

INTERIOR BOARD OF LAND APPEALS

Pogo Producing Co., et al.

138 IBLA 142 (February 10, 1997)

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Editor's Note: Reconsideration denied by order dated September 22, 1997; appeal filed, sub nom. IMC Kalium Carlsbad v. Babbitt, Yates Petroleum, and Pogo Producing, Civ. No. 97-1524 JC (D. N.M. Nov. 26, 1997); rev'd Jan. 12, 1999, 32 F.Supp.2d 1264; appeal filed, by Pogo and Yates, not by Interior; No. 99-2047 (10th Cir.); rev'd D.Ct. (thus affirming IBLA) (March 16, 2000); 206 F.3d 1003

POGO PRODUCING CO. ET AL.

IBLA 93-246

Decided February 10, 1997

Appeal from a decision of the Deputy State Director, Lands and Minerals, New Mexico State Office, Bureau of Land Management, rejecting the high bid for competitive potassium lease NMNM 86719.

Reversed and remanded.

1. Potassium Leases and Permits: Generally—Potassium Leases and Permits: Leases

The Secretary of the Interior has discretionary authority to reject a high bid in a competitive potassium lease sale where the record discloses a rational basis for the rejection. A BLM decision rejecting a high bid in a competitive potassium lease sale on the grounds that the bid was not made in good faith and that lease issuance would not be in the best interest of the recovery of potash resources will be reversed where the record does not support BLM's supposition that the high bidders have no intention of developing the potassium resources subject to the lease or its conjecture that potash resources will be wasted if the bidders acquire the lease.

APPEARANCES: Gregory J. Nibert, Esq., and Christine E. Lale, Esq., Roswell, New Mexico, and A.J. Losee, Esq., Ernest L. Carroll, Esq., and Mary Lynn Bogle, Esq., Artesia, New Mexico, for appellants; Margaret Miller Brown, Esq., Office of the Field Solicitor, U.S. Department of the Interior, Santa Fe, New Mexico, for the Bureau of Land Management; Dan Morehouse, Superintendent of Mine Engineering and Construction, Carlsbad, New Mexico, Charles C. High, Jr., Esq., El Paso, Texas, and James R. Bird, Esq., Washington, D.C., for intervenor IMC Fertilizer, Inc.

OPINION BY ADMINISTRATIVE JUDGE IRWIN

Pogo Producing Company and Yates Petroleum Corporation (applicants or appellants) have appealed the January 5, 1993, decision of the Deputy State Director, Lands and Minerals, New Mexico State Office, Bureau of Land Management (BLM), rejecting their high bid for tract No. 2 offered at the competitive potassium lease sale held on August 20, 1992. BLM concluded that the bid "was made in bad faith and not in the best interest of recovery of the potassium resources. Additionally, the proposed plan submitted could pose an undue economic hardship on the potash industry" (Decision at 1).

This appeal involves the continuing conflict between oil and gas lessees and potash lessees over proper development of those resources within the designated Potash Area near Carlsbad, New Mexico, established by an October 21, 1986, order of the Secretary of the Interior, 51 FR 39425 (Oct. 28, 1986) (1986 Order). See generally Yates Petroleum Corp., 131 IBLA 230 (1994).

By letter dated April 30, 1991, IMC Fertilizer, Inc. (IMC), requested BLM to offer potassium leases by competitive sale in T. 22 S., R. 31 E., New Mexico Principal Meridian (NMPM), in Eddy County, New Mexico, within the designated Potash Area. In response to this request, BLM held a competitive potassium lease sale in Carlsbad, New Mexico, on August 20, 1992, offering 2 parcels of land: Parcel No. 1 consisting of 640 acres in secs. 34 and 35, T. 22 S., R. 29 E., NMPM, and Parcel No. 2 embracing 5,280 acres of land in secs. 3, 4, 5, 8-11, 13, 14, 23, 24, and 26, T. 22 S., R. 31 E., NMPM. Both the written detailed statement of the lease sale and the oral statement opening the sale informed the bidders that the Secretary of the Interior reserved the right to reject any and all bids, as well as the right to offer the lease to the next qualified bidder if the successful bidder failed to obtain the lease for any reason. See 43 CFR 3535.3-3(f). 1/ Applicants and IMC bid for Parcel No. 2, with applicants ultimately submitting the high bid of \$6 per acre.

By decision dated October 22, 1992, BLM rejected applicants' potassium lease bid. In this decision BLM referred to "detailed economic mining information" presented in a report written by George Warnock, applicants' consultant. The information was prepared before the bidding process but not received by BLM until afterwards, BLM's October 22 decision stated. "Mr. Warnock stated why the applicants cannot economically recover the potash from the leased area," BLM's decision stated.

His report states that the only company which can mine the tenth ore zone * * * is the * * * (IMC) [and] * * * states IMC is the only operator in the Carlsbad potash District capable of processing mixed langbeinite and sylvite ore. The report also states that Western Ag Minerals could conceivably mine the lease. The IMC showed serious interest in the lease by their bidding at the lease sale.

(Oct. 22, 1992, Decision at 1). BLM stated: "There are three ore zones present in the lease area; the second, the fourth, and the tenth. There is

1/ 43 CFR 3535.3-3(f) provides: "The authorized officer shall also prepare and make available a detailed statement of sale containing: * * * (f) A statement that the Secretary reserves the right to reject any and all bids, and the right to offer the lease to the next qualified bidder if the successful bidder fails to obtain the lease for any reason * * *."

also indicated ore in the eighth zone. * * * We conclude the area can be mined. Not mining this area for potash would result in undue waste of potash." Id. at 1-2.

BLM found applicants' actions prior to the lease sale, including filing applications for permits (APD's) to drill oil and gas wells within the lease boundaries and appealing BLM decisions that rejected some of these APD's, together with the statement that only IMC could successfully mine the lease area, indicated major langbeinite deposits would not be mined if the lease were issued to applicants. "The statement by Mr. Warnock on behalf of applicants, prior to lease issuance, that the lessee does not intend to develop the deposit exhibits bad faith," BLM stated. 43 CFR 3594.1(a) provides that "[m]ining operations shall be conducted in a manner to yield the ultimate maximum recovery of the mineral deposits * * *," BLM noted. "The Warnock report indicates that only IMC and perhaps Western Ag Minerals are capable of mining the potash reserves," BLM stated, adding that, despite their interest in acquiring the lease, applicants had expressed no desire to mine, joint venture, or otherwise promote potash development. BLM rejected applicants' lease bid, citing 43 CFR 3535.6. 2/ BLM also rejected the bid under 43 CFR 3535.3-3(f), supra note 1.

Applicants sought reconsideration of the October 22, 1992, decision and met with BLM on November 19, 1992, to explain the genesis of their decision to bid on the lease and to present evidence documenting the evolution of that decision. The supplemental materials included separate reports by Leo Lammers and Gary L. Hutchinson, independent consultants hired by applicants to evaluate the offered leases, detailing the presale geologic and economic analyses undertaken to ascertain the potential for economic return from lease acquisition. 3/ Applicants contended that these documents demonstrated that their bid was made in good faith upon a well-founded belief that, based on data currently available, at least the fourth ore zone subject to the offered lease contained a potentially economic deposit of potash. In addition, applicants argued it was improper for BLM to consider the exploration and mining regulations in 43 CFR Part 3590 in determining whether they were qualified bidders. Applicants also argued

2/ 43 CFR 3535.6 provides:

"(a) If the high bid is rejected for failure of the successful bidder to sign the lease form and pay the balance of the bonus bid, or otherwise comply with the regulations of this subpart, the one-fifth bonus accompanying the bid shall be forfeited to the United States.

"(b) If the lease cannot be awarded for reasons determined by the authorized officer to be beyond the control of the successful bidder, the authorized officer shall reject the bid and the deposit submitted with the bid shall be returned."

3/ See, e.g., Exhs. 4, 7, 12, and 13, Yates Petroleum Corporation Review of Work Done in Preparation for Bidding at the Aug. 20, 1992, BLM Potassium Sale, Eddy County, New Mexico, submitted to BLM State Director Larry Woodard on Nov. 19, 1992, by A.J. Losee, Esq., with an accompanying Letter of the same date.

that 43 CFR 3535.3-3(f), supra note 1, does not give the Secretary unfettered discretion to reject a bid. Applicants argued that the fact that IMC was the only operator in the Potash District currently capable of processing mixed langbeinite and sylvinite ore should not preclude issuance of a lease to another bidder. Applicants objected to BLM's reliance on Warnock's remarks made in another context, for another purpose, as manifesting applicants' bad faith.^{4/} On November 24, 1992, BLM withdrew its October 22, 1992, decision in order to retain jurisdiction over the matter pending review of the material submitted by applicants.

In his January 5, 1993, decision the Deputy State Director rejected applicants' high bid for tract No. 2 again, concluding that the bid was made in bad faith and not in the best interest of recovery of the potassium resources and that the proposed plan outlined in the supplemental materials, which envisioned simultaneous development of oil and gas and potash resources, could pose an undue hardship on the potash industry. BLM's decision was based on applicants' "presentation of two conflicting mineral development scenarios, their attempt to acquire the potash lease to develop oil and gas, and their proposal for development in violation of the [1986 Order]," and again cited 43 CFR 3535.6 and 3535.3-3(f), supra.

The Deputy State Director amplified the grounds for his decision. He noted that applicants' statement of reasons (SOR) in support of their appeals of BLM's denials of numerous APD's for wells located in secs. 11, 14, and 23 within the potash lease area due to potash considerations, filed after the competitive potassium lease sale, asserted that the potash resources, at least under sec. 23, were not economic or minable. Additionally, technical reports and cost analyses prepared by Warnock for appeals of the APD denials stated that applicants were economically unable to mine the subject lease and that only IMC could profitably mine the potash reserves. On the other hand, applicants' supplemental materials submitted to BLM on November 19, 1992, including maps and notes on cost analyses, indicated that a potentially economically significant deposit of langbeinite existed within the lease boundary, including areas embraced by the appealed APD's. This information, chiefly authored by Hutchinson, who utilized cutoff grades considerably higher than those used by the potash industry, supported applicants' ability to construct and operate a mine based on fourth ore zone reserves of approximately 1,700 acres extending over parts of 7 sections. The Deputy State Director found applicants' espousal of these seemingly incompatible positions, i.e., arguing that the potassium deposit was uneconomic when seeking approval of APD's while contending that the potash was economic when pursuing a potassium lease, were "evidence of bad faith in that neither company, being oil and gas companies by nature, seriously intends to develop the potassium resources" and contradicted the general policy of the 1986 Order "insofar as a company attempts to obtain a potassium lease for the purpose of developing oil and gas resources" (Decision at 3).

^{4/} See Letter dated Nov. 19, 1992, to BLM State Director Larry Woodard from Gregory J. Nibert, Esq.

As to the simultaneous development of potash and oil and gas resources suggested by applicants' counsel in the letter accompanying the supplemental materials, the Deputy State Director observed that no simultaneous development of both resources had occurred since promulgation of the 1986 Order. Not only would such development violate that Order, but, he added, simultaneous development would disregard the safety of the miners working underground since hydrocarbons could migrate from a producing well into the potash bearing formation and pose a hazard to future mining operations. Furthermore, any significant hydrocarbon release would prompt the Mine Safety and Health Administration (MSHA) to declare all or part of the potash basin as gassy, thus necessitating the use of fire safe equipment, the extra expense of which would place an undue economic hardship on affected potash operations or force those operations to close.

The Deputy State Director found that Hutchinson's use of high grade cutoffs as the basis for his economic analysis of lease development eliminated recovery of potash reserves in the 2nd and 10th ore zones, observing that the 10th ore zone within secs. 11, 14, and 23 formed a substantial area of the potassium lease. Since these 3 sections contained the sites of 21 of the APD's that were denied and appealed, the Deputy State Director stated Hutchinson's "high grading" scenario "further demonstrates bad faith by the applicant" (Decision at 4).

The Deputy State Director also faulted Hutchinson's analysis for focussing solely on the cost of initiating a new operation on the lease and ignoring the option of subleasing the 10th ore zone to an established potash operation which had already incurred capital costs and could profitably mine lower grade ore, the possibility of mining lower grade ores once capital costs had been met, and other alternatives to enhance the Ultimate Maximum Recovery (UMR) of the deposit. "Therefore, the applicants[] proposed development plan would not be in the best interest of UMR (43 CFR 3594.1)." Id. 5/

In their SOR, appellants argue that the applicable regulations mandate that BLM award a competitive lease to the high bidder as long as that bidder is qualified and the bid equals or exceeds the minimum value placed on the acreage by BLM. They contend that they have indisputably satisfied all the regulatory requirements for a qualified bidder and have submitted

5/ Although the record contains a copy of a Jan. 7, 1993, BLM decision awarding the lease to IMC as the second high bidder, the lease issued to IMC on Mar. 5, 1993, pursuant thereto, NM 90581, was cancelled by BLM on Dec. 10, 1993, in accordance with an Oct. 28, 1993, stipulated judgment entered in U.S. District Court. Pogo Producing Co. & Yates Petroleum Corp. v. BLM, Civ. No. 93-0213 JP (D. N.M. Oct. 28, 1993). For our decision on IMC's appeal of BLM's Dec. 10, 1993, decision, docketed as IBLA 94-244, see IMC Fertilizer, Inc., 138 IBLA 160 (1997).

all the necessary statements and funds to entitle them to receive the lease. BLM's rejection of their high lease bid, they assert, stems from the agency's improper consideration of irrelevant criteria and unfounded speculation.

Appellants contend that their subjective motivation is irrelevant since the competitive leasing regulations neither require nor authorize BLM to speculate as to the impetus for a bidder's decision to seek a lease. In any event, they deny that their bid was made in bad faith, pointing to the supplemental materials as definitive evidence that the decision to bid grew out of exhaustive research and analysis leading to the conclusion that acquisition of the lease had considerable profit potential. They aver that BLM's reliance on an alleged inconsistency in appellants' position is not only inappropriate but also factually inaccurate since BLM took Warnock's statements, which were made for an entirely different purpose and covered a much more limited geographic area than Hutchinson's analysis, completely out of context. Appellants insist that, properly construed, Warnock's study, generated in connection with APD denials and directed at assessing the probability of interference of oil and gas development with mining in a single section, sec. 23, and Hutchinson's analysis, designed to evaluate the potential for potash development over more than 12 sections of land, including sec. 23, exhibit no inconsistency since the potentially economic potash area reflected on Hutchinson's map is well outside the area of actual or proposed oil and gas development addressed by Warnock. Appellants presented the supplemental materials to BLM, they explain, to substantiate the economic analysis undertaken before deciding to bid on the lease. Since those materials reflected a likelihood of economic return to appellants if they acquired the lease, they assert that BLM's bad faith determination ignores the facts revealed by those materials and rests solely on unfounded speculation and conjecture.

Appellants dispute the Deputy State Director's statement that, as oil and gas companies, they do not seriously intend to develop the potassium resources, arguing that not only do the competitive leasing regulations not require a present ability to develop, but also that they have significant geological and engineering staffs and mineral interests other than oil and gas. In any event, appellants reiterate that the supplemental materials sufficiently establish their intent to develop the potassium resources. Appellants also deny BLM's suggestion that, contrary to the 1986 Order, they seek to obtain a potassium lease for the purpose of developing oil and gas resources. Acquisition of a potassium lease has no bearing on the development of oil and gas resources, they maintain, since BLM retains the authority to approve or disapprove any oil and gas APD for the lease area.

Appellants contend that BLM's concerns about simultaneous development are similarly misplaced because simultaneous development does not constitute a hazard to underground miners and, moreover, such considerations have no bearing on whether appellants qualified for lease issuance. Furthermore, appellants assert that simultaneous development does not contradict the 1986 Order since that Order mandates the establishment of drilling islands within potash enclaves and authorizes drilling in barren

areas within the enclaves. Thus, the Deputy State Director's statement that awarding them the lease would not be in the best interest of the potassium resources is improper, appellants submit, because not only do the competitive leasing regulations not authorize such an assessment at the bid acceptance stage, but also his conclusion is directly contradicted by the evidence in the record.

Appellants argue that none of the regulations cited by the Deputy State Director as grounds for rejecting their bid supports his decision. They insist that 43 CFR 3535.3-3(f), rather than authorizing the Secretary to discriminate against a high bidder not historically in the potash industry in favor of an existing potash producer which submits a lower bid, restricts the Secretary's bid rejection discretion to only those situations where the successful bidder fails for some reason to obtain the lease or where a violation of the regulations exists. Nor do 43 CFR 3535.6 and 43 CFR 3590 sustain BLM's rejection, appellants assert, since 43 CFR 3535.6 simply directs BLM to either retain or return the bonus bid after bid rejection, depending on the reason for the rejection, and 43 CFR 3590 concerns post-lease issuance exploration and mining operations, not lease issuance criteria. In this regard, appellants note that their supplemental materials did not amount to a mineral development scenario or a mine or exploration plan since such strategies can be developed only after lease issuance and subsequent exploration work and are not required at the lease bidding stage.

Appellants also contend that Board precedent establishes that the only appropriate grounds for bid rejection are the bidder's failure to comply with the regulations or the inadequacy of the bid and that any high bid rejection must be supported by a rational basis as reflected in the record. Appellants submit that BLM's rejection of their high bid for reasons other than those set forth in the regulations and Board decisions, coupled with BLM's efforts to ensure that IMC received the lease, have effectively destroyed the competitive leasing process and undermined the belief that the system is fairly administered and that, therefore, BLM's arbitrary and capricious bid rejection must be reversed. ^{6/}

In its response ^{7/}, BLM characterizes this case as the first in which a party has attempted to obtain a potash lease while exhibiting conflicting

^{6/} Included as an attachment to appellants' SOR is a letter from Hutchinson to them commenting on the Deputy State Director's rejection decision, offering additional analysis and explication of the processes leading to the decision to bid for the lease, and elaborating on the rationale for his belief that the potash resource subject to the lease is potentially economic but that further exploration work must be performed to determine the actual commercial potential of the deposit before specific mining development options, including subleasing, can be evaluated.

^{7/} BLM's response consists of a cover letter from the Solicitor's Office incorporating two attached memoranda, one written by BLM geologist James A. Olsen, responding page by page to appellants' SOR, and the other authored

interests apparently outweighing the development of the potash resources on the lease. BLM acknowledges that appellants are qualified bidders under the competitive leasing procedures but maintains that its rejection of their high bid falls within its discretion under 43 CFR 3535.3-3(f) to reject any and all bids, relying on the absence of published restrictions limiting that right as support for its view that rejections for apparent bad faith are permissible. The crux of BLM's opposition to awarding the lease to appellants is appellants' status as oil and gas companies that have appealed BLM denials of APD's for oil and gas wells in the potash area and BLM's belief that appellants, therefore, appear to have a strong motive not to develop the potash resources in sections where they have potential oil and gas reserves. BLM claims that appellants' actions to date have consistently supported such a motive and undercut appellants' insistence that their bid was made in good faith. Warnock's and Hutchinson's studies—which, BLM maintains, cover the same area but present conflicting results since some of the minable reserves delineated by Hutchinson, whose study BLM considers reasonable, include land affected by the APD's—further undermine appellants' assertions of good faith. ^{8/} The uncertainty introduced by appellants, BLM explains, precludes it from agreeing with appellants' claim that awarding them the lease would be in the best interest of recovery of potash reserves.

BLM expands on its safety and undue hardship concerns, speculating that hydrocarbon production could release methane gas into otherwise minable ore zones, creating gassy mine conditions which would necessitate the use of expensive permissible equipment and possibly make mining unprofitable. BLM also disputes appellants' contention that issuing the lease to them would not affect oil and gas development in the potash area since BLM must still approve APD's, noting that if appellants obtained the lease, they would be able to designate protected potash reserves and might select reserves which would not interfere with their proposed drilling. Although BLM admits that it could refuse to accept such a designation, appellants could contest the rejection, adding to BLM's financial burden. BLM also clarifies its definition of simultaneous development as including active development of both resources in closer proximity than authorized by BLM and suggests that the safest way to extract both minerals appears to be to mine the potash first and then extract the hydrocarbons after second mining subsidence has ceased.

IMC, which was granted intervenor status by Board order dated May 14, 1993, argues that BLM's decision must be upheld because, if appellants are awarded the lease, potassium resources will be wasted by increased oil well

fn. 7 (continued)

by BLM mining engineer Craig C. Cranston, addressing each point raised in Hutchinson's letter. The synopsis of BLM's arguments presented in the text is based on Olsen's memorandum.

^{8/} BLM agrees that appellants were not required to present mineral development scenarios and that economic analyses done before mining are subject to considerable change, but insists that once the reports became part of the record, the agency was obligated to consider them.

drilling activity. IMC asserts that the BLM decision maximizes the total recovery of both potash and oil and gas and that BLM properly exercised its regulatory right to reject any and all bids by refusing to accept appellants' high bid, since that action comports with BLM's duty to maximize resource values for the public rather than simply lease natural resources to the highest bidder. IMC stresses safety concerns, noting that while oil and gas can be recovered after mining has been completed, mining near abandoned oil and gas wells may never occur due to the safety hazard presented by the possibility of encountering methane gas. Appellants' motives are relevant, IMC contends, because BLM may not lease resources to those who would wantonly and recklessly waste them. While conceding that appellants could receive an economic return from potash mining, IMC suggests that appellants' real profit potential derives from the additional revenue that could be generated if additional wells were drilled and some of the potash wasted. In short, IMC maintains that since appellants' business directly conflicts with the development of potassium and in fact wastes that resource, BLM properly rejected their bid.

Appellants filed a reply addressing the new issues raised by BLM's and IMC's responses. ^{9/} They assert that neither BLM nor IMC enumerates any legal support for rejecting appellants' high bid other than 43 CFR 3535.3-3(f). Appellants dispute BLM's interpretation of that regulation as affording it unbridled discretion to reject the high bid of an otherwise qualified bidder, averring that such a novel construction finds no support in prior Board decisions. They reiterate that apparent bad faith is not a proper standard for determining a competitive lessee's qualifications and that, even if it were a proper inquiry, neither BLM nor IMC has presented any evidence establishing that appellants bid on the lease in bad faith. Not only has BLM failed to meet its burden of showing bad faith, but appellants contend that they have amply demonstrated that their bid was made in complete good faith. ^{10/} Appellants deny that potash will be wasted if they are awarded the lease, arguing that the evidence in the record confirms their expressed desire to acquire the lease, expend substantial sums of money to drill core holes and determine the quantity and quality of the potassium mineralization on the lease, and then budget, plan, and commence mining operations designed to realize an economic return on their investment should the potash mineralization prove valuable. BLM's acknowledgement that they satisfied all the regulatory criteria to qualify as an acceptable bidder, appellants submit, mandates that they be awarded the potash lease.

^{9/} We hereby grant appellants' request to accept their reply brief and deny BLM's motion to strike that document. We also grant BLM's request that we consider its supplemental agency response.

^{10/} Appellants also object to BLM's failure to apply the apparent bad faith standard to IMC, which, they claim, has admitted that lease acreage will not be mined for at least 35 years and apparently seeks the lease to limit competition by taking potential reserves off the market.

Appellants discount Olsen's memorandum which, they assert, not only ignores the legal issues determinative of their appeal, but also rests on conjecture and suspicion insufficient to justify BLM's rejection decision. Specifically, they identify several misleading matters raised in the memorandum including currently irrelevant safety concerns, premature apprehensions over hypothetical scenarios of mine development, and groundless doubts about the capabilities of appellants' staff with regard to potash mining. Appellants aver that, Olsen's suppositions to the contrary notwithstanding, they have a strong motive to develop the potash resources and to discover means to safely extract potash in areas currently or previously subject to oil and gas development, adding that their only impetus for obtaining the potash lease, as well as for securing their oil and gas leases (which cover only a minimal amount of the acreage apparently containing economic potash resources), flows from their desire to maximize their economic return through production of both potash and oil and gas. BLM's anxieties over simultaneous development are unfounded, appellants insist, because neither oil and gas nor potash production operations can occur without prior BLM approval. ^{11/}

Appellants criticize IMC's response as focussing on safety concerns and other issues not germane to the bidder qualification issues. They reject IMC's concern that unfettered oil and gas drilling would take place should appellants control both the potash lease and oil and gas leases, asserting that BLM does not divest itself of its authority to approve oil and gas wells simply because the oil and gas operator and the potash lessee are one and the same and would undoubtedly continue to disapprove oil and gas drilling where such drilling would cause an undue waste of potash. Appellants reiterate that, since the competitive leasing regulations fail to mention the motive of an otherwise qualified bidder, inquiry into that issue has no relevance to lease issuance and repeat that, in any event, the evidence does not support IMC's inference that appellants intend to wantonly or recklessly waste the potash resource. Appellants acknowledge that, currently, only IMC and Western Ag mine and mill langbeinite and that only IMC presently mines and mills mixed potash containing langbeinite and sylvite, but insist that another company, given the resource base, could begin mining operations and apply technology readily available to process those ores, adding that they have such resources and are prepared to use them to timely evaluate and, if warranted, develop the potash lease. While not denying that they seek an economic return from their oil and gas leases, appellants contend that, as conceded by IMC, they also have the potential for an economic return from the potash resources, and that this fact alone validates the propriety of their lease bid. In any event, appellants recognize that if they hold both oil and gas and potassium

^{11/} Appellants also dismiss Cranston's memorandum responding to Hutchinson's letter as immaterial since it does not address any of the legal issues pending before the Board and contains numerous misleading and unsupported statements.

leases, they will owe a duty to the United States to develop both resources and maximize production of each without unduly wasting the other. ^{12/}

In BLM's supplemental agency response, the Solicitor's Office argues that BLM's bad faith determination does not rest on the agency's subjective belief that appellants have a strong motive not to develop the potash resources but derives, instead, from objective information obtained from appellants themselves in advance of the bidding process indicating that appellants believe that the potash in question is not worth developing and should be forfeited in favor of oil and gas development. The Solicitor's Office admits that BLM does not have the discretion to reject a high lease bid where BLM merely suspects, based on the agency's knowledge of the applicant's business and market conditions, that an applicant might not be able to develop minerals and concedes that a bidder's status as an oil and gas company rather than a potash company is irrelevant since anyone, regardless of prior experience in the potash industry, may successfully bid on and hold a potash lease as long as they are otherwise qualified. The Solicitor's Office distinguishes the present situation, however, on the ground that here BLM's determination that appellants cannot develop the potash originates from appellants' own statements.

The Solicitor's Office argues that when, prior to lease issuance, BLM receives credible information evidencing an intent not to develop the minerals, the agency must exercise its discretion to reject the bid since such an intent is tantamount to a fraud on the Government. BLM's fiduciary responsibility to ensure wise and efficient development of mineral resources, as reflected in the potash lease development regulations of 43 CFR 3594.1 calling for the maximum recovery of mineral deposits, mandates that the agency have the authority to reject a lease bid under such circumstances if the provisions of 43 CFR 3535.3-3(f) are to have any meaning at all. The Solicitor's Office suggests that appellants' belated claim that they have every intention of developing the potash if their tests show that they can make a profit centers on the word "if," speculating that appellants will simply run a few perfunctory tests and then declare that they are unable to justify development of the potash, thereby continuing to hold the potash resources indefinitely by complying with the most minimal of regulatory requirements.

Even assuming that appellants truly want and have the ability to mine the potash resources, the Solicitor's Office forecasts numerous problems arising from appellants' acquisition of the potash lease. Specifically, the Solicitor's Office postulates that controlling the proximity of potash mining to oil and gas operations would be difficult since, although BLM can control how close an oil and gas well can be drilled to a mine operation,

^{12/} The other issues raised in appellants' reply concerning the propriety of BLM's issuance of the potash lease to IMC during the pendency of this appeal have been resolved by U.S. District Court proceedings and will not be addressed here. See note 5, supra.

it has no such power over how near a mining operation can encroach upon an oil and gas well. Because appellants, as oil and gas companies, have argued strenuously, over the vociferous opposition of the potash industry, that APD's should be approved at locations closer than a quarter mile from potash mines and that any danger to such mines is illusory, the Solicitor's Office fears that appellants' control of both the potash and oil and gas coupled with BLM's lack of a regulatory system for limiting where mining activity occurs could create a potentially dangerous situation should appellants opt to mine too close to an oil and gas well. If appellants' mines become gassy, the Solicitor's Office predicts that MSHA would declare the entire basin gassy, resulting in the collapse of the potash industry.

[1] The Secretary's authority to lease lands known to contain valuable deposits of potassium derives from 30 U.S.C. § 283 (1994), which provides that such lands not otherwise covered by prospecting permits or leases "shall be held subject to lease by the Secretary of the Interior through advertisement, competitive bidding, or such other methods as he may by general regulations adopt, and in such areas as he shall fix." The regulations promulgated pursuant to this statutory provision require such lands to be "leased only through competitive sale to the qualified bidder who offers the highest acceptable bonus bid." 43 CFR 3535.1(a). Additional regulatory provisions describe the procedures to be followed in offering a potassium lease for competitive sale and, as noted above, specify that the detailed statement of the sale must include "[a] statement that the Secretary reserves the right to reject any and all bids, and the right to offer the lease to the next qualified bidder if the successful bidder fails to obtain the lease for any reason." 43 CFR 3535.3-3(f).

Appellants do not dispute that the Secretary has the discretionary authority to reject a high bid, and Board precedent, albeit in other competitive leasing contexts, amply establishes the Secretary's discretion not to lease. See, e.g., GeoResources, Inc., 99 IBLA 369, 371 (1987) (oil and gas lease); Grant S. Lyddon, 98 IBLA 321, 322 (1987) (geothermal resources lease); Suzanne Walsh, 98 IBLA 213, 214 (1987) (oil and gas lease); Getty Oil Co., 27 IBLA 269, 272-73 (where the Board concluded that the language of 30 U.S.C. § 1003 (1994), directing that known geothermal resources be leased to the highest qualified bidder by competitive bidding, was so similar to 30 U.S.C. § 226(b) and (c) (1982), the oil and gas competitive leasing statutory provisions, as to require analogous construction of the two provisions). We find the statutory and regulatory language governing competitive potassium lease sales sufficiently comparable to the provisions controlling geothermal resources and oil and gas competitive leasing to render precedent concerning bid rejection discretion established under those leasing programs applicable to competitive potassium leasing procedures. Compare, e.g., 30 U.S.C. § 283 (1994) and 43 CFR Subpart 3535.3-3(f) with 30 U.S.C. § 226(b) (1982) and 43 CFR 3120.5 (1987) and with 30 U.S.C. § 1003 (1994) and 43 CFR 3220.5.

Although appellants would limit the Secretary's rejection discretion to only those situations where some failure on the part of the high bidder prevents that bidder from receiving the lease or where the lease bid

is inadequate, we find the Secretary's authority is not so circumscribed. As delineated in 43 CFR 3535.3-3(f), the Secretary retains two distinct rights: the right to reject any and all bids and the right to offer the lease to the next qualified bidder if the successful bidder fails to obtain the lease for any reason. Appellants' argument ignores the first of these rights. Since the regulations clearly reserve the right to reject any and all bids, the Secretary has no obligation to accept any bid. GeoResources, Inc., *supra*; Suzanne Walsh, 91 IBLA 119, 122 (1986). The Secretary's rejection authority extends to situations where bid acceptance would conflict with the public interest. See Coquina Oil Corp., 29 IBLA 310, 312 (1977); Getty Oil Co., 27 IBLA at 273. Such discretion is not totally unfettered, however, since the record must disclose a rational basis for the rejection and must be sufficient to establish that the decision was not arbitrary, capricious, or in error. GeoResources, Inc., *supra*, and cases cited; Getty Oil Co., *supra*.

Thus, the key issue before us is whether the record reveals reasonable grounds for BLM's conclusion that appellants' high bid was made in bad faith and not in the best interest of recovery of the potassium resources and therefore should be rejected. We find the record insufficient to support BLM's rationale for rejecting appellants' high bid and reverse the Deputy State Director's decision.

The major underpinnings of BLM's bad faith determination consist of the perceived inconsistencies between the Wamock and Hutchinson evaluations of the economic potential of the potash ore zones within the lease area and appellants' numerous appeals of BLM denials of APD's for oil and gas wells within the designated Potash Area. We have carefully examined the supplemental materials provided by appellants documenting the genesis of their decision to bid. Although we find indications that appellants had more than one objective in bidding on the lease, we are not persuaded they were proceeding in bad faith or with improper ulterior motives in offering their bid. Yates' consultant, Gary Hutchinson, for example, advised:

I encourage you to continue to pursue approval to bid on the Potash Leases August 20.

The root of Yates's problem getting approvals for drilling within the potash area is the BLM's outdated economic data, disinterest in commerciality of potash, and mandate to protect potash mines. The economically troubled potash industry is, of course, prodding BLM to "do its job".

The outlines of known potash deposits that I showed you yesterday are much smaller than the BLM will show using their very low cut-off grades. However, if a reasonable mineral exploration company has the leases and drills some core holes for tonnage and grade information[,] then performs feasibility studies using real world data, the BLM personnel will be disarmed with facts and science[,] thereby aiding Yates's ability to obtain drilling approvals within the lease area.

There must be an amount of investment that makes bidding on potash cost effective relative to legal action[,] which at best will only cover up but not fix the drilling approval problem.

(Memorandum from Gary Hutchinson to Randy Patterson dated Aug. 12, 1992, Exh. 13, supra note 3).

As indicated by the first paragraph of this memorandum, not everyone in the Yates Corporation was initially inclined to "get into potash." See Hutchinson's diary for Aug. 12, 1992, Exh. 14. Hutchinson's November 1, 1992, summary of his activities for Yates, exhibit 7, recounts his efforts to persuade Yates' management that it would be advantageous to bid. Concerning his August 10, 1992, evaluation of potash zone 4 in Parcel 2 with Leo Lammers based on interpretation of oil well logs, Hutchinson wrote:

The 4th zone was similarly evaluated and determined to be predominately Langbeinite. The core hole grades are on average quite good but some suffer dramatically when diluted for minimum mining thicknesses. Five of the core hole values are of mineable grade when compared to an estimate of actual Langbeinite mining costs experienced in the area. All but two of the core holes show marginally economic values. This zone shows a surprisingly high potential for commerciality. Leo and I agreed that it was worthy of additional exploration funding from a minerals exploration company standpoint in anticipation of identifying an ore body.

* * * * *

A tonnage estimate of the 4th zone was calculated and shows the potential for a 20 year mine at a million tons mined per year. That amount should be sufficient quantity to put in a small mine if the tonnage and grade hold up with more exploration. * * * [W]e determined that a \$200,000 to \$250,000 acquisition, exploration, and initial feasibility study budget would be within reason for a mineral exploration company planning on subleasing to a mining company when a proven reserve had been established[,] thereby recovering the initial cost.

Upon concluding that the 4th zone has considerable potential for investment, Leo and I described our procedure and economic analysis to Nelson Muncy who agreed that a recommendation should be made to Yates management.

(Exh. 7 at 2).

In an August 11 presentation to Yates' potash project attorney, Hutchinson reports that the attorney thought Yates was legally qualified to bid and "did not feel it would harm our plan to pursue drilling rights through the regulatory processes in the state." Id. Because the presentation to Randy Patterson, Yates' corporate secretary and land department head, was short, Hutchinson wrote him the August 12 memorandum set forth

above. Hutchinson wrote that he "was delighted to hear that Yates Management had approved the bid" when he returned home later that day. "I'm confident that I can effect a positive outcome from the property for both oil production and potash production if the leases are eventually awarded to Yates and Pogo," he concluded. *Id.* at 3.

Appellants were quite candid about their motives in their request that the State Director reconsider BLM's initial October 22, 1992, decision rejecting their bid:

Frustrated by the regulations that unilaterally allowed potash mining companies and BLM representatives to arbitrarily withdraw oil and gas exploration areas from use by the oil and gas lessees as well as the requirements that hold all potash exploration and mining information confidential, Yates and others embarked on a program to develop potash mining information from public sources. The knowledge developed from this program would allow Yates to make an independent determination as to whether oil and gas exploration could be safely and economically conducted in the same area as potash mining.

(Yates Petroleum Corporation Review of Work Done in Preparation for Bidding at the Aug. 20, 1992, BLM Potassium Sale, Eddy County, New Mexico, *supra* note 3, Exh. 1 at 1).

Whether or not BLM agrees with all the parameters utilized by Lammers and Hutchinson in evaluating the economic potential of the ore zones subject to the lease (and we note that BLM has acknowledged the reasonableness of Hutchinson's analysis), those evaluations reveal that appellants undertook a serious examination of the possible commerciality of the deposits and concluded that the potential for an economic return from mining the potash ore warranted submitting a bid for tract No. 2. That appellants state that additional core hole drilling and other exploration work must be performed before a definitive determination of the projected profitability of the deposit can be made and a detailed mining plan developed does not undermine the good faith of their decision to bid.

Warnock's March 18, 1992, report, prepared to assess the probability of interference of oil and gas development with potash mining in various portions of the designated Potash Area, relied on the 1984 Potash Map accepted by BLM and concluded that the potash reserves in the area would not be mined within the next 20 to 30 years, if ever, because present economics did not justify the risk of capital for the marginal returns resulting from mining the potash reserves in the studied area. Appellants explain that the potentially economic potash area defined by Hutchinson extends well beyond the area of oil and gas development analyzed by Warnock since only a portion of appellants' oil and gas leases slightly overlaps the potash lease area. Hutchinson's letter attached to appellants' SOR also points out the congruity between his and Warnock's results.

In our view BLM's conclusion, based on the inconsistencies between the Warnock and Hutchinson submissions, that appellants submitted their bid

in bad faith is unwarranted. We do not agree that the reports demonstrate appellants espouse contradictory positions on the economic viability of the potash deposit depending on whether they seek APD approval or potash lease acquisition. Even if the studies did conflict, neither the fact that a later, more comprehensive evaluation specifically designed to evaluate the economic potential of potash lease procurement reached a somewhat different result than an earlier study prepared for a different purpose nor appellants' continued reliance on the earlier Wamock study as support for the issues it was commissioned to address, demonstrates bad faith. Rather, the two analyses conform to appellants' acknowledged goal of pursuing the profitable development of both oil and gas and potash.

Careful perusal of BLM's decision and its submissions on appeal reveals that the animating factor behind BLM's bad faith determination is appellants' status as oil and gas operators diligently pursuing the development of oil and gas leases located in portions of the designated Potash Area. BLM expressly states in the Olsen memorandum that appellants' actions on the APD's in the potash lease area form the major issue in this case. BLM apparently considers an interest in oil and gas development in the area to automatically translate into a complete disregard for the potash resources located there. Appellants acknowledge that they seek to optimize oil and gas development on their oil and gas leases, but they also profess the desire to maximize the recovery of potash resources from the lease should it be awarded to them. While BLM finds the concurrent development of oil and gas incompatible with safe potash recovery, appellants disagree and actively pursue simultaneous development of those resources. Resolution of that disagreement, however, is not necessary in order to settle the issues raised in the present appeal since we find that appellants' expressed desire to produce both oil and gas and potash does not suffice to establish that appellants' bid was made in bad faith. BLM's speculation that appellants seek the potash lease in order to develop oil and gas resources not only lacks factual underpinnings, but also ignores the fact that a potassium lease grants the lessee the right to produce potash and associated minerals, not oil and gas.

We further reject the claim that awarding the potash lease to appellants would not be in the best interest of recovery of the potassium resources because it would result in the undue waste of potash and could pose an economic hardship on the potash industry. The fact that Hutchinson's analysis identifies as uneconomic some potash ore zones BLM considers commercial does not mean that those zones will be wasted should appellants be awarded the lease. As mining progresses and initial costs are recouped, appellants will be in a better position to determine the economic viability of mining those zones. Furthermore, contrary to BLM's decision, the supplemental materials reveal that appellants recognize that subleasing the mining of the lease to an established potash mining company might be a workable alternative to maximize recovery of the potash, although they would defer any such decision until after completion of additional exploration work. See Supplemental Materials, Exh. 7 at 2.

Both BLM's and IMC's remaining arguments rely on speculation and assume that BLM will fail to fulfill its responsibilities to carefully

scrutinize mining plans of operations submitted pursuant to 43 CFR 3592.1 before granting the approval necessary to allow mining to occur. We believe BLM's authority to approve or disapprove APD's and proposed potash mining plans will be adequate to regulate the parties' activities in the area. 13/

Since the record does not provide a rational basis for the Deputy State Director's rejection of appellants' high bid for the potassium lease, we reverse his decision and remand the matter to BLM for potassium lease issuance, all else being regular. 14/ GeoResources, Inc., 99 IBLA at 371.

13/ We note that some of the issues surrounding the feasibility of simultaneous oil and gas and potash development and the possible safety hazards to underground miners will be addressed in the hearing ordered in Yates Petroleum Corp., supra, 131 IBLA at 235-36.

On Jan. 29, 1997, counsel for IMC in the hearing ordered in Yates Petroleum Co., supra, filed a motion on behalf of IMC suggesting we allow further briefing in this case in order to allow the parties to provide information developed at that hearing relevant to the issues in this case. IMC states that there is a "wealth of additional information developed in the related cases that in our view overwhelmingly confirms that BLM was entirely justified in rejecting Appellants' bid on the lease involved in this case" (Intervenor's Motion to Schedule Supplemental Briefs at 2). IMC believes "that it is very important that the Board be fully informed of the potential consequences of its action in this case for the implementation of Secretarial policy." Id. at 13.

We have considered the examples IMC provides in its motion as well as the exhibits containing documents and testimony from the hearing. IMC points out that Administrative Law Judge Patricia McDonald, in the hearing before her, has denied appellants' motion for summary judgment granting appellants' APD's in the area of the lease involved in this case and "will defer decision on the Martha wells until the IBLA has decided the pending cases." Id., Exh. 2, Denial of Motion for Partial Summary Judgment, Yates Petroleum Corp. v. BLM, IBLA 92-612, May 3, 1996, at 2. We find the information IMC has provided consistent with the evidence in the record of this case, although we do not draw the same conclusion from it as IMC does. We were not aware of Judge McDonald's May 3, 1996, order and do not wish to delay a decision in this case any further. Our decision is also consistent with Judge McDonald's jurisdiction. We deny IMC's motion to schedule supplemental briefs.

14/ We find the additional relief sought by appellants in this proceeding beyond the scope of the Board's authority and deny those requests.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed and the case is remanded to BLM for further action consistent with this decision.

Will A. Irwin
Administrative Judge

I concur:

T. Britt Price
Administrative Judge