HELIS OIL & GAS COMPANY, L.L.C.

185 IBLA 28 Decided July 10, 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

HELIS OIL & GAS COMPANY, L.L.C.

IBLA 2013-14 Decided July 10, 2014

Appeal from a decision of the Office of Natural Resources Revenue affirming an Order to Report and Pay Additional Royalties. ONRR-11-0057-OCS.

Affirmed in part; set aside and remanded in part.

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

   Dear Operator/Payor letters are not authoritative or binding on the Department unless issued by an official with the authority to bind the Department prospectively.

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

   The regulation at 30 C.F.R. § 1206.152(b)(1)(i) does not apply to unprocessed gas taken as royalty-in-kind to be sold by the lessor. The regulation expressly pertains to unprocessed gas sold by the lessee when royalty is to be paid in value.

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

   Use of the prices ONRR would have received for its royalty-in-kind gas volumes to cash out imbalances is consistent with applicable law and appellant's lease requiring that value for royalty purposes shall be based on the highest price paid or offered at the time of production for the major portion of like-quality products.

APPEARANCES: Robert B. Allen, Esq., Houston, Texas, Nancy L. Pell, Esq., Washington, D.C., L. Poe Leggette, Esq., Denver, Colorado, for appellant; Michael P. Marchetti, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Lakewood, Colorado, for the Office of Natural Resources Revenue.

OPINION BY ADMINISTRATIVE JUDGE PRICE

Helis Oil & Gas Company, L.L.C. (Helis), has appealed from a September 27, 2012, decision of the Director, Office of Natural Resources Revenue (ONRR), affirming a demand for additional royalties in the amount $470,202.80 (Decision). ONRR issued its April 26, 2011, Order to Report and Pay Additional Royalties (Order) for unprocessed gas volume imbalances associated with a pilot Royalty-In-Kind (RIK) program for production from Outer Continental Shelf (OCS) Oil and Gas Lease OCS-G 26480 (Lease) for the period November 2008 through October 2009, including under-delivered flash gas volumes.[1/] Helis challenged the Order on the ground that ONRR was required to calculate additional royalty using index prices as set forth in guidance provided to all RIK program participants.[2/]

Background

By letter dated September 30, 2008, ONRR's predecessor, the Minerals Management Service,[3/] notified Helis that Lease OCS-G 26480 had been selected to participate in the pilot RIK program beginning November 1, 2008. Statement of Reasons (SOR), Ex. 3 (Dear Operator Letter) at 1. The Dear Operator Letter was issued by the Acting Manager, Natural Gas Front Office, RIK. It constituted notice that the United States would take its royalty in-kind and, in the absence of program regulations, stated the procedures by which the right would be exercised in the pilot program. More specifically, the Dear Operator Letter stated that monthly imbalances

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[1/] Under the Mineral Leasing Act of 1920 (MLA), 30 U.S.C. §§ 181-287 (2006), the Secretary is responsible for the assessment and collection of royalties for gas produced from Federal and Indian lands. The Act vests in the Secretary the authority "to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of the Act." 30 U.S.C. § 189 (2006). In addition to the MLA, the Lease is subject to the Outer Continental Shelf Lands Act of 1953 (OCSLA), 43 U.S.C. §§ 1331-1356 (2006), and the Federal Oil and Gas Royalty Management Act of 1983, 30 U.S.C. §§ 1701-1758 (2006), and their implementing regulations.

[2/] Helis did not address the amount assessed for flash gas because it requested an extension of time to give ONRR an opportunity to consider the matter further, discussed more fully below.

[3/] For convenience, we refer to both as ONRR.

would be cashed out either by making up the delivery or by cashing out "based on the applicable index price net of transportation costs," and that imbalances that remained at the "cessation of the RIK term" would be "settled under a cash out payment" in the same manner. *Id.* at 4. Due to an oversight, Helis' platform operator, Apex Oil and Gas, Inc. (Apex), failed to deliver any RIK gas to ONRR in the first 7 months of the program. SOR, Ex. 4 (Decl. of Lisa Ingraham, Helis Market Analyst) at 2, ¶ 6. Helis avers it sold those RIK volumes to third parties using prices derived from Platts Gas Daily Average (GDA) or a weighted average based on the GDA and Platts monthly index price for the Transcontinental (Transco) Gas Pipeline zone. SOR at 4. Upon notification by ONRR, Helis confirmed the failure to deliver with Apex and agreed to a makeup delivery schedule pursuant to which Helis delivered all the entitled volumes plus half of Helis' entitlements for the remainder of the RIK term. *Id.* at 2; SOR, Ex. 4 at 2, ¶ 7.

By letter dated September 23, 2009, ONRR notified Helis that the RIK program would terminate effective November 1, 2009; existing RIK contracts would be allowed to expire; the lease would revert to royalty in value status; RIK royalties due under the lease would be cashed out; and ONRR would no longer have any authority to take any more RIK. Decision at 3 (Administrative Record (AR) at 3).[4/] On April 26, 2011, ONRR issued its Order directing Helis to pay $468,649.29 in royalties for RIK imbalances, asserting the Order "supersede[d] all issued Dear Operator Letters involving the resolution of operator imbalances on oil and gas production related to properties that have been in RIK." Order at 2 (AR at 37). The royalty amount was computed as follows:

Production Month	Imbalance (over)/under (MMBtu)	ONRR's net contract price for month	Calculated gas value (owed)/due
November 2008	67655	$ 5.502947	$ 372,301.88
December 2008	54643	$ 6.310791	$ 344,840.55
January 2009	66489	$ 5.794776	$ 385,289.90
February 2009	62124	$ 3.956254	$ 245,778.32
March 2009	66198	$ 3.572112	$ 236,466.67

[4/] The record does not include a copy of this letter and to our knowledge, it is not available online (ONRR in general provides only representative samples of Dear Operator letters online), but we assume it contained the same language regarding the cashing out method.

April 2009	59082	$ 3.314881	$ 195,849.80
May 2009	67702	$ 3.237880	$ 219,210.95
June 2009	(74570)	$ 3.490424	$ (260,280.92)
July 2009	(82766)	$ 3.638996	$ (301,185.14)
August 2009	(71488)	$ 3.182009	$ (227,475.46)
September 2009	(73006)	$ 2.723052	$ (198,799.13)
October 2009	(49361)	$ 3.637818	$ (543,348.13)
Totals	(7298)		$ 468,649.29

See Settlement Sheet attached to Order.[5/] In addition, ONRR assessed and ordered Helis to pay $1,553.51 for under-delivered flash gas volumes of 473 MMBtu for the same reporting period. *Id.*

Helis appealed to the ONRR Director pursuant to 30 C.F.R. Part 1290. Helis did not challenge the imbalance volumes identified by ONRR, but did object to the use of contract prices ONRR received from purchasers on the same pipeline in each month (less transportation and/or quality differentials) to compute the amount owed.[6/] Helis argued that the value of the imbalance volumes should be calculated on the basis of the gross proceeds accruing to it pursuant to an arm's-length contract, citing 30 C.F.R. § 1206.152(b)(1)(i). Helis submitted the following table to show the royalty amount that resulted from applying the gross proceeds rule:

[5/] Our table duplicates columns 3 through 5 of ONRR's settlement sheet. The figures in parentheses in the second column of our table indicate gas deliveries in excess of the Government's monthly RIK entitlement, and those in parentheses in the fourth column represent the calculated gas value Helis owed to the Government.

[6/] The following are ONRR's Net Contract Prices for the period in question, with Helis' prices provided in parentheses. November 2008 $5.50 ($5.94); December 2008 $6.31 ($5.16); January 2009 $5.79 ($4.06); February 2009 $3.96 ($3.79); March 2009 $3.57 ($3.51); April 2009 $3.31 ($3.23); May 2009 $3.24 ($3.57); June 2009 $3.49 ($3.54); July 2009 $3.64 ($3.19); August 2009 $3.18 ($3.03); September 2009 $2.72 ($2.52); October 2009 $3.64 ($3.65). Answer at 6 n.5.

ONRR states the prices it received and expenses it incurred are proprietary. It offered to submit that data pursuant to the protective provisions of 43 C.F.R. § 4.31, but as Helis has not directly challenged ONRR's price calculations, we accept them as well.

months did not deliver	imbalance	Helis sales price less transport.	ONRR net contract price	value of difference (owed)/due
November	67655	5.942	5.503	($ 29,738)
December	54643	5.158	6.311	$ 63,007
January	66489	4.051	5.795	$115,928
February	62124	3.789	3.956	$ 10,376
March	66198	3.511	3.572	$ 4,063
April	59082	3.232	3.315	$ 4,903
May	67702	3.570	3.238	($ 22,485)

Notice of Appeal to ONRR at 2-3 (AR at 21-22) (Helis supplied the information found in the third and last columns; the table excluded those months that gas was delivered (June through October 2009) because Helis does not dispute ONRR's assessment for those months).

Arguing ONRR overestimated the value by $146,052.91, Helis initially paid $322,596.38, the amount it contended was due under the Order, but later posted a letter of credit so that the entire royalty amount demanded by ONRR was paid. Decision at 4 (AR at 4); Notice of Appeal to ONRR at 4 (AR at 23); ONRR e-mail message from Judith Clark to Pamela Reiger dated Mar. 1, 2012 (AR at 11). Helis requested a 30-day extension to respond to the Order regarding additional royalty owed for flash gas, having previously requested that ONRR separately consider the matter in light of an acknowledged error on the part of Helis' gas transporter, Transco Gas Pipeline. Notice of Appeal to ONRR at 1-2 (AR at 20-21).

In his Decision, the ONRR Director asserted the Dear Operator Letters had clearly articulated the policy on "cash out" of imbalances: "ONRR 'cashes out the volume imbalances using the contracted sales price, less transportation, fuel, and/or quality bank costs each month there is an imbalance.' Order at 2." Decision at 5 (AR at 5). He reasoned that "[t]he use of the RIK contract price to value the imbalance quantity is reasonable, regardless of who owes the imbalance – the Government or the lessee. The price reflects the value ONRR would have received if Helis had, in fact, delivered the proper volume of gas." *Id.* The Director concluded that "the use of the RIK contract price to value the imbalance accurately reflects the damages the Government suffered . . . due to the lessee's underdelivery and the undeserved benefit the Government enjoyed for a particular month due to the lessee's overdelivery" and is consistent with the statutory mandate that royalty obligations accrue monthly. *Id.* He further concluded Helis had failed to affirmatively show how ONRR's flash gas determination was in error. He upheld the Order and denied the appeal.

Analysis

The Dear Operator Letter Does Not Bind the Department

Helis contends ONRR is contractually bound by the Dear Operator Letter to value imbalances using an applicable index and may not change the method for cashing out RIK imbalances retroactively. SOR at 5 (citing *The Superior Oil Co.*, 12 IBLA 212 (1973)). Helis characterizes the Dear Operator Letter as "an element in the contract between the parties." *Id.* at 5, 6. Helis argues it used the Platts GDA to calculate its sales proceeds, which establishes the Platts GDA as the applicable index contemplated in the Dear Operator Letter, noting that ONRR has not identified another applicable index. *Id.* To the extent the term "applicable index" is ambiguous, Helis maintains the ambiguity must be resolved in its favor under the doctrine of *contra proferentum*. *Id.* at 5-6.

ONRR contends Helis' reliance on the Dear Operator Letter and 30 C.F.R. § 1206.152 is misplaced, arguing identical Dear Operator Letters were sent to all similarly situated operators and are not binding on the Department. Answer at 10.

In its Reply, Helis reiterates its position that ONRR is contractually bound to value cash-out volumes using the "applicable index" and that ONRR's Order constitutes a breach of contract. Reply at 1, 2.

[1] Helis cites *The Superior Oil Co.*, 12 IBLA 212 (1973) (A.J. Thompson dissenting), to support its contentions,[7/] by overlooking current precedent holding

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7/ The Board has most frequently cited *Superior Oil Co.*, 12 IBLA 212, for its discussion of transportation costs, most recently in *Nexen Petroleum USA, Inc.*, 175 IBLA 286, 393-94 (2002). We have occasionally cited the case in connection with general principles of contract or statutory construction. *See Churchill County Board of Comm'rs*, 61 IBLA 370, 375 (1982); *L.O. Power*, 22 IBLA 15, 18 (1975); *Ocean Drilling & Exploration Co.*, 21 IBLA 137, 142 (1975); *St. Joe Minerals*, 20 IBLA 272, 277 (1975); *Exxon Co., USA*, 15 IBLA 345, 360 (1974). It appears only one Board decision citing *Superior Oil* touched upon the binding effect of communications (continued...)

Dear Operator/Payor letters are neither substantive rules requiring notice and comment under the Administrative Procedure Act, 5 U.S.C. §§ 551, 553 (2006), nor binding on the Department unless issued by an official with the authority to bind the Department. As the court in *Devon Energy Corp. v. Kempthorne*, 551 F.3d 1030 (D.C. Cir. 2008), explained, "agency actions do not have the force of law unless they 'mark the consummation of the agency's decisionmaking process' and either determine 'rights or obligations' or result in discernible 'legal consequences' for regulated parties." 551 F.3d at 1039 (citing *Bennet v. Spear*, 520 U.S. 154, 177-78 (1997)). The court followed the reasoning in *Amoco Prod. Co. v. Watson*, 410 F.3d 722, 732 (D.C. Cir. 2005), aff'd, 549 U.S. 84 (2006) (quoting *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1256, 1257 (D.C. Cir. 1996)), among others, where the court plainly stated that "the Payor Letter here is not an agency statement with future effect because nothing under DOI regulations vests the Letter's author . . . with the authority to announce rules binding on DOI. . . . 'The Letter is not an agency rule at all, legislative or otherwise, because it does not purport to, nor is it capable of, binding the agency.'" 551 F.3d at 1039; *cf. W & T Offshore, Inc.*, 184 IBLA 272, 288 (2014). Clearly, the procedure prescribed by the Acting Manager, Natural Gas Front Office, RIK, was guidance only, as he had no statutory or delegated authority to bind the Department so as to constrain ONRR's options in valuing RIK imbalances at the end of the RIK program.[8/] Therefore, the Dear Operator Letter did not require ONRR to use index prices to determine value for royalty purposes.

The Gross Proceeds Rule Does Not Apply to Royalty Owed for RIK Imbalances

In the alternative, Helis argues ONRR should have calculated royalty using the gross proceeds rule under 30 C.F.R. § 1206.152(b)(1)(i) (2009) (formerly 30 C.F.R. § 206.152(b)(1)(i)) to determine value. It reasons that in the absence of misconduct or evidence that it breached the duty to market or received additional consideration not reflected in the gross proceeds it received for under-delivered RIK gas volumes,

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7/ (...continued)
outside the oil and gas lease contract, and that case involved value determination letters specifically requested by and issued to the appellant. *Amoco Prod. Co.*, 85 IBLA 121, 124 (1985).

8/ If Helis means to suggest its reliance on the Dear Operator letter otherwise establishes a binding obligation, the court rejected Devon's similar claim. 551 F.3d at 1040. We note, moreover, that ONRR avers "there is no evidence here that the index prices were ever actually used by the Agency to cash out RIK imbalances, at least in the way Helis argues they should have [been used] based on the Dear Operator Letter." Answer at 10 (footnote omitted). Helis did not acknowledge or challenge that assertion in its Reply.

"ONRR must accept Helis' gross proceeds as the value of production for the undelivered months." SOR at 7-8. We find no merit in this assertion.

[2] The regulation at 30 C.F.R. § 1206.152(b)(1)(i) does not apply to unprocessed gas taken as RIK to be sold by the lessor. To the contrary, the regulation explicitly pertains only to unprocessed gas sold by the lessee when royalty is to be paid in value. 30 C.F.R. § 1202.150(a) ("Royalty shall be paid in value unless ONRR requires payment in kind. When paid in value, the royalty due shall be the value, for royalty purposes, determined pursuant to 30 CFR part 1206 of this title multiplied by the royalty rate in the lease."). ONRR correctly asserts that when RIK is taken, "the Operator's duty is to deliver the appropriate volume of gas, not the appropriate dollar value of the gas." Answer at 15. ONRR properly concluded the RIK imbalances could not be valued for royalty purposes pursuant to 30 C.F.R. § 1206.152(b)(1)(i).

ONRR's Cash Out Method Reasonably Calculated Fair Market Value

Under the OSCLA, ONRR was required to obtain "not less than its fair market value" for its RIK. 43 U.S.C. § 1353(c)(1) (2006). *See also* MLA, 30 U.S.C. § 192 (2006); sec. 342 of the Energy Policy Act of 2005, 42 U.S.C. § 15902(b)(3) (2006). The cash out prices for outstanding RIK delivery imbalances therefore must also reflect not less than its fair market value to achieve the statutory mandate. Here, ONRR estimated the value it would have received from purchases from the same pipeline had Helis timely delivered RIK each month using Net Contract Prices. ONRR argues that its method of calculating the value of the imbalances using Net Contract Prices has a rational basis and is supported by the record. Answer at 3, 4.[9/] We agree.

ONRR's Net Contract Prices were multiplied by the volume of gas over- and under-delivered by Helis each month during the period in question. ONRR explains:

> In the seven months of November 2008 through May 2009, when gas demand was high because of colder temperatures, ONRR was able to obtain prices ranging from $3.23 (in May 2009) to $6.31 (in December 2008) for its RIK gas. Helis did not deliver any gas these months, despite an obligation to deliver between 54,643 MMBtu (in December

[9/] ONRR states "[i]ndex prices were a factor in the prices ONRR received for its RIK gas but were not directly used in the calculation of ONRR's Net Contract Prices." Answer at 4. ONRR further states that "the index prices contributed to the price ONRR received for its RIK gas. As a result, ONRR's Net Contract Prices were indirectly derived from index prices." *Id.* at 10. Whether "the index prices" are or were included in the Platts GDA is not stated by either party or otherwise clear from the record before us, but the issue is immaterial, given our view of the case.

> 2008) and 67,702 MMBtu (in May 2009) of RIK gas each month. [AR], Page 000064. Helis admits that "no gas was delivered to MMS during the first seven months of the contract period." SOR, page 2. Helis also admits to a windfall when it sold the gas "that should have been delivered as [RIK]" when the price of gas was relatively high. SOR[,] page 4. As a result, the Government lost a substantial amount of money that it should have received from its sale of RIK gas [in] these months. The Agency offset these losses with the value of the gas over-delivered in the five (5) months of June 2009 through October 2009. The offsets were also calculated using ONRR Net Contract Prices which ranged from $2.72 (in September 2009) to $3.64 (in July and October 2009). *Id.* Clearly, ONRR's Net Contract Prices were calculated reasonably and applied consistently.

Id. at 5.

Section 6 of Helis' Lease, effective November 1, 2004, stipulates a royalty rate of 16-2/3 percent of production, payable in amount or value. The Lease further provides:

> (b) *The value of production for purposes of computing royalty on production from this lease shall never be less than the fair market value* of the production. *The value of production shall be the estimated reasonable value of the production as determined by the lessor*, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field or area, to the price received by the lessee, to posted prices, to regulated prices, and to other relevant matters. Except when the Lessor, in its discretion, determines not to consider special pricing relief from otherwise applicable Federal regulatory requirements, the value of production for the purposes of computing royalty shall not be deemed to be less than the gross proceeds accruing to the Lessee from the sale thereof. In the absence of good reason to the contrary, *value computed on the basis of the highest price paid or offered at the time of production in a fair and open market for the major portion of like-quality products produced and sold from the field or area where the leased area is situated will be considered to be a reasonable value*.

Lease at 2, section 6(a), (b)(emphasis added).

[3] Unlike the two alternate methods Helis advocates, use of the prices ONRR would have received for its RIK volumes to cash out imbalances is consistent with the OSCLA and with Helis' Lease, both of which require value for royalty purposes to be

established on the basis of the highest price paid or offered at the time of production for the major portion of like-quality products. Nothing in the Lease or authorizing statutes entitles Helis to reap the windfall that results from permitting it to accept ONRR's generally higher Net Contract Prices for over-deliveries while using Helis' generally lower prices for its under-deliveries.[10/] Moreover, Helis in no way challenges the method by which ONRR determined prices for sales from the same pipeline during the period in question. Therefore, in the absence of rules governing valuation of RIK imbalances, and in the absence of a challenge to ONRR's calculations and determination of Net Contract Prices for the period at issue or any suggestion that those prices are not in line with the prices ONRR actually received, we agree that ONRR reasonably interpreted its statutory obligation, and find that its use of ONRR's Net Contract Prices was fair to both parties, consistent with the statute and Lease terms, reasonable, and well supported by the record, and provided the Government a return of not less than fair market value for imbalances. Accordingly, we affirm the Decision upholding the Order determining Helis owes $468,649.29 in royalties for the imbalance gas volumes.

Royalty Owed on Flash Gas

With respect to the flash gas issue, Helis argues ONRR erroneously assessed royalties on 473 MMBtu of flash gas volumes for two reasons. It contends "ONRR incorrectly relied on reports of flash gas allocated to Helis by pipeline operator, Transco" when it "should calculate flash gas royalties based on volumes allocated to

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[10/] Insofar as Helis contends the Dear Operator Letter could authorize a valuation method that could result in less than fair market value for the lessor and a windfall to the lessee, ONRR's further argument that the Letter "was based on an erroneous interpretation of the law" is well founded. *See* Answer at 11. In *Superior Oil*, the Board distinguished *Sinclair Oil and Gas Co.*, 75 I.D. 155 (1968), on the basis of the same principle, noting *Sinclair* was a case involving

> a situation where the Geological Survey initially required something "less than the royalty called for by the terms of the leases in satisfaction of appellant's obligations to the United States." [75 I.D.] at 175. The Survey's misconstruction of the royalty terms of the lease had been based upon an erroneous interpretation of the Act of August 8, 1946, 30 U.S.C. § 226(c) (1970). 75 I.D. at 157, 168, 171, 173. Thus, in *Sinclair*, the acceptance by the Geological Survey of royalties less than those required by law did not preclude the Government from subsequently requiring from the lessee the full royalties required by law.

Superior Oil, 12 IBLA at 226 n.10.

each producer by the platform operator, Apex." SOR at 9. Helis further alleges ONRR mistakenly assessed royalties on flash gas volumes that were never allocated to Helis, stating that some of the gas was delivered to the Markham separation plant for its use as fuel. *Id.* According to Helis' analysis, *see* SOR, Ex. 7, it owed a royalty amount of $215.42 for 59 MMBtu and is now entitled to a refund of $1,338.09, stating Helis has been communicating with Apex representatives "to assist in settling the flash gas imbalance." *Id.*

ONRR argues that Helis has not shown error in its calculations regarding the flash gas volumes, because it did not submit any documentation to support its assertions, despite the years that have passed since the termination of the RIK program in 2009. Answer at 16-17.

We agree that the Decision properly held Helis had failed to establish any basis for disturbing the Order to pay additional royalties for flash gas volumes. However, with its Reply, Helis belatedly supplied Williams Gas Pipeline - Transco Daily Location Allocation data to support its argument regarding the proper treatment of flash gas volumes, moving the Board to remand the matter to ONRR for further consideration. Helis notably did not offer any explanation for its lack of diligence or an argument why it should be relieved of the usual consequence of failing to submit its evidence before now. While we certainly could affirm the Decision's ruling on the flash gas volumes, ONRR has not objected to the requested remand. For that reason alone, we will remand this matter so that ONRR can take further action.

Therefore, 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 is affirmed in part and the issue of flash gas under-deliveries is set aside and remanded to ONRR for further action.

// original signed
T. Britt Price
Administrative Judge

I concur:

// original signed
Christina S. Kalavritinos
Administrative Judge