No. 02-476

In the Supreme Court of the United States

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AND AMERICAN PETROLEUM INSTITUTE, PETITIONERS

v.

REBECCA WATSON, ASSISTANT SECRETARY OF THE INTERIOR FOR LAND AND MINERALS MANAGEMENT, ET AL.

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

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Secretary of the Interior validly adopted regulations to define the "value of production," as that term is used in a series of federal mineral leasing statutes, for the purpose of computing royalties owed on leases of federal land.

2. Whether the Secretary's construction in a formal regulation of the statutory term "value of production," as that term is used in a series of federal mineral leasing statutes, is entitled to deference under the principles of *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 279 F.3d 1036. The opinion of the district court (Pet. App. 20a-47a) is reported at 91 F. Supp. 2d 117. The district court's amended order and final judgment (Pet. App. 17a-19a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 8, 2002. Petitions for rehearing were denied on June 21, 2002 (Pet. App. 49a-50a, 51a-52a). The petition for a writ of certiorari was filed on September 19,

2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Independent Petroleum Association of America (IPAA) and the American Petroleum Institute (API) filed suits under the judicial review provisions of the Administrative Procedure Act (APA), 5 U.S.C. 701 *et seq.*, challenging a final rule issued by the Department of the Interior concerning the determination of royalties for natural gas produced from federal leases. See *Amendments to Transportation Allowance Regulations for Federal and Indian Leases to Specify Allowable Costs and Related Amendments To Gas Valuation Regulations*, 62 Fed. Reg. 65,753 (1997). The district court enjoined the Department from applying most of the challenged portions of the rule. The court of appeals reversed in relevant part, finding that most of the regulations are consistent with the agency's past practice and that they are based on a reasonable interpretation of the federal mineral leasing statutes entitled to deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

1. The federal mineral leasing statutes were "intended to promote wise development of these natural resources and to obtain for the public a reasonable financial return on assets that 'belong' to the public. The Secretary of the Interior is the statutory guardian of this public interest." *California Co.* v. *Udall*, 296 F.2d 384, 388 (D.C. Cir. 1961). The Department of the Interior issues and administers oil and gas leases for federal and Indian lands pursuant to the Mineral Leasing Act (MLA), 30 U.S.C. 181-287 (for onshore public domain lands); the Mineral Leasing Act for Acquired Lands, 30 U.S.C. 351-359 (onshore acquired lands);

Indian leasing statutes, 25 U.S.C. 396a-396g (tribal leases), 25 U.S.C. 396 (leases of allotted lands); and the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1331-1356. The Minerals Management Service (MMS) is the Interior Department bureau that collects, verifies and distributes revenues from oil and gas leases issued under those statutes.[1]

Under the federal mineral leasing statutes, oil and gas lessees must pay royalty fixed as a specified percentage of the "amount or value of the production" saved, removed, or sold from the lease. See 43 U.S.C. 1337(a)(1) (OCSLA); 30 U.S.C. 226 (MLA); 25 C.F.R. 211.13 (1995) (tribal leases before 1996); 25 C.F.R. 211.41(b) (tribal leases 1996-present); 25 C.F.R. 212.16 (1995) (allotted land leases before 1996); 25 C.F.R. 212.41(b) (1996-present). A typical royalty rate for onshore leases is 12.5% and for offshore leases is 16.67%. See 30 U.S.C. 226(b)(1)(A) (MLA); L28 (16.67% rate on typical offshore lease).[2] In exchange for the right to retain most of the proceeds from lease production, lessees bear the costs and risks of exploration and production and related operations.

The Secretary of the Interior has express authority to "prescribe such rules and regulations as may be necessary to carry out" the leasing provisions. *E.g.*, 30 U.S.C. 189 (MLA); 25 U.S.C. 396, 396d (tribal and allotted land leases); 43 U.S.C. 1334(a) (OCSLA). The

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[1] All revenues from Indian leases are paid to the Indian beneficiaries. For most federal onshore leases, the MLA provides that 50% of royalties and other revenues received (90% in the case of Alaska) are to be paid to the State in which the leased federal lands are situated. See 30 U.S.C. 191.

[2] For convenience, this brief cites petitioners' lodging with this Court with the letter "L," followed by the page number in the lodging.

Department of the Interior has long defined the "value of production"—the amount on which the percentage royalty is paid—by regulation. See, *e.g.*, *California Co.*, 296 F.2d at 386-388; *United States* v. *Ohio Oil Co.*, 163 F.2d 633, 635 (10th Cir. 1947), cert. denied, 333 U.S. 833 (1948). Accordingly, federal lease forms do not include a specific formula for calculating the "value of production" on which the royalty is to be paid. Instead, the forms expressly reserve to the Secretary the authority and discretion to establish the reasonable value of production for royalty purposes. *E.g.*, L24-L25, L28, L33. The leases also recite that they are entered into subject to the appropriate leasing statute and the Secretary's regulations. *E.g.*, L28 (lease is issued "under, pursuant, and subject to [OCSLA] and to all lawful and reasonable regulations of the Secretary of the Interior * * * when not inconsistent with any express and specific provisions herein"); L32 (lease is "issued pursuant to" and "subject to [OCSLA]," "all regulations issued pursuant to [OCSLA]," certain specific later promulgated regulations, "and all other applicable statutes and regulations").

2. The Department of the Interior's gas royalty valuation regulations were modified in a major rule-making in 1988. See 53 Fed. Reg. 1272 (1988). The 1988 regulations continued the longstanding principle of federal royalty valuation that the minimum value of production for royalty purposes is the lessee's "gross proceeds" received for the disposition of gas. 30 C.F.R. 206.152(h) (federal unprocessed gas), 206.153(h) (federal processed gas), 206.172(h) (Indian unprocessed gas), 206.173(h) (Indian processed gas).[3] The gross proceeds

[3] The rules governing the royalty value of gas produced from Indian leases were revised effective January 1, 2000. 64 Fed. Reg.

rule has been in force at least since 1942 for onshore leases, and since federal offshore leasing began in 1954.[4]

The gross proceeds rule provides that all elements of value a lessee receives for disposition of federal oil or gas are part of royalty value. *E.g.*, *Wheless Drilling Co.*, 13 I.B.L.A. 21, 30 (1973) (gross proceeds includes "any additional sums paid by the purchaser * * * as consideration for the purchase of gas"); *Amoco Prod. Co.*, 29 I.B.L.A. 234, 236-237 (1977) ("[p]roceeds of a sale, unless there is something in the context showing to the contrary, means total proceeds"). The current regulations thus define "gross proceeds" to include "the total monies and other consideration accruing to an oil and gas lessee for the disposition of unprocessed gas, residue gas, and gas plant products produced." 30 C.F.R. 206.151, 206.171. That definition encompasses "all consideration flowing from the buyer to the seller for the gas." 53 Fed. Reg. at 1241.

The regulations also define the expenses that may be deducted from gross proceeds when calculating value for royalty purposes. For natural gas, the regulations establish two such deductions: the cost of transportation to markets remote from the lease and the cost of processing to remove heavier liquid hydrocarbons entrained in the gas stream. *E.g.*, 30 C.F.R. 206.156-206.157 (transportation, federal leases); 30 C.F.R. 206.158-206.159 (processing, federal leases). The transportation allowance embraces "only those costs

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43,515 (1999). Those new rules are not at issue here. All references in this brief to 30 C.F.R. 206.171 *et seq.*, are to the pre-2000 rules.

[4] See 30 C.F.R. 250.64 (1954-1979), subsequently recodified to 30 C.F.R. 206.150 (1988) (offshore leases); former 30 C.F.R. 221.47, subsequently recodified to 30 C.F.R. 206.103 (1988) (onshore and Indian leases), promulgated at 7 Fed. Reg. 4132 (1942).

which are directly related to the transportation of lease production." 53 Fed. Reg. at 1261. The same principle applied before the 1988 revisions; the minimum royalty value was gross proceeds accruing to the lessee, reduced only by the two types of cost (transportation and processing) expressly provided for in the regulations. See *Walter Oil & Gas Corp.*, 111 I.B.L.A. 260, 265 (1989) ("The only allowances recognized as proper deductions in determining royalty value are transportation allowances for the cost of transporting production from the leasehold to the first available market * * * and processing allowances for processed gas authorized by 30 C.F.R. 206.152(a)(2) (1987).").

The regulations promulgated in 1988 continued to specifically prohibit lessees from deducting the costs of putting production into marketable condition, including such functions as gathering, compression, dehydration, and desulphurization ("sweetening"). *E.g.*, 30 C.F.R. 206.152(i) (1997), 206.153(i) (1997), 206.172(i) (1997), 206.173(i) (1997). In short, the 1988 rules expressly provided that "[t]he lessee is required to place gas in marketable condition at no cost to the Federal Government unless otherwise provided in the lease agreement." 30 C.F.R. 206.152(i) (1997); see 30 C.F.R. 206.153(i) (1997) (similar), 206.172(i) (1997) (similar), 206.173(i) (1997) (similar). See *Amerada Hess Corp.* v. *Department of the Interior*, 170 F.3d 1032 (10th Cir. 1999) (upholding marketable condition rule); *Mesa Operating Ltd. P'ship* v. *Department of the Interior*, 931 F.2d 318 (5th Cir. 1991), cert. denied, 502 U.S. 1058 (1992); see also *California Co.*, 296 F.2d at 388 (upholding Interior's definition of "production" to mean production in marketable condition, and approving disallowance of deduction for gathering, compression, and dehydration costs).

3. a. The regulation under challenge in this case, promulgated in 1997, was intended primarily to clarify how the above rules for valuing production were to apply in light of the changes in the gas industry that began in the 1980s. Although before that time producers sometimes sold gas directly to an end user, with the pipeline providing only transportation, it was more common for producers to sell gas to the pipeline, which then resold it to local distribution companies, public utilities, or industrial consumers. Pet. App. 3a. In the 1980s, regulatory reforms instituted by the Federal Energy Regulatory Commission (FERC) encouraged competition among producers for the direct sale of gas to purchasers, ultimately changing the pipeline's typical role from purchaser to transporter only. Thenceforth, when producers sold directly to a remote purchaser, the producer would incur the cost, set by the pipeline, of transporting the gas away from the lease to the point of sale. The pipeline would be required to charge separate rates for transportation and for other services it provided, such as storage, production, and gathering. *Ibid.*; see 57 Fed. Reg. 13,279-13,283 (1992) (FERC); 62 Fed. Reg. at 65,753 (MMS). See generally *United Distribution Cos.* v. *FERC*, 88 F.3d 1105 (D.C. Cir. 1996) (upholding new FERC rules), cert. denied, 520 U.S. 1224 (1997).

b. Responding to those changes, MMS issued a Notice of Proposed Rulemaking on July 31, 1996, explaining that the proposed rule

> should provide specific guidance to lessees and royalty payors on which transportation service components are deductible transportation costs. This guidance is necessary because transportation service components previously aggregated may now be

> separately identified in transportation contracts, and new transportation costs * * * are emerging. Further, some "transportation" service components reflect non-deductible costs of marketing rather than transportation. The purpose of this proposed rule is to clarify for the oil and gas industry which cost components or other charges are deductible (related to transportation) and which costs are not deductible (related to marketing) for Federal and Indian leases.

61 Fed. Reg. 39,932 (1996). MMS proceeded to address particular cost components, newly "unbundled" as a result of FERC's regulatory reforms, and proposed to classify those items either as deductible transportation costs or non-deductible other costs. See *id.* at 39,932-39,936; see also 62 Fed. Reg. at 65,754, 65,762 (final rule).

After comment by interested states, Indian Tribes, industry trade associations, and lessees/producers, MMS published the final rule on December 16, 1997, effective February 1, 1998. See 62 Fed. Reg. at 65,753. MMS noted that it "has never allowed marketing costs as deductions from royalty value and maintains this position in the final rule." *Id.* at 65,760. Accordingly, the final rule distinguishes between charges such as those for actual transportation of gas, which are deductible, and charges for marketing and other non-transportation services, which are not. See *id.* at 65,757-65,760; 30 C.F.R. 206.157(f), 206.177(f) (1998). As amended in the 1997 rulemaking, the regulations provide that lessees must "place gas in marketable condition *and market the gas for the mutual benefit of the lessee and the lessor* at no cost to the Federal Government" or Indian lessor. 30 C.F.R. 206.152(i) (emphasis added to language added in 1997) (federal unprocessed gas); see 30 C.F.R. 206.153(i) (federal processed gas), 206.172(i) (1998) (Indian unprocessed gas), 206.173(i) (1998) (Indian processed gas). Lessees may not deduct their marketing costs from gross proceeds, regardless of whether they sell their gas at the wellhead or at a distant point. See 62 Fed. Reg. at 65,755-65,756.

4. In March 1998, petitioner trade groups, which represent much of the natural gas industry, filed these facial challenges to the 1997 regulatory amendments. On March 28, 2000, the district court granted summary judgment to petitioners. Pet. App. 48a. The district court held that the new regulations were not a proper exercise of the Secretary's statutory authority to define the "value of production" for royalty purposes.

In reaching that conclusion, the district court declined to defer to the Secretary's interpretation of the governing statute and prior regulations, holding that, "[w]hile according appropriate deference to an agency's reasonable interpretation of its own regulations, courts must view such interpretations with skepticism when they affect contracts to which the agency is a party." Pet. App. 38a. The district court noted that under the leasing statutes, royalties apply to "the amount or value of production saved, removed, or sold from the lease." *Id.* at 36a (internal quotation marks omitted) (citing, *e.g.*, 43 U.S.C. 1335(a)(8), 1337(a) and (b)(3)). Under that language, the district court held that "the government's royalty interest is limited to the value of production at the lease or wellhead, not in value enhancements resulting from downstream activities." Pet. App. 36a. In the court's view, "the government's royalty interest on the value of production may not include proceeds received by lessees that are attributable to matters other than gas production." *Ibid.* The court concluded that the new rule, "to the extent that it imposes a duty on lessees to market gas downstream at no cost to the lessor and disallows the deduction of downstream 'marketing' costs, is invalid." *Id.* at 47a; see *id.* at 18a (amended order).[5]

5. a. The court of appeals reversed the district court's holding that the Secretary must allow lessees to deduct marketing and other non-transportation costs incurred for "downstream" sales. Pet. App. 1a-14a. The court rejected petitioners' argument that *Chevron* deference "is inappropriate for regulations that affect contracts in which Interior has financial interests." *Id.* at 7a. The court explained that "in the mineral leasing statutes Congress has granted rather sweeping 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 leasing statutes].'" *Ibid.* (quoting statutes). Those purposes "include the administration of federal leases, which involves collecting royalties and determining the methods by which they are calculated." *Ibid.* The court recognized that "the availability of *Chevron* deference depends on congressional intent," *id.* at 8a, but it found "no indication here of a special intent to withhold deference. " *Id.* at 9a. The court also noted that its conclusion was supported by its own application of *Chevron* deference in other contexts, in which there was "a recognized risk of agency self-aggrandizement, such as interpretations of their own jurisdictional limits." *Id.* at

[5] The district court also held invalid certain regulations to the extent they limit allowable costs for firm demand charges in determining transportation cost allowances. Pet. App. 18a. That holding was affirmed by the court of appeals, *id.* at 14a, and is not at issue here.

8a. As the court explained, "given the ubiquity of some form of agency self-interest, a general withdrawal of deference on the basis of agency self-interest might come close to overruling *Chevron*." *Id.* at 8a-9a (citation omitted).

The court also rejected petitioners' argument that *Chevron* did not apply because "the case involves interpretation of contracts, not of a statute." Pet. App. 5a. The court explained that "the contracts themselves lead * * * back to the agency," because "they incorporate the regulations and recognize Interior's authority to modify them." *Id.* at 6a. The court observed that *Chevron* principles should take into account that rules in this context may "have a serious impact on pre-existing transactions," thus "add[ing] a nuance to ordinary review for whether the agency has been arbitrary or capricious." *Ibid.* But, the court reasoned, "this added nuance is quite different from a general denial of deference." *Ibid.*

Applying those principles to the regulations at issue here, the court found "nothing unreasonable in Interior's refusal to allow deductions for so-called 'downstream' marketing costs." Pet. App. 9a. The court noted that petitioners "acknowledge that marketing costs for sales *at the lease* have historically been nondeductible." *Ibid.* Beginning from that premise, the court explained that there is no basis "for introducing a distinction between marketing for leasehold sales," which is concededly nondeductible, and marketing "for 'downstream' sales," which petitioners argue must be deductible. *Ibid.* The court also noted that "producers are under no duty to market 'downstream' and may opt to sell at the leasehold," thus avoiding the possibly greater costs of marketing their gas "downstream." *Id.* at 10a. The court held that the Secretary was not required to accept petitioners' "almost metaphysical" theory that "when the maximum value of gas can be realized by a downstream sale, then not only transportation costs but also the cost of efforts undertaken to identify and realize that value must somehow be more like transportation itself than they are like on-lease marketing." *Ibid.* Instead, the court concluded, the Secretary acted permissibly in retaining the "usual distinction between marketing and transporting costs," which the agency had "historically applied * * * to downstream sales," as well as sales at the wellhead. *Ibid.* "Given the difficulty in slicing up marketing costs on the basis of the point of sale, and given that Interior must take administrability into account," the court found "nothing unreasonable in [the Secretary's] hewing to the old line between marketing and transportation." *Id.* at 11a.

The court also rejected petitioners' argument that the new regulations impermissibly altered the status of so-called "[i]ntra-hub transfer fees," which are sales fees charged "when a lessee *sells the gas* at the pipeline's junction at the hub," by making them nondeductible. Pet. App. 11a (brackets omitted). The court noted that in the past "costs of this sort, even though reasonably classifiable as marketing, would have been bundled with transportation costs, making precise separation administratively troublesome, if not impossible." *Ibid.* The court held that, once the changed regulatory environment required unbundled rates and permitted identification of those costs, "it was reasonable for Interior to rigorously apply its conventional distinction between marketing and transportation." *Id.* at 11a-12a.

b. Judge Sentelle filed a brief concurring opinion. Pet. App. 15a-16a. He stated that he "join[ed] without reservation the conclusion of the court and the reasoning that is essential to it." *Id.* at 15a. He agreed with the court that *Chevron* deference is appropriate in this case because the ordinary prerequisites for deference —express or implied delegation of authority to an agency charged "with the administration and therefore the interpretation of [an] 'ambiguous' act," *ibid.*—are present. He further agreed with the court that there is "no indication here of a special intent to withhold deference in the interpretation of this act on a question as to which Congress has not spoken directly." *Ibid.* (internal quotation mark omitted). In Judge Sentelle's view, however, the court's reference to the application of *Chevron* to an agency's construction of its own authority and the court's discussion of agency self-interest was "troubling." *Ibid.* He found, however, that that "discussion is no more than dicta, and not at all essential to the court's conclusion." *Id.* at 16a. Accordingly, he "concur[red] in the decision reached and in the balance of the opinion." *Ibid.*

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

1. a. Petitioners contend (Pet. 18) that the regulations at issue in this case are not entitled to *Chevron* deference because "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Franconia Assocs.* v. *United States*, 122 S. Ct. 1993, 2001 (2002) (internal quotation marks omitted). As the court of appeals explained, however, the government in this case did not enter into leases that purported to or did in some way

override the Secretary's authority to construe ambiguous statutory terms and fill gaps left by Congress in the mineral leasing statutes. To the contrary, the leases "lead * * * back to the agency," because they "incorporate the regulations and recognize Interior's authority to modify them." Pet. App. 6a.

In particular, the leases require that royalties be paid on the "value of production saved, removed, or sold from the leased area." *E.g.*, L24, L28, L33. Those terms are derived from the relevant statutes, see pp. 2-3, *supra*, and are not defined in the leases themselves. The leases do, however, recite, in a variety of formulations, that they are entered into "under, pursuant, and subject to [*e.g.*, OCSLA] and to all lawful and reasonable regulations of the Secretary of the Interior * * * when not inconsistent with any express and specific provisions herein," L28—a formulation that includes future regulations. See Pet. App. 6a. Accordingly, by leaving the crucial term "value of production" undefined and by expressly subjecting the leases to otherwise valid regulations, the leases recognize the Secretary's authority, by promulgating regulations, to adopt reasonable constructions of the key statutory terms used to compute the royalty, such as "value of production."

b. Petitioners contend (Pet. 25) that deference is inappropriate because the lease provisions incorporate regulations only if they are "not inconsistent with lease rights granted or specific provisions of th[e] lease." They argue (Pet. 19) that the regulations are not "consistent with the bargain in the lease contract that lessees owed royalties on the value of production at the lease." In petitioners' view, because marketing gas sold away from the lease increases the value of that gas, the costs of such marketing should be deductible.

Petitioners' contention is mistaken. As the court of appeals explained, the regulations historically have "called for calculation of royalty on the basis of 'gross proceeds'" received by the lessee. Pet. App. 2a. When gas is sold at the leasehold, the *only* deduction from gross proceeds permitted is for certain processing costs not otherwise relevant here. See pp. 5-6, *supra*. Thus, as the court of appeals noted, petitioners "acknowledge that marketing costs for sales *at the lease* have historically been nondeductible." Pet. App. 9a.[6] The fact that effective marketing efforts related to selling gas at the lease result in the lessee's receiving a better price for its production does not make those costs deductible.

The same principle applies to gas sold away from the lease. The regulations historically have permitted a deduction for "transportation costs when production is sold at a market away from the lease." Pet. App. 2a. But the regulations have never permitted lessees to deduct marketing costs simply because the gas is sold

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[6] Petitioners argue (Pet. 19) that "[t]he court of appeals never addressed the premise on which the Department based the 1997 regulation: that the statutory and lease contract provision[] limiting the government's royalty claim to the value of production at the lease was trumped by the lessees' 'implied' contractual duty to market production without cost to the lessor." Contrary to petitioners' assertion, however, the longstanding implied covenant of federal lessees to market production, see, *e.g.*, *Walter Oil & Gas Corp.*, 111 I.B.L.A. 260, 265 (1989); *Arco Oil & Gas Co.*, 112 I.B.L.A. 8, 11 (1989), does not "trump" the statutory and lease provisions. Instead, it is perfectly consistent with them. The court of appeals expressly recognized that marketing costs have never been and should not now be deductible in determining the "value of production," regardless of whether the gas is sold at the lease or away from it. See, *e.g.*, Pet. App. 11a (noting that there is "nothing unreasonable in [the Secretary's] hewing to the old line between [nondeductible] marketing and [deductible] transportation").

away from the lease. *Id.* at 3a. As with gas sold at the leasehold, the fact that marketing efforts may result in the lessee's obtaining a better price for the gas, as petitioners assert (*e.g.*, Pet. 20), does not make those marketing costs deductible. The Secretary's new regulations simply carry forward the longstanding principle that the value of production at the lease is based on what the lessee receives for the gas, wherever the lessee chooses to sell it, minus the lessee's actual costs of moving the gas to any remote point of sale. In the 1997 regulations, the Secretary applied that established principle to the new circumstances in which unbundled pipeline charges make it possible more accurately to distinguish between deductible transportation costs and nondeductible other costs. See Pet. App. 11a-12a. The regulations are thus entirely consistent with the statutory mandate that royalties be calculated based on the "value of production," as well as with the incorporation of the same standard in gas leases.

c. In short, the basic structure and scheme of the mineral leasing statutes and the lease terms that govern the lessees' royalty obligations lead to the same conclusion. The mineral leasing statutes establish royalty as a percentage of the "value of production," provide no further definition of that term, and grant the Secretary broad rulemaking authority to implement the statutes and administer mineral leasing. The leases similarly base the royalty on the "value of production" and expressly recognize that they are entered into subject to and pursuant to the Secretary's regulations. The recognition in the leases of the continued authority of otherwise valid regulations is a basic term of the bargain to which the lessee agrees when it enters into the lease. Accordingly, application of *Chevron* principles to the Secretary's regulations is required by the statutory delegation of authority and fulfills the terms of the bargain to which the lessee agreed.

2. Petitioners argue (Pet. 24-25) that, under *United States* v. *Seckinger*, 397 U.S. 203 (1970), lease terms must be construed against the drafter (here, the government)—the *contra proferentem* doctrine. *Seckinger*, however, involved the question whether an indemnification clause in a government construction contract should be construed to permit the government to recover indemnification from the contractor for the government's own negligence. The case had nothing to do with the scope of regulatory authority delegated by Congress; there were no regulations pertinent to the question the Court decided; and the contract at issue did not purport to incorporate any government regulations. The Court's adoption of ordinary principles of contract interpretation—including the doctrine of *contra proferentem*, see *id*. at 210-211—to resolve the question presented in *Seckinger* provides no authority for petitioners' argument that *Chevron* principles should be disregarded in construing the regulations challenged in this case.

3. Petitioners also contend (Pet. 26-27) that the decision of the court of appeals conflicts with decisions of several other courts of appeals that have construed government contracts in accordance with settled principles of contract law. There is no conflict. None of the decisions cited by petitioners adopted the rule of law they advance here—that *Chevron* deference does not apply to an agency's regulatory interpretation of a statute it administers if the regulations are incorporated in contracts between the government and private parties.

a. In *Meadow Green-Wildcat Corp.* v. *Hathaway*, 936 F.2d 601 (1st Cir. 1991) (Breyer, J.), a Forest Service "Term Permit" provided that the permittee's fee would be based on a fixed amount unless "an error is found in [that] amount." *Id.* at 603. The court construed the term "error" in the permit de novo under general principles of the law of contracts, without giving deference to the construction for which the government argued. In *Meadow-Green*, the term at issue ("error") was not a statutory term that had been incorporated into the permit at issue; there were no regulations that addressed the meaning of that term; and nothing in the permit itself purported generally to incorporate existing and future regulations. In this case, by contrast, the term at issue is a statutory term—"value of production"—that is used in the individual leases; the government's interpretation of that term is embodied in a formal regulation; and the leases themselves expressly recite that they are entered into pursuant to and subject to present and future regulations. Accordingly, the court's determination in *Meadow-Green* not to defer to the government's construction of the permit in that case provides no support for petitioners' claim that no deference is due to the Secretary's regulations in this case.

b. Petitioners also cite (Pet. 26) a series of Federal Circuit cases for the proposition "that no deference is given to agency interpretations of regulations incorporated into government contracts (or of the contracts themselves) where, as here, the government has a financial stake in the contract." Those cases, however, do not support petitioners' argument here.

In one of the cases cited, *Southern California Edison Co.* v. *United States*, 226 F.3d 1349 (Fed. Cir. 2000), the court in fact did defer to the government's construction of its regulations, in part because "Congress delegated significant responsibility for the administration of the[]

* * * contracts to the Secretary," and therefore "the statutory and regulatory framework supports the application of judicial deference." *Id.* at 1358. Deference is warranted here for precisely those same reasons.[7]

In two other cases cited by petitioners, the Federal Circuit simply recited the general principle that "the interpretation of a [government] contract is reviewed as a matter of law, with no deference owing to the interpretation adopted by * * * the agency." *Lockheed Martin IR Imaging Sys., Inc.* v. *West*, 108 F.3d 319, 322 (Fed. Cir. 1997); see *Metric Constructors, Inc.* v. *NASA*, 169 F.3d 747, 751 (Fed. Cir. 1999) ("This court reviews contract interpretation without deference."); see also *Tennessee Gas Pipeline Co.* v. *FERC*, 17 F.3d 98 (5th Cir. 1994) (same for non-government contracts) (cited at Pet. 27). Neither case addressed the question whether *Chevron* deference ordinarily due to an agency's interpretation of a statutory term embodied in

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[7] Another case cited by petitioners (see Pet. 26), *Burgin* v. *Office of Personnel Management*, 120 F.3d 494 (4th Cir. 1997), involved a claim by a federal employee for benefits assertedly due under a health plan purchased from a private insurer pursuant to the Federal Employees Health Benefits Program. The court declined to defer to the conclusion of the Office of Personnel Management (OPM) that, on the facts of the case, the employee was not entitled to the benefit. *Id.* at 497-498. Because *Burgin* had nothing to do with the validity of a regulation or *Chevron* deference, its holding has little relevance here. It is noteworthy, however, that the court in *Burgin* noted that it would "show substantial deference to an agency's interpretations of its own regulations, relying on the agency's unique expertise and policymaking prerogatives," and that it would therefore "defer to the agency's determination of whether a health benefits contract meets regulatory requirements." *Id.* at 497 (citation and internal quotation marks omitted). Those principles suggest that the Fourth Circuit would agree with the decision of the court of appeals in this case.

a regulation adopted pursuant to an express delegation of authority by Congress should be denied, because the regulation would affect royalties due under contracts with the government that expressly incorporate the regulation. Neither case accordingly provides any support for petitioners' argument.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[8] One other case cited by petitioners (Pet. 26), *Brown* v. *United States*, 195 F.3d 1334 (Fed. Cir. 1999), did involve the construction of a regulation that had been incorporated into a contract. The court stated that "[t]o the extent the trial court's determination turned on its interpretation of [the regulation], it presents questions of law subject to *de novo* review." *Id.* at 1340. That statement regarding the proper scope of appellate review has nothing to do with the issue in this case. The court in *Brown* had no occasion to—and did not—consider whether *Chevron* deference is owed to agency regulations that have been incorporated into contracts.