INTERIOR BOARD OF LAND APPEALS

Shell Oil Co. (On Reconsideration)

132 IBLA 354 (May 11, 1995)

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<u>Editor's Note</u>: Reconsideration denied by order dated July 17, 1995; <u>appeal</u> <u>filed</u>, Civ. No. 95-492 MMS (D. Del.), <u>venue</u> <u>held</u> <u>proper</u>, 920 F.Supp. 559 (March 13, 1996), <u>aff'd</u>, 945 F.Supp. 792 (Nov. 14, 1996); <u>aff'd</u>, 125 F.3d 172 (3rd Cir. Sept. 19, 1997).

SHELL OIL CO.
(ON RECONSIDERATION)

IBLA 91-266 Decided May 11, 1995
130 IBLA 93 (1994)

Petition for reconsideration of a Board of Land Appeals decision reversing a decision of the Director, Minerals Management Service, that required production of sales contracts and other documents concerning crude oil sales from Federal leases. MMS-90-0217-O&G.

Petition for reconsideration granted; <u>Shell Oil Co.</u>, 130 IBLA 93 (1994), reversed; Director's decision affirmed.

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

MMS had statutory and regulatory authority to require production of documents concerning crude oil sales contracts made by an affiliate of a Federal oil and gas lessee that were needed to insure there had been compliance with the gross proceeds rule established by Departmental regulation 30 CFR 206.102(h) (1989).

APPEARANCES: Sarah L. Inderbitzin, Esq., Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service; William G. Riddoch, Esq., Houston, Texas, for Shell Oil Company.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

In <u>Shell Oil Co.</u> (<u>Shell</u>), 130 IBLA 93 (1994), the Board of Land Appeals reversed a March 1, 1991, decision of the Director, Minerals Management Service (MMS), that required Shell Oil Company (Shell) and Shell Western Exploration and Production Inc. (SWEPI), to produce documents concerning crude oil production from 32 Federal onshore oil and gas leases in California between January 1, 1985, and December 31, 1988. On October 3, 1994, MMS petitioned for reconsideration of <u>Shell</u>, alleging the decision failed to adequately consider the effect of Departmental regulation 30 CFR 206.102(h) (1989), incorrectly interpreted the rule at 30 CFR 206.102(b)(1)(i) (1989), improperly relied upon valuation regulations effective March 1, 1988, for the audit period 1985 through 1988, and was inconsistent with a holding made in <u>Santa Fe Energy Products Co.</u>, 127 IBLA

265 (1993), that ordered production of records of sales to third parties by a sales affiliate. On December 14, 1994, we ordered reconsideration, finding, in response to an allegation by MMS, that the Board did indeed conclude in Shell that "if MMS can establish a reasonable value for SWEPI's production using the benchmarks in [30 CFR] 206.102, there is no need to consider what the gross proceeds are" (Order dated Dec. 14, 1994, at 1). Upon reconsideration, Shell is reversed, and the March 1991 decision by the Director, MMS, is affirmed.

SWEPI, a wholly owned operating subsidiary of Shell, was the operator and designated royalty payor for the subject Federal leases. During the time in question, SWEPI sold all crude production from the leases to Shell pursuant to an agreement that established the price for crude oil purchases at Shell's adjusted posted price, or, if Shell had no posted price for the area or production type, the market price as reasonably determined by Shell. The Shell decision here under review, construing valuation regulations at 30 CFR 206.102(b) and (c), concluded that royalty computations should be made using the rule applicable to transfers of production not made under an arm's-length contract. In so doing, we held that since SWEPI did not post prices or have arm's-length sales contracts for like quality oil, "the arithmetic average of contemporaneous third party posted prices for like quality oil in the same field establishes reasonable value for royalty calculation under [30 CFR] 206.102(c)(2)." 130 IBLA at 97. Neither Shell nor MMS has challenged that conclusion.

In response to MMS' contention that information concerning Shell's disposition of the production from the leases was needed in order to determine the gross proceeds accruing to SWEPI, however, we found that:

> Such information may be sought from a lessee's market affiliate in order to establish gross proceeds in accordance with both 30 CFR 206.103 (1987) and 30 CFR 206.102(b)(1)(i). See Santa Fe Energy Products Co., 127 IBLA at 265. Shell, however, is not SWEPI's marketing affiliate, and, contrary to the contention by MMS, this case is distinguishable from Santa Fe Energy Products Co. for that reason, since in that case there was a transfer to a marketing affiliate.

Shell, 130 IBLA at 97. In so doing, we begged the question whether, assuming the valuation method employed to compute royalty was reasonable, MMS must nonetheless determine gross proceeds accruing to the lessee in order to establish minimum value.

[1] Departmental regulation 30 CFR 206.102(h) (1989) provides that "[n]otwithstanding any other provision of this section, under no circumstances shall the value of production, for royalty purposes, be less than

the gross proceeds accruing to the lessee for lease production." The preamble to this rule explains that:

> The purpose of § 206.102(h) is to make it clear that no matter what valuation method is used, the value for royalty purposes cannot be less than the lessee's gross proceeds less applicable allowances. Therefore, if a benchmark derived value less applicable allowances is less than gross proceeds less applicable allowances, gross proceeds less applicable allowances is to be used as the value for royalty purposes.

52 FR 30826, 30843-44 (Aug. 17, 1987). Consequently, no matter what regulatory benchmark is used to determine royalty, MMS must compare the result obtained thereby against a gross proceeds analysis in any case.

Considering whether MMS was authorized to demand production of sales contracts and exchange agreements for transactions beyond the point of first sale, the Board found in Santa Fe Energy that the obligation to report gross proceeds accruing to the lessee cannot be avoided by an inter-affiliate transfer made in contemplation of later sale to third parties. Id., 127 IBLA at 268. It was there concluded that a request by MMS for production of petroleum records could not be satisfied by a report that, as between affiliated corporations, the posted price was used to facilitate transfer of Federal crude oil to the marketing company. Id. at 268. Upon reconsideration of the question whether MMS had authority to require disclosure of information regarding the transfer of production to Shell in this case, therefore, we find that the marketing affiliate distinction, upon which the Shell decision turned, had no relevance to the question whether the gross proceeds rule must first be applied.

The Federal Oil and Gas Royalties Management Act, 30 U.S.C. § 1711 (1988), requires the Secretary to "establish a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties." 30 U.S.C. § 1711(a) (1988). See also Phillips Petroleum Co. v. Lujan, 963 F.2d 1380 (10th Cir. 1992). Administrative agencies vested with investigatory power have broad discretion to require the disclosure of information concerning matters within their jurisdiction. See Phillips Petroleum Co. v. Lujan, 951 F.2d 257, 260 (10th Cir. 1991), and cases cited therein. Accordingly, MMS has authority to demand production of documents relevant to royalty determination. While it may direct such a request concerning SWEPI's sale to Shell, the question here is whether MMS may demand information regarding Shell's sales to third parties so as to determine the value of production from the Federal leases at issue.

Departmental regulations establish that parties are affiliated if one controls, or is controlled by, or is under common control with another.

30 CFR 206.101 (arm's-length contract). The term lessee, however, is specific and cannot be expanded to include an affiliate of the lessee. 30 CFR 206.101 (lessee). In support of the argument by Shell that it is an affiliate, but not the lessee, and therefore need not produce sales records demanded by MMS, Shell has furnished a copy of an MMS policy paper, Valuation of Sales to Affiliates, dated October 14, 1993. Shell contends that this document is consistent with the valuation regulations and provides support for our prior Shell decision that excused Shell from reporting to MMS because Shell was not a marketing affiliate (as that term is defined by 30 CFR 206.101). Pertinently, the policy paper states that:

> The gross proceeds accruing to the lessee are considered the minimum value for royalty purposes. The gross proceeds standard is applicable to both arm's-length and non-arm's-length sales. Gross proceeds may be reduced by appropriate processing and transportation allowances, but may not be reduced by costs associated with marketing the production, whether the contract is arm's-length or non-arm's-length.

(Policy Paper at 2). With respect to sales of oil after March 1, 1988, from a lessee to an affiliate (other than a marketing affiliate), the paper states:

> The value for both oil and gas is to be determined by the first applicable benchmark [in 30 CFR 206.102(c)] * * *.
>
> When applying the benchmarks, it is necessary to consider the gross proceeds requirement discussed previously. Gross proceeds may not be reduced by costs to place the product in marketable condition or marketing costs. If the resale from the affiliate to a third party occurs in the same field as the first sale from the lessee to the affiliate and if the affiliate is performing services other than transportation or processing (i.e., marketing services), the resale price would represent the minimum value for royalty purposes under the gross proceeds requirement. [Emphasis in original.]

(Policy Paper at 3-4).

Contrary to the argument advanced by Shell, therefore, the policy paper also indicates that there is an obligation and an expectation that MMS will look beyond any inter-affiliate transfer to determine whether other factors affect production value. As suggested in Santa Fe, supra, affiliates participating in a transfer of Federal lease production in contemplation of sales to a third party should expect MMS to scrutinize any inter-affiliate transfer and all subsequent affiliate sales. As a result, SWEPI and Shell should have anticipated that MMS would review

their handling of Federal production in order to properly determine royalty in accordance with statutory and regulatory requirements; they must therefore provide the relevant information sought by MMS. Accordingly, we find that Departmental regulations implementing 30 U.S.C. § 1711 (1988) anticipate that MMS will need to seek such information and provide the necessary authority that it may do so.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, Shell Oil Co., 130 IBLA 93 (1994), is reversed and the 1991 MMS Director's decision is affirmed.

Franklin D. Arness
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge