). We find nothing in the record to support W&T's argument.

We agree with ONRR's assertion that its Orders and Decision requiring cash payments "did not alter W&T's legal duty to pay royalties, . . . did [not] impair W&T's rights to explore for and take gas from the subject leases, . . . [and] did not interfere with W&T's ability to perform under the leases or destroy any of its reasonable expectations with respect thereto." Answer at 40. W&T fails to demonstrate how it might have changed its method of performance had it known that at the end of the RIK period ONRR would require cash payments to resolve production imbalances.

There is no dispute regarding W&T's failure to pay the full amount of royalties with respect to each of the production months at issue. ONRR has now determined the amount of additional royalties that W&T should have paid for those months. W&T would have been required to pay in kind had it tendered RIK to resolve production imbalances. However, requiring payment in cash does not result in the payment of more royalties than would have been due had it paid timely. The production volumes on which royalty is based do not change, regardless of whether the form of payment is in value rather than kind. ONRR identified payment in value as the proper method for calculating and collecting royalties and interest at the termination of the RIK Program. W&T had actual knowledge that ONRR would cash out outstanding balances when the Program ended, and W&T is deemed to have knowledge of the statutory and regulatory provisions authorizing that methodology. *See W. Energy Res., Inc.*, 172 IBLA 395, 402 (2007), *aff'd*, *W. Energy Res., Inc. v. Kempthorne*, No. 1:07-cv-02684-RPM (D. Colo. Jan. 16, 2009) (citing *Fed. Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 384-85 (1947)).

We fail to see how ONRR's methodology has placed an additional burden on W&T. The Orders apply and are consistent with both Dear Operator Letters. We reject W&T's contention that ONRR has somehow impeded W&T's performance or otherwise breached its duty to engage in good faith and fair dealing.

D. ONRR Properly Required W&T to Resolve Production Imbalances

[4] W&T asserts that it was not the lessee or the owner of operating rights with respect to certain of the Leases and certain production months during the period

---

[14] (...continued)
(2006). *See* SOR at 23-24. W&T states that it seeks "documents evidencing the agency's policies for resolving imbalances after the termination of RIK deliveries." *Id.* at 23. ONRR states that the FOIA request "is still pending." Answer at 41 n.16. In any event, ONRR's failure to respond to the FOIA requests is not at issue here, since we are adjudicating only the appeal from the Director's July 2012 decision.

of time from February 2003 through October 2008, and therefore is not liable under section 102(a) of FOGRMA, 30 U.S.C. § 1712(a) (2006), for any additional royalties for production imbalances attributable to the Leases. *See* SOR at 8-10. W&T argues that it was merely a designee, and as such cannot be required to pay any additional royalties that became due by virtue of production imbalances. *See* SOR at 8 (citing *Mesa Operating Ltd. P'ship (On Reconsideration)*, 128 IBLA 174, 182-83, 101 I.D. 8, 12-13 (1994)). It thus concludes that ONRR's requirement to pay additional royalties violates the statute's "clear prohibition." *Id.*

ONRR concluded that, during the course of the accounting period, W&T assumed responsibility for resolving all of the production imbalances remaining upon termination of the RIK Program. *See* Decision at 22 (citing Encl. 1 to March 2010 Order ("The gas mcf volumes: up to 04/2006 are provided by Kerr McGee, Energy Resources and Hess as lease/unit reporting operators until all agreed to have W&T report. W&T provides statements beginning 05/2006. MMS understands that all parties have agreed that W&T will cash out with MMS for all operators.")). Thus, when it was later determined that additional royalties were owed, ONRR issued its March and December 2010 Orders to W&T, with written notice to the lessees, demanding payment of such royalties. *See* March 2010 Order at 5; December 2010 Order at 5-6. In affirming the Orders, the Director stated that designation of W&T as the designee, for the purposes of resolving all of the production imbalances at issue, was not challenged by W&T on appeal to the Director. *See* Decision at 22. Nor is that designation now challenged on appeal to the Board.

It is true that W&T did not own the entirety of the record title and/or operating rights in the Leases during the whole accounting period. SOR at 8; *see id.* at 8-9, n.17. Therefore, to the extent W&T was not the lessee or operating rights owner of certain of the Leases during the accounting period, W&T has no liability for the payment of additional royalty on production from those Leases. *See* Decision at 21. However, W&T is currently the lessees' designated payor (or designee) for purposes of making the royalty payments they owe on production from the Leases at issue. ONRR issued its Orders to pay additional royalties to W&T in its capacity as designated payor.

Section 102(a) of FOGRMA provides that a lessee may designate a person to make royalty payments due under its lease on behalf of the lessee, whereupon the designee "may, in its own name, pay, offset or credit monies, make adjustments, [and] request and receive refunds[.]" 30 U.S.C. § 1712(a) (2006); *see* 30 C.F.R. §§ 1202.51(b), 1202.150, 1206.151 ("*Lessee* . . . includes any person who has an interest in a lease as well as an operator or payor who has no interest in the lease but who has assumed the royalty payment responsibility"), and 1218.52(a) and (b). Section 102(a) of FOGRMA further states that, "[n]otwithstanding any other provision of . . . [FOGRMA] to the contrary, *a designee shall not be liable for any* *payment obligation under the lease*." 30 U.S.C. § 1712(a) (2006) (emphasis added). Rather, primary liability rests on the owner of operating rights in the lease, and secondary liability rests on the owner of record title in the lease, where the owner of record title is other than the owner of operating rights. *Id.*

We agree with ONRR that W&T, as the designee of record, is a proper recipient of ONRR's demand or order to pay for purposes of collecting additional royalties in satisfaction of an outstanding RIK obligation. *See* 30 C.F.R. §§ 1702(25) ("'obligation' means . . . any duty of a lessee or its designee . . . to deliver oil or gas royalty in kind") and 1724(b)(1) ("[Secretary's authority to] take any other or further action regarding [an] obligation[] includ[es] (but not limited to) the issuance of any order . . . [or] demand . . . seeking any . . . payment, principal, [or] interest") (2006). Further, a demand or order to pay may clearly be issued to a designee (with written notice to the lessee). *See* 30 U.S.C. §§ 1702(23) ("'demand' means . . . an order to pay issued by the Secretary . . . to a lessee or its designee (with written notice to the lessee who designated the designee)") and 1702(26) ("'order to pay' means a written order issued by the Secretary . . . to a lessee or its designee (with notice to the lessee who designated the designee)") (2006). FOGRMA authorizes issuance of a demand or order to pay *to a designee (with written notice to the lessee)* in satisfaction of an outstanding production imbalance at the end of the RIK Program.[15] *See* Answer at 8 ("[A] lawful demand may be issued to a person not actually liable for the royalty obligation (*i.e.*, to a designee)").

ONRR properly issued its Orders to W&T.

E. ONRR Properly Did Not Consider Production Imbalances Prior to February 2003

W&T argues that ONRR misapplied the statute of limitations in 30 U.S.C. § 1724(b)(1) (2006) by not taking into account W&T's overdeliveries for the

[15] We note that the statute of limitations applicable to judicial, as well as Secretarial, demands regarding royalty obligations, set forth at 30 U.S.C. § 1724(b)(1) (2006), provides, in subsection (b)(2), that "[a] judicial . . . demand that is timely commenced under paragraph (1) *against a designee* shall be considered timely commenced as to any lessee who is liable pursuant to section 1712(a) of [30 U.S.C.] . . . for the obligation that is the subject of the judicial . . . demand." (Emphasis added.) The statute thus acknowledges that a judicial demand for additional royalties can be brought against a designee, and that a Secretarial demand for additional royalties can be brought against a designee. *See also* 30 U.S.C. § 1724(d)(1) (2006) (Secretary and lessee or its designee may agree to tolling of limitations period), (d)(4) (order to perform restructured accounting may be issued to lessee or its designee).

period prior to February 2003.[16] According to W&T, ONRR's determination to restrict its consideration of production imbalances to the period from February 2003 through October 2008 was unlawful because it failed to take into account any imbalances that occurred before February 2003, back to the start of the RIK Program in November 2001. W&T claims that those prior imbalances would have significantly offset the final imbalances and corresponding additional royalties asserted by ONRR. *See* SOR at 24-26. W&T contends that ONRR's approach "inflated" the amount of additional royalties deemed to be owed. *Id.* at 25. W&T asserts that ONRR "ignore[d] the [overall cumulative] imbalance in favor of W&T that existed as of February 2003," in the amount of "a total of 33,355 Mmbtu," due to W&T's having "overdelivered the RIK volume in eight months and underdelivered the RIK volume in seven months." *Id.* at 6 (citing Cheatham Declaration, ¶ 3, at 1-2).

W&T claims that ONRR was not precluded from taking into account the prior imbalances because ONRR was not demanding payment of additional royalties that became due more than 7 years before the demand for payment, but rather was "defin[ing] the performance that was owed for the period February 2003–October 2008." SOR at 25. It explains that the net overdelivery that occurred before

---

[16] Section 115(b)(1) of FOGRMA provides:

> A judicial proceeding or demand which arises from, or relates to an obligation, shall be commenced within seven years from the date on which the obligation becomes due and if not so commenced shall be barred. If commencement of a judicial proceeding or demand for an obligation is barred by this section, the Secretary, a delegated State, or a lessee or its designee (A) *shall not take any other or further action regarding that obligation, including* (but not limited to) *the issuance of any order*, request, demand or other communication *seeking any . . . accounting, determination, calculation, recalculation, payment,* principal, interest, assessment, or penalty[;] . . . and (B) shall not pursue any other equitable or legal remedy, whether under statute or common law, with respect to an action on or an enforcement of said obligation.

30 U.S.C. § 1724(b)(1) (2006) (emphasis added).

Section 115(c)(1) provides that an "*obligation becomes due* when the right to enforce the obligation is fixed," and section 115(c)(2), states that the right to enforce a royalty obligation "is fixed . . . *on the last day of the calendar month following the month in which oil or gas is produced*," 30 U.S.C. § 1724(c) (2006). (Emphasis added.)

ONRR properly points out that the royalty obligation becomes fixed on the last day of the month following the month of production, whether the obligation is to pay RIV or RIK, since 30 U.S.C. § 1702(25) (2006) defines "obligation" to mean "any duty of a lessee or its designee . . . to deliver oil or gas royalty in kind; or . . . to pay . . . monies including . . . the principal amount of any royalty[.]" *See* Answer at 4.

February 2003 effectively constituted a "predeliver[y]" of production for the period after February 2003. W&T adds that it "owed deliveries of a specific total volume of gas for the period February 2003–October 2008, but [that] W&T overdeliveries prior to February 2003 reduced the total volume that W&T was required to deliver to ONRR for the subsequent seven years." *Id.* W&T argues that ONRR was required to expand the accounting period, and "offset any overdeliveries from the period *prior to February 2003* against any underdeliveries occurring after that date." SOR (MMS-10-0020-OCS) at 10-11 (emphasis added).

[5] In auditing a lease account, ONRR is required to offset royalty overpayments against royalty underpayments made with respect to the same lease over the course of the *audit* period, even where the lessee is itself barred from seeking to recoup the overpayments. *See Forest Oil Corp. (On Reconsideration)*, 116 IBLA 176, 181-83, 97 I.D. 239, 241-43 (1990);[17] *Mobil Oil Corp.*, 65 IBLA 295, 303-04 (1982); *Shell Oil Co.*, 52 IBLA 74, 78 (1981); Sol. Op., "Applicability of Sec. 10 of the Outer Continental Shelf Lands Act," M-36977, 100 I.D. 418, 421-24 (1993).

In this case, ONRR was required to offset overpayments of RIK against underpayments of RIK during the selected accounting period from February 2003 through October 2008, so that W&T was ultimately required to pay the net additional royalties found to be due the United States as a result of the offsetting process. *See Amoco Prod. Co. v. Fry*, 118 F.3d 812, 817 (D.C. Cir. 1997). ONRR concluded, however, that it was completely barred by the 7-year statute of limitations from factoring any underpayments or overpayments of RIK prior to 7 years before the March 2010 Order into its overall accounting of production imbalances. *See* Decision at 18. ONRR held that taking such imbalances into account would violate 30 U.S.C. § 1724(b)(1) (2006). In the absence of W&T's demand on "seeking any . . . accounting, determination, calculation, recalculation, or payment," for overdeliveries of RIK more than 7 years before the accounting period, we must agree with ONRR's analysis. 30 U.S.C. § 1724(b)(1) (2006).

For any production month more than 7 years prior to the March 2010 Order, ONRR would have been precluded by the statute of limitations from refunding or requiring payment of any additional royalties, whether in value or in kind, that accrued by reason of a production imbalance. Any such action would have

---

[17] The Board's decisions in *Forest Oil*, 113 IBLA 30 (1990), *Forest Oil (On Reconsideration)*, 116 IBLA 176, 97 I.D. 239 (1990), were overruled in part by the Secretary in *Mesa Operating Ltd. P'ship*, 98 I.D. 193 (1990). The decision on reconsideration was reversed in part by the Director, Office of Hearings and Appeals, in *Forest Oil Corp.*, 9 OHA 68, 98 I.D. 248 (1991), to the extent the Board had approved offsetting in circumstances where the company had improperly sought to recoup its overpayments by crediting future underpayments of royalty.

constituted "further action" regarding the royalty payor's obligation to either deliver RIK or pay RIV within the meaning of 30 U.S.C. § 1702(25) (2006). Such further action is specifically barred by 30 U.S.C. § 1724(b)(1) (2006). ONRR correctly states that "given the date of the March 16, 2010[,] Order and the operation of 30 U.S.C. § 1724(b)(1), February 2003 is the absolute earliest date that . . . ONRR . . . could take *any* actions with respect to W&T's royalty obligations resulting from the production imbalances." Answer at 43. ONRR properly established February 2003 as the starting point for its RIK accounting for the Leases.

W&T asserts that even if ONRR is barred by the statute of limitations from taking pre-February 1, 2003, imbalances into account in its royalty determination, ONRR should have considered those imbalances pursuant to the common law doctrine of equitable recoupment. *See* SOR at 25-26 (citing *Bull v. U.S.*, 295 U.S. 247, 262 (1935); *McElroy Metal Mill, Inc. v. Hughes*, 322 So.2d 822, 826 (La. Ct. App. 1975); LA. CIV. CODE art. 1893 (West 2013)). ONRR rejected this argument, concluding that the statute of limitations likewise barred the pursuit of any equitable remedy arising under common law, including the doctrine of equitable recoupment. *See* Decision at 18. We agree with ONRR that it is barred as a matter of equity from offsetting any RIK net overpayment that occurred before February 2003 against the RIK net underpayment that occurred after February 2003. To hold otherwise would be contrary to the statute of limitations, which applies to both equitable and legal remedies, whether arising under statute or common law, "with respect to an action on or an enforcement of [an] obligation [by ONRR]." 30 U.S.C. § 1724(b)(1) (2006).[18]

[18] W&T invokes the District Court's Sept. 30, 1994, opinion in *Murphy Exploration & Prod. Co. v. U.S.*, No. 1:92-cv-01156-HFB (W.D. Ark.), in support of its view that ONRR was required to factor the net RIK overpayment prior to February 2003 into its royalty accounting with respect to the Leases. *See* SOR at 26. However, as ONRR properly points out, that opinion was unpublished and was later vacated by the Court on Dec. 27, 1994, and thus does not provide any precedential authority. *See* Decision at 18-19; Answer at 44 n.18. In any event, we note that *Murphy Exploration* holds that overpayments that occurred before the statute of limitations period are "time-barred," which is ONRR's view here, leaving only equitable recoupment as an available remedy. However, unlike 30 U.S.C. § 1724(b) (2006), the statute of limitations in *Murphy Exploration* did not specifically preclude "equitable" remedies. *See* Memorandum Opinion, *Murphy Exploration & Prod. Co. v. U.S.*, No. 1:92-cv-01156-HFB (W.D. Ark.), dated Sept. 30, 1994, at 17-19 (citing 43 U.S.C. § 1339 (1994)).

F. ONRR Did Not Err by Valuing Production Imbalances With Respect to Each Production Month

W&T argues that, even if it is required to pay cash to resolve volumetric imbalances, ONRR erred by requiring it to value the imbalance that existed each production month, rather than the cumulative imbalance that existed upon termination of the RIK Program, when the total imbalance became fixed. *See* SOR at 17-19.

[6] We find no error in ONRR's methodology for calculating the value of the production imbalance. ONRR properly took into account the fact that W&T failed to pay the full amount of RIK owed *with respect to each production month* during the February 2003 through October 2008 accounting period. We have held that ONRR was not precluded from determining the imbalance that arose in each production month. Once production concluded for each production month, W&T could determine the royalty that was owed by the last day of the month following the month of production, whether in value or in amount. An imbalance arose when that RIV or RIK was not paid by the deadline. Thus, in the case of each production month for which the full RIV or RIK was not paid, the imbalance became fixed not on the last day of the RIK Program, *i.e.*, October 31, 2008, but rather on the last day of the month following the month of production (throughout the period from February 2003 through October 2008).

We find no support for W&T's argument that ONRR should define an aggregate total for all of the volumetric imbalances as of the termination of the RIK Program, rather than for each Lease, for every month, and that the imbalances became fixed only upon ONRR's decision to require payment of additional royalty.[19] *See* SOR at 18. Nor has it shown that doing so results in an appreciably different royalty obligation. Additional royalties therefore were due and owing in full at the end of the month following each production month, regardless of when ONRR demanded payment of such additional royalties. Further, the additional royalties were properly calculated according to the applicable cost and other pricing factors used to value production which were at the time of production. While W&T derides such factors as "historical monthly values," we regard them as accurate reflections of the value of the production imbalances throughout the accounting period. *Id.* at 18. Accordingly, W&T's proposal to select an arbitrary point in time, years later, for

[19] W&T uses this argument as the foundation for its claim that ONRR was not only required to wait until the end of the RIK period to determine any net production imbalance, but also that ONRR was required to calculate interest on the net imbalance rather than on imbalances pertaining to individual production months. We address that interest argument below.

valuing the production imbalance for each production month according to cost and other pricing factors that were not in effect at the time of production is rejected.

G. ONRR Did Not Improperly Adopt a New Cash Balancing Methodology

W&T argues that, even if it is required to pay cash to resolve volumetric imbalances, ONRR improperly adopted a new cash balancing methodology in its Orders that is at odds with the methodology originally articulated at the start of the RIK Program. *See* SOR at 19-21. W&T asserts that the new methodology was violative of basic fairness and the "fair notice doctrine" because it retroactively rescinded the longstanding methodology adopted in the Dear Operator Letters, and W&T and other similarly-situated royalty payors relied upon that methodology during the period the RIK Program was in effect. W&T complains that ONRR changed "its policy concerning both the timing of valuation and the time at which interest commences running." *Id.* at 20.

W&T contends that ONRR elected to enter into RIK contracts in accordance with the Dear Operator Letters, and that those contracts, "rather than regulations," governed the RIK Program. SOR at 5. W&T claims that, following the termination of the RIK Program, ONRR "repudiated" the cash balancing approach adopted in the Dear Operator Letters and "retroactively imposed a new cash balancing method." SOR at 7. W&T contends that ONRR's orders to pay, which were said to supersede the Dear Operator Letters, provided that interest would accrue starting at the "historical" end of the last day of the month following the month of production, not the end of the RIK period. *Id.*

ONRR responds that "the Orders did not retroactively change anything" in the Dear Operator Letters, and that, in any event, the letters were "not binding agency rules," having not been issued "by an official with authority to bind the agency." Answer at 37. ONRR acknowledges that the 2000 Dear Operator Letter "indicated imbalances would be cashed out in the final month of in kind delivery upon cessation of the RIK program," and "interest would accrue from 60 days after the final month of delivery." *Id.* However, ONRR emphasizes that the 2005 Dear Operator Letter "seems to allow cashing out imbalances throughout the [RIK] contract period," and "states interest will begin to accrue the month following the month of production." *Id.* ONRR also states that what is consistent is that both letters provide that "ONRR and the lessee would attempt to mutually agree on acceptable methods to resolve imbalances." *Id.*

[7] We conclude that the Orders did not retroactively change the substance of the Dear Operator Letters. The 2005 Dear Operator Letter rescinded the policy adopted in the previous 2000 Dear Operator Letter, providing that volumetric imbalances were to be resolved with cash out payments based on the applicable sales

price in effect at the time of production, with interest accruing after the end of the month following the month of production. The 2010 Orders adhered to the policy adopted in the 2005 Dear Operator Letter. Neither Dear Operator Letter definitively established a cash balancing methodology that ONRR retroactively rescinded in issuing its 2010 Orders and Director's Decision.

W&T cites the Board's decision in *Sun Exploration & Prod. Co.*, 112 IBLA 373, 97 I.D. 1 (1990), in support of its position. In that case, the Board held that ONRR could not, in an order, retroactively require a royalty payor to value production in a different manner than it had been valuing production throughout a prior period in time, where the new procedure represented an abrupt departure from ONRR's well-established practice. The Board concluded that the resulting prejudice to the lessee of the new procedure was not outweighed by the statutory/regulatory purpose sought to be advanced. *See* 112 IBLA at 386-92, 97 I.D. at 8-11.

In the present case, we reject W&T's argument that it was prejudiced by ONRR's deviation from a well-established practice. Moreover, we fail to discern any retroactive action by ONRR, given that ONRR had not taken any action prior to issuance of the 2010 Orders to collect the additional royalties deemed to be owed by virtue of the production imbalances that had occurred during the RIK period. ONRR did not require W&T to value the imbalances in a different manner than W&T had previously valued the imbalances and ONRR had previously accepted. In point of fact, until it issued the Orders, ONRR had never required W&T to value the imbalances. We thus find the case of *Sun Exploration* inapposite.

The fair notice doctrine holds that a Federal agency may not penalize a private party for failing to adhere to a particular standard of conduct when the agency did not properly articulate the standard before the party acted. *See* SOR at 20 (citing, *e.g.*, *Trinity Broad. of Florida, Inc. v. FCC*, 211 F.3d 618, 628 (D.C. Cir. 2000) ("[Court is concerned with] whether 'by reviewing the regulations and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform'" (quoting *Gen. Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995))).

We discern no violation of the fair notice doctrine here. We see no evidence that W&T had come to expect that, should there be a production imbalance during the RIK period, ONRR would value the imbalance in accordance with the methodology set forth in the 2000 Dear Operator Letter. Even if W&T had formed such an expectation, the fact is that the 2005 Dear Operator Letter superseded the earlier letter. Moreover, there is no apparent detrimental *reliance* by W&T on the previous methodology. It was not until ONRR issued its Orders requiring W&T to pay additional royalties based on cash valuation that any burden was placed on W&T. At that point, W&T could and did challenge ONRR's determination to employ the new methodology as violative of the applicable statutes and regulations. We now resolve that challenge by upholding the Orders.

H. ONRR Did Not Err in Valuing Production Imbalances by Contract Sales Prices Obtained on Third-Party Sales of RIK Originally Received by the United States

[8] W&T argues that, even if it may be required to pay cash to resolve volumetric imbalances, ONRR was required to determine the additional royalties in accordance with 30 C.F.R. § 1202.150(a) and 30 C.F.R. Part 1206, rather than according to the contract sales prices obtained on the third-party sales of the natural gas originally received by the United States. *See* SOR at 19. W&T asserts that ONRR failed to properly value the imbalances in violation of its own regulations, and concludes that the Orders are unenforceable. *See id.* (citing *Fina Oil & Chem. Co. v. Norton*, 332 F.3d 672, 676-79 (D.C. Cir. 2003)). We find no regulatory violation.

The Director rejected W&T's contention that ONRR's use of the contract sales prices obtained on third-party sales of the natural gas delivered to the United States as RIK was improper. He concluded that the contract sales price reflected "the value ONRR would have received if W&T had, in fact, delivered the proper volume of gas to which ONRR was entitled." Decision at 12. The Director stated that the contract sales price approach served "to value the imbalance quantity, whether the imbalance was owed to ONRR or to W&T[.]" *Id.* We agree.

In the case of underdeliveries, ONRR was entitled to the value of the quantity of additional natural gas that should have been delivered by W&T, which, like the gas originally delivered by W&T, must be valued according to the contract sales price that ONRR would have received on the subsequent third-party sales of the gas. *See ARCO Oil & Gas Co.*, 131 IBLA at 303-04; Answer at 34. Clearly, there would be no question were the unpaid RIK made up by the delivery of additional gas. However, ONRR is entitled to recover the *value* of the additional gas that should have been delivered. Unless the imbalance is valued at the contract sales price, ONRR would not receive the equivalent of what it would have received had W&T delivered the full RIK on time and the United States been able then to sell the gas at that price.

Similarly, in the case of overdeliveries, W&T was entitled to the value of the additional quantities of natural gas it delivered, which likewise was valued according to the contract sales price that ONRR received on the subsequent third-party sales of the gas.

I. The Requirement to Pay Late-Payment Interest from the End of Each Production Month is Lawful

W&T argues that ONRR improperly computed late-payment interest, either in favor of the United States or W&T, by starting with the end of each month following the month of production, and then calculating the net interest for the entire RIK period that ended October 31, 2008. W&T maintains that ONRR was required to wait until the end of the RIK period to assess interest, when the net production imbalance for the entire RIK period "became fixed for the first time, with interest accruing only from that same date." SOR at 2. Prior to that time, "because of the ongoing attribution of RIK deliveries to 'make-up' previous underdeliveries that were part of the fluctuating imbalance, it is impossible to attribute . . . a 'time value' to production from a specific month, therefore rendering interest inapplicable." *Id.* at 27. W&T concludes that "even if the Board determines that W&T owes a cash payment [for additional royalties], any such payment *was not owed before ONRR terminated its election to be paid in-kind*," and "interest did not accrue prior to that date[.]" *Id.* (emphasis added).

[9] ONRR is required, by statute and regulation, to charge interest in the case of late payments and underpayments of royalty and to credit interest in the case of overpayments of royalty. *See, e.g., Amoco Prod. Co. v. Baca*, 300 F. Supp. 2d at 17; *Sanguine Ltd.*, 155 IBLA 277, 283 (2001); *Marathon Oil Co.*, 119 IBLA 345, 351-52, n.10 (1991); *Mobil Oil Corp.*, 107 IBLA 332, 334 (1989); 2003 Handbook at 5-2 to 5-3; GAO Report at 7-8; Decision at 20.

Section 111(a) of OCSLA, 30 U.S.C. § 1721(a) (2006), provides that "the Secretary shall charge interest" on late payments or underpayments of royalty, computed on the basis of the deficiency in royalty, "[i]n the case of oil and gas leases where royalty payments are not received by the Secretary on the date that such payments are due, or are less than the amount due[.]" *See* 30 C.F.R. §§ 1218.54(a) ("An interest charge shall be assessed on unpaid and underpaid amounts from the date the amounts are due") and (c) ("Interest will be charged only for the number of days the payment is late"), 1218.150(b) ("The failure to make timely . . . payments of any monies due pursuant to leases . . . will result in the collection of the amount past due plus a late payment charge"), (c) ("Late payment charges will be assessed on any late payment or underpayment from the date that the payment was due until the date that the payment was received"), and (d) ("Late payment charges apply to all underpayments and payments received after the due date. These charges include production . . . royalties[.]"), and 1218.704(a). Second, section 111(h) of OCSLA, 30 U.S.C. § 1721(h) (2006), provides that "[i]nterest shall be allowed and paid or credited on any overpayment, with such interest to accrue from the date such overpayment was made[.]"

W&T does not deny ONRR's right to assess late-payment interest. Instead, it argues that, in determining whether any late-payment interest was owed, ONRR was required to wait until the end of the RIK period on October 31, 2008, when it would then decide whether there was a net production imbalance either in favor of the United States or the royalty payor based on all of the overpayments and underpayments for all of the production months during the RIK period.[20] We have rejected the contention that ONRR could not determine production imbalances at the end of each month and determine the royalty on that basis. That conclusion negates W&T's assertion that late-payment interest would be charged only at the end of the RIK period.[21]

Under the statute and regulations, a late-payment occurs when a required royalty payment, whether in kind or in value, is not made on or before the last day of the month following the month of production.[22] *See Sanguine Ltd.*, 155 IBLA

---

[20] W&T further argues that it does not owe any late-payment interest, since it is required only to make a final RIK delivery in satisfaction of the net production imbalance for the RIK period. However, this approach would obviate the collection of any interest, which is contrary to the statutory direction in 30 U.S.C. § 1721(a) (2006) that "the Secretary shall charge interest on . . . underpayments[.]" We have found no support for W&T's position that interest can only be imposed on RIV underpayments, and not RIK underpayments.

[21] W&T argues that it should not incur interest on RIV payments that it had "no ability to make" during the accounting period. SOR at 27. W&T offers the untenable argument that it had no way of knowing the contract sales prices at which ONRR had sold the natural gas delivered by W&T, and thus could not have calculated the additional RIV that was owed for the underdelivered natural gas. *Id.* (emphasis added). However, W&T does not explain why it was not in a position to know that it had underpaid RIK and to have the ability to make additional deliveries of natural gas to the United States, resolving the RIK underpayment. *See* Answer at 47 ("[W&T] knew or should have known that the outstanding production imbalances required resolution").

[22] The 2003 Handbook provides, at page 5-12, for the computation of interest as follows: "*For interest you owe MMS*, calculate that interest from the due date of the sales month you are adjusting to the date we receive your payment. *For interest MMS owes you*, calculate that interest from the due date of the sales month you are adjusting . . . to the date we receive your Form MMS-2014 recouping the overpayment."

We note that the 2005 Dear Operator Letter provided that, in the absence of a mutual agreement for resolving imbalances, the operator was to make a cash out payment for each month of the imbalance, with "[i]nterest . . . *accru[ing] from the*

(continued...)

at 282-83. Interest properly accrues *to the United States*, when the royalty payor does not pay royalty in full as of the due date, *i.e.*, the last day of the month following the month of production. Interest properly begins to accrue *to the royalty payor* when royalty is more than fully paid as of the date it was due. In both cases, the party is receiving a "time value" to any overpayment or underpayment of the royalty that was due, regardless of whether that royalty was payable as RIV or RIK. *See Exxon Mobil Corp.*, 166 IBLA 226, 231-32 (2005); *Sanguine Ltd.*, 155 IBLA at 283, and cases cited.

ONRR's approach to computing interest properly takes into account all of the interest accruing from the end of each month following the month of production, whether in favor of the United States or the payor. W&T would deny this interest, holding that ONRR must wait until the end of the RIK period to determine the value for purposes of calculating interest. We conclude that ONRR properly computed late-payment interest.

J. Requiring W&T to Pay Additional Royalties is Supported by the Record

Finally, W&T argues that ONRR's requirement to pay the additional royalties attributable to production imbalances for the period from February 2003 through October 2008 was not supported by the record. *See* SOR at 27-29. W&T asserts that ONRR failed, at a minimum, to document "the volumes and values underlying its claim" to additional royalties for the accounting period. *Id.* at 28. W&T claims that such data would include sales contracts, for all the production months at issue, showing the price of natural gas sold by the United States to third parties.

We agree that ONRR is required to provide a reasoned and factual explanation, supported by facts in the administrative record, for its decision to require the payment of additional royalties on natural gas produced from the Leases during the accounting period. *See, e.g.*, *Anadarko Petroleum Corp.*, 181 IBLA at 412; *Exxon Co., U.S.A.*, 113 IBLA 199, 205 (1990).

We further agree that the administrative record, in its original form, did not fully support ONRR's requirement to pay additional royalties based on production imbalances during the accounting period from February 2003 through October 2008. However, along with its Answer, ONRR filed a "Supplemental Record," in electronic form, which contains 739 pages of "additional documents that ONRR used to calculate the principal amounts due under both of the underlying Orders, and the

---

[22] (...continued)
end of the month following the month of production." 2005 Dear Operator Letter at 5 (emphasis added).

late-payment interest due with respect to the March 16, 2010, Order." Answer at 1-2 n.2. A copy of the Supplemental Record has been provided to W&T.

We conclude that the record submitted and supplemented on appeal adequately substantiates the volumes of natural gas produced; the RIK that was due and what was paid; the resulting production imbalances; the contract sales prices received by the United States on the third-party sales of natural gas; the resulting computation of additional royalties owed; and the computation of interest that accrued on unpaid royalty.[23] W&T has failed to demonstrate any error or deficiency in the administrative record, as it presently exists, or to offer its own documents contradicting that record. Further, we conclude that ONRR has adequately explained the basis for its decision to require the payment of additional royalties and interest thereon.

CONCLUSION

We, therefore, hold that the Director of ONRR properly denied W&T's appeals from the March and December 2010 Orders that required W&T to pay a total of $1,723,578.52 in additional royalties with respect to the Leases for the period from February 2003 through October 2008, and from the June 2010 Invoice that required W&T to pay a total of $673,516.99 in late-payment interest.[24]

---

[23] In his decision, the Director observed that W&T was required to keep adequate records regarding its natural gas production, the resulting royalty owed, and RIK payments in satisfaction of that royalty. He stated that W&T could itself have determined whether there was any production imbalance for any production month or throughout the accounting period, and whether any additional royalty was owed. Moreover, given that ONRR and W&T had communicated numerous times concerning ONRR's accounting efforts, he questioned "why W&T now . . . is unable to understand the basis for the Orders when it played an active role in determining the amount that ONRR demanded." Decision at 7. In addition, ONRR explains:

> The March 16, 2010[,] Order includes a "cash out summary" derived from ONRR's records and reports from . . . W&T [that] . . . includes information showing [as to each production month] the monthly gas imbalance, the gas Btu factor, ONRR's contract [sales] price for the particular month, and the value of the imbalance owed to or by the Government. . . . [T]he Supplemental Record contains detailed documents supporting the information listed in the cash out summary.

Answer at 48.

[24] We note that the Director concluded that since none of the lessees appealed or joined in W&T's appeal from the March and December 2010 Orders, as they were

(continued...)

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is affirmed.

/s/
James F. Roberts
Acting Chief Administrative Judge

I concur:

/s/
Christina S. Kalavritinos
Administrative Judge

[24] (...continued)
permitted to do by 30 C.F.R. § 1290.103, the Orders were binding on the lessees upon affirmance by the Director, in accordance with 30 C.F.R. § 1290.106(c). *See* Decision at 22-23. This is not disputed by W&T on appeal to the Board, and we find it to be a correct statement of the law. The Orders will, in view of the Board's affirmance of the July 2012 decision, remain binding on the lessees. *See* Answer at 9.