

INTERIOR BOARD OF LAND APPEALS

Robert L. Bayless

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ROBERT L. BAYLESS

IBLA 97-526

Decided June 8, 1999

Appeal from a decision of the Acting Deputy Commissioner of Indian Affairs, affirming an order directing oil and gas lessee to perform restructured accounting on Indian leases in accordance with dual accounting requirements. MMS-93-0094-IND.

Affirmed as modified.

1. Bureau of Land Management—Indians: Mineral Resources: Oil and Gas: Tribal Lands—Oil and Gas Leases: Royalties: Payments

MMS, in calculating the royalty due on Indian leases, must use volumes as determined at the approved volume measurement point established by BLM.

2. Indians: Mineral Resources: Oil and Gas: Tribal Lands—Oil and Gas Leases: Royalties: Payments

Dual accounting is required to determine royalty for Jicarilla Tribal leases even when there was no sale of the wet gas at the wellhead and the gas was processed into components before being sold.

3. Indians: Mineral Resources: Oil and Gas: Tribal Lands—Oil and Gas Leases: Royalties: Payments

Where an Indian lessee does not sell natural gas liquid products processed from wet gas, but instead trades them for residue gas of equivalent Btu content, MMS properly values the production by bypassing the first benchmark under 30 C.F.R. §§ 206.152 and 206.153(c) (which considers the proceeds under the nonarm's-length contract and is therefore inapplicable) and using the second benchmark (which utilizes other information relevant in valuing like-quality residue gas or gas plant products, including gross proceeds under arm's-length contracts for like-quality residue gas or gas plant products from the same gas plant or other nearby processing plants). For the second benchmark, MMS properly directs use of transportation-adjusted residue gas prices, adjusted for Btu content, to reflect the value of the wet gas before processing.

APPEARANCES: Tommy Roberts, Esq., Farmington, New Mexico, for Appellant; Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Robert L. Bayless has appealed from the July 10, 1997, joint decision of the Acting Associate Director (AAD), Policy and Management Improvement, Minerals Management Service (MMS), and the Acting Deputy Commissioner of Indian Affairs (ADC) (the AAD/ADC decision), insofar as that decision directed Bayless to perform restructured accounting in accordance with dual accounting requirements on Indian leases within 30 days after issuance of the decision. <sup>1/</sup>

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<sup>1/</sup> By Order dated Sept. 25, 1997, we granted Appellant's request for stay of the effectiveness of the AAD/ADC decision pending consideration of his appeal.

The AAD/ADC decision granted Bayless' appeal as to certain aspects of the Dallas Area Audit Office's (DAAO's) order. For example, DAAO had found that Bayless had improperly claimed in-kind fuel fees, fees charged for conditioning the product, and transportation allowance deductions. Those findings were reversed by the AAD/ADC decision, subject to Bayless' documenting and justifying his factual contentions and correctly classifying the costs on the correct forms (AAD/ADC decision at 17-24). Bayless has not pursued any aspects of that issue in the present appeal.

Bayless expressly indicates that the AAD/ADC decision clarified that dual accounting was "not required for Bayless' Federal leases." (Statement of Reasons (SOR) at 6.) That issue is therefore not before us. The present appeal addresses only Bayless' obligations under his Indian leases.

Bayless' appeal documents identified only the following issues under challenge in this appeal: whether, under the factual circumstances presented in this case, royalties due under Tribal oil and gas leases must be computed in accordance with dual accounting requirements (Petition for Stay at 2; SOR at 6); whether the benchmarks under 30 C.F.R. § 206.152 were correctly applied in the AAD/ADC decision (SOR at 6); and what are the proper volumes of production to be used for royalty computation purposes, which in turn invokes the issue what is the appropriate measurement point for production from wells connected to a gathering system known as the Cabresto Gathering System. (Petition for Stay at 2.)

Bayless states that he "incorporates and adopts by reference the 'ARGUMENTS' set forth in the [statement of reasons filed with the AAD/ADC (MMS SOR)] and in the [Response to DAAO's Field Report (Response to Field Report)] insofar as those arguments pertain to the issues as to which the [AAD/ADC] ruled against Bayless in the" AAD/ADC decision. (SOR at 5.) It is not clear how the various aspects of the AAD/ADC decision (which contains lengthy and complex instructions on royalty accounting) relate to the legal issues identified by Bayless on appeal. The burden is on Bayless, as Appellant, to specify error in the decision appealed from. To the extent that Bayless has not specified error in the AAD/ADC decision and relies on arguments previously raised before the AAD/ADC, and to the extent that they are not expressly considered herein, those arguments are rejected.

On January 25, 1993, MMS' DAAO wrote Bayless to advise him that it was "currently reviewing royalty reporting by [him] on eight Jicarilla Indian leases from September 1989 through February 1990." DAAO advised that its review of those eight Indian leases disclosed that Bayless had (1) failed to report and pay royalties on the total production measurement point volumes attributable to the leases, and (2) failed to apply dual accounting. DAAO concluded that, as a result, "royalties were underpaid for the period September 1989 through February 1990 on each of the Jicarilla leases." (DAAO Letter at 1.)

The propriety of Bayless' gas volume measurement practice on these leases was the subject of litigation before this Board resulting from decisions by the Farmington, New Mexico, Resource Area Office, Bureau of Land Management (BLM). Robert L. Bayless, 138 IBLA 210 (1997) (petition for reconsideration denied Aug. 15, 1997). In January 1993, when DAAO issued its letter, the question of whether Bayless was incorrectly measuring volumes was uncertain, and the record shows a difference of opinion on the subject at that time amongst BLM officials.

DAAO found that its "review of the eight Jicarilla leases for September 1989 through February 1990 disclosed that Bayless failed to apply the 'Dual Accounting' requirements, as required by the Jicarilla Tribal lease agreements and Subpart D of the regulations." DAAO noted that Bayless had acknowledged "that it did not value gas from Jicarilla Tribal leases in accordance with 'Dual Accounting,'" and that, "[a]s a result, Bayless undervalued the gas and underpaid royalties." (DAAO Letter dated Jan. 25, 1993, at 3.) DAAO's letter concluded that, "in order to bring royalty payments into compliance with the lease terms and regulations," Bayless must:

(1) Within 90 days of receipt of this letter, provide this office a schedule, by month and lease from January 1987 to present, comparing reported gas sales volumes, sales values, and royalties paid with recalculated sales volumes, sales values, and royalties based on the "Gross Proceeds Valuation Method", "Btu Valuation Method", and the "Processed Gas Valuation Method" for all Jicarilla Tribal leases and any other Indian lease containing similar "Dual Accounting" language. Value for royalty should be based on the method that yields the greatest royalties to the Indian lessor.

Recalculated sales volumes and values for each of the three valuation methods should be based on wellhead metered volumes pursuant to approved production measurement points.

Recalculated sales volumes for the "Processed Gas Valuation Method" should include the value of 100 percent of the [natural gas liquids (NGL's)] attributable to the lease, reduced by the actual processing costs incurred by the party processing the gas (limited to no more than two-thirds of the value of the extracted

NGL's unless otherwise determined by the Secretary of the Interior). If gas plant data on NGL's is unavailable, you may use procedures published in the "Dear Payor" letter dated July 27, 1992. If approved processing allowances have not been established by MMS for the gas plant, you may use an allowance of up to two-thirds of the value of the NGL's, subject to future audit and modification.

MMS directed Bayless, "[w]ithin 120 days of receipt of this letter, [to] report and pay any additional royalties based on items 1 through 3 above."

On appeal to the AAD/ADC, Bayless argued that it had used the correct "production measurement point." (MMS SOR at 8-12.) That issue was within BLM's jurisdiction, not MMS'. Bayless pointed out that the DAAO incorrectly stated that BLM "considers [the] wellhead orifice meters to be the production measurement points." To the contrary, (although it was not completely settled at the time of DAAO's or the AAD/ADC decision) BLM did approve use of off-lease meters as the volume measurement point for some of the time in question in this dispute. See Robert Bayless, supra at 212.

Bayless also argued that application of the dual accounting formula to the facts of the case was arbitrary, capricious, and an abuse of discretion. He asserted that dual accounting should not be required where there was no market for produced gas prior to processing, in that Bayless had no choice whether to sell the gas prior to processing. In these circumstances, Bayless argued, the Jicarilla Tribe is not entitled to the benefit of the better of the wellhead market and the post-processing market. (MMS SOR at 15-16.) Bayless asserted that the obligation to dual account is triggered only when the lessee has a choice whether to sell the gas before or after processing. He added that the "purpose of encouraging the lessee to sell into the higher of the two markets can only be served if two markets do, in fact, exist," and that "[t]here is nothing in [the decision in Jicarilla Apache Tribe v. Supron Energy Corp., 782 F.2d 855 (10th Cir. 1986), modified, 793 F.2d 1171 (1986), cert. denied, 479 U.S. 470 (1986),] the Tribal Leases or the regulations that requires the creation of a hypothetical or artificial market where no actual market exists." (MMS SOR at 18.)

Bayless also argued that, in any event, the "Btu method" ordered by DAAO was in error and that the theoretical market must instead be "constructed by the DAAO in accordance with [30 C.F.R. § 206.152.]":

The most basic error of the DAAO's Btu method, in addition to violating § 206.152 and ignoring actual wellhead sales, is its underlying assumption that a Btu of gas at the wellhead has the same market value as a Btu of residue gas at the plant tailgate. The DAAO completely disregards the market realities and the enhanced value added by transportation. Assuming that dual accounting is appropriate even in the absence of a wellhead market, the DAAO cannot base its "theoretical" wellhead value on the tailgate value of Bayless' gas unless the transportation

costs incurred by Bayless to transport the gas from the Central Delivery Point Meter to the tailgate are deducted. 30 C.F.R. § 206.156(a).

(MMS SOR at 20-21.) <sup>2/</sup>

On December 14, 1993, DAAO filed its Field Report with the ADC. DAAO noted that BLM had advised it by memorandum dated August 31, 1992, that it (BLM) had conducted an independent measurement handling and inspection and concluded that Bayless had improperly reported production based on measurement of commingled production, allocating volumes back to individual leases, rather than wellhead measurements. (Field Report at 1.) However, DAAO noted that, BLM subsequently disclosed that it had actually approved Bayless' August 12, 1992, request for off-lease measurement of commingled volumes for the 8 Jicarilla leases as well as 15 other wells. Noting this conflict, DAAO advised that it was "awaiting further clarification" from BLM. It asserted that, "[b]y approving the off-lease measurement point for the above eight [Jicarilla] leases, the BLM has approved a measurement point which will result in the Jicarilla Tribe's being paid on approximately 25,000 Mcf per month less than it measured at the wellhead." (Field Report at 2.) However, it correctly recognized that resolution of that issue was properly before BLM. (Field Report at 4.)

As to the dual accounting question, DAAO noted that Bayless had acknowledged that it did not value gas from Jicarilla Tribal leases under that system. DAAO stated that the "Btu valuation method" consistently yielded a higher value for royalty than the value reported by Bayless, but that sufficient information was not available to accurately calculate value with the "processed gas valuation method." DAAO noted that its order required Bayless "to report and pay any additional royalty due after comparing reported gas sales volumes, sales values, and royalties paid with recalculated sales volumes, sales values, and royalties based on the 'Gross Proceeds Valuation Method,' 'Btu Valuation Method,' and the 'Processed Gas Valuation Method' for all Jicarilla Tribal leases and other Indian leases containing similar 'Dual Accounting' language, for the time period January 1987 to present." (Field Report at 2.) DAAO also cited court decisions supporting the imposition of the dual accounting requirement in Indian matters. (Field Report at 4.)

In his January 3, 1994, response to the Field Report, Bayless acknowledged that he "did not apply dual accounting principles," but asserted that "dual accounting is not required given the facts of this case." (Response at 2.) He added that the Field Report did not challenge his assertion that actual markets for both unprocessed and processed gas produced from the subject leases did not exist for the periods of time in question. Id.

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<sup>2/</sup> Bayless also asserted that attempts to collect royalties accruing more than 6 years and 90 days prior to final agency action are barred by 28 U.S.C. §§ 2415 and 2416 (1994). He has not pursued that argument on appeal.

On July 10, 1997, the AAD/ADC decision was issued. It states: "Until such time that IBLA either denies rehearing or decides the issue on rehearing, the instant case will proceed as though BLM's volumetric determination is correct." (AAD/ADC decision at 34.) However, the decision acknowledged that, "[s]hould IBLA reverse or revise [BLM's] decisions, this decision will be considered modified so as to require Bayless to compute wet gas volumes consistently with IBLA's ruling." (AAD/ADC decision at 35.)

The AAD/ADC decision ruled that a dual accounting value comparison was required for these Indian leases under the circumstances of the case. It described the "dual accounting comparison" as

a procedure whereby the payor must determine the royalty due on gas production by selecting the higher value from comparing the value of processed residue gas and extracted liquids (less an appropriate allowance) with the value of unprocessed wet gas. 25 CFR 211.13 (1995). Both values are compared with the lessee's actual gross proceeds, because gross proceeds are always the minimum value for royalty purposes. 30 CFR 206.152(h) and 206.153(h) (1988-present); former 30 CFR 206.103 (1987) (applicable to earlier periods).

(AAD/ADC decision at 10.) It noted that Bayless had been ordered to perform a dual accounting value comparison for all of his Indian leases for the period January 1987 to the date of the DAAO letter, January 1993.

The decision rejected Bayless' principal argument that dual accounting was not required because there is no market for Bayless' gas prior to processing, ruling that dual accounting is required by both the lease terms and applicable regulations, citing section III of Notice to Lessees and Operators of Indian Oil and Gas Leases 1A (NTL-1A), 42 Fed. Reg. 18135 (Apr. 5, 1977); 3/ 25 C.F.R. § 211.13 (1995); Indian lease terms at section 3(c); 4/ and 30 C.F.R. § 206.155. It noted that the requirement for dual accounting on Indian leases also has been upheld by the courts in Jicarilla Apache Tribe v. Supron Energy Corporation, 782 F.2d 855 (10th Cir. 1986), and in Jicarilla Apache Tribe v. Continental Oil Co., No. CIV-76-430-C (D.N.M. 1988). It ruled that nothing in those authorities supported Bayless' contention that dual accounting is required only when a

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3/ That section provided that the royalty value would be the highest value resulting from three separate computations, namely, (1) the value of the wet gas stream at the wellhead adjusted for Btu content, (2) the value of the separate components after processing and after reducing the value of the liquids to reflect the manufacturing allowance, and (3) gross proceeds accruing to the lessee.

4/ Section 3(c) of the lease terms requires the lessee

"to pay \* \* \* a royalty of 12½% percent of the value or amount of all oil, gas, and/or natural gasoline \* \* \* and that royalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), whichever is greater."

(Emphasis supplied.)

market for both unprocessed wet gas and processed gas exists. (AAD/ADC decision at 13.) <sup>5/</sup> The decision concluded:

The lease and the regulations expressly require that royalty be valued on the greater of the value of the unprocessed gas or the combined value of the residue gas and products derived from processing (less the appropriate allowance). Both values in turn, must be compared to Bayless' gross proceeds. Consequently, Bayless must perform the dual accounting value comparison for his Indian leases for the audit period and thereafter. Bayless' claims with respect to not having to perform dual accounting are rejected and this portion of his appeal is denied.

(AAD/ADC decision at 13.)

The decision next considered how Bayless should calculate royalty value:

In performing the dual accounting comparison, Bayless must calculate the following measures of royalty value and select the method that yields the greatest royalty:

- A. the combined value of the residue gas after processing and the Extracted liquids, less a permitted allowance for the costs of processing (sometimes called the "net realization" method);
- B. the value of the unprocessed "wet" gas; and
- C. Bayless' gross proceeds.

(Decision at 13.) It then considered each of these three methods in detail.

The decision considered how the "net realization" method should be applied to Bayless' case (Method "A"). It described the unusual nature of Bayless' sales agreement for the wet gas, and its implications for the calculating royalty under the "net realization" method:

Bayless' "keep whole" contract for gas produced from the eight reviewed leases and delivered to the Plant—under which Bayless does not receive extracted liquids back at the Plant tailgate, but instead, receives a Btu equivalent of the [Plant volume reduction (PVR)] in additional dry gas—is a somewhat

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<sup>5/</sup> It also ruled that there was "at least some market for unprocessed gas in this case, as evidenced by the fact that Bayless sold some production at the [central delivery point (CDP)] prior to processing." In view of our holding that dual accounting may be required even where there is no such market, it is unnecessary to resolve this factual question.

unusual processing contract. To value his gas as processed gas under applicable regulations, Bayless must value [(1)] that portion of the dry gas he received, which was extracted from his original gas stream and [(2)] the liquids extracted from that stream at the processing Plant, even though Bayless did not receive the liquids back at the plant tailgate.

(AAD/ADC decision at 15 (footnote omitted).) Applying 30 C.F.R. § 206.153(b)(1), the decision concluded that the value of the dry, residue gas (the first component) must be no less than the arm's-length sale proceeds of the sale of that gas. <sup>6/</sup> As to the value of extracted liquids (the second component), the decision noted that, under the "keep whole" contract, Bayless had no arm's-length proceeds from the sale of these liquids that could be used as a measure of value for them. It concluded: "Because the liquids were disposed of under an arrangement other than an arm's-length sale (they were traded for residue gas), they must be valued according to the 'benchmarks' applicable to non-arm's-length dispositions under 30 CFR 206.153(c)." The decision concluded that the first benchmark under § 206.153(c)(1) did not apply because Bayless had no "proceeds" from the liquids at all. However, the decision found that Northwest's proceeds for disposition of the extracted liquids was "other information relevant in valuing like-quality \* \* \* gas plant products" under the second benchmark in § 206.153(c)(2). Accordingly, it directed Bayless to obtain that information from Northwest or its successor and to use it in valuing the liquids extracted from the eight Jicarilla (and any other Indian leases) on and after March 1, 1988. <sup>7/</sup>

The decision then addressed the second alternative method of calculating royalty: determining the value of the unprocessed "wet" gas (Method "B"). The decision ruled that wet gas value must be established under 30 C.F.R. § 206.152, because all the production from the eight reviewed leases occurred after promulgation of that provision in 1988. The decision considered the three factual situations present by Bayless' case and addressed each in turn: (1) Months in which all wet gas was actually sold unprocessed at arm's length at the CDP, concluding that the arm's-length price is the proper measure of value under the wet gas methodology as prescribed in § 206.152(b)(1); (2) months in which some wet gas was sold unprocessed at the CDP and some transported to the plant, ruling that, under the second benchmark of section 206.152(c)(2), the arm's-length sales price of the wet gas is the proper measure of the unprocessed value, for dual accounting purposes, of the gas transported to the

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<sup>6/</sup> The decision noted that all the production for the eight Indian leases reviewed was after Mar. 1, 1988. It stated, should any period prior to that date be involved for leases other than the eight reviewed leases, the arm's-length sales price would be accepted as value for residue gas for purposes of the required dual accounting recomputation and comparison, as it was one of the principal factors taken into consideration to establish value under 30 C.F.R. § 206.103 (1987), and 25 C.F.R. § 211.13.

<sup>7/</sup> As noted above, the AAD/ADC decision proceeded to reverse DAAO's disallowance of certain deductions from the royalty basis.

plant; 8/ and (3) months in which there were no wet gas sales at the CDP, and all the gas was transported to the plant and sold after processing, ruling that, under the second benchmark, the value received for residue gas adjusted for transportation is "other information relevant in valuing like-quality gas" for determining wet gas value because there were sales of processed gas for that month, and directing Bayless to use transportation-adjusted residue gas prices in those months to derive the unprocessed gas value using the Btu calculation method. 9/ The decision concluded that, "because the wet gas value will be determined at the CDP under this method, Bayless is not entitled to any transportation allowance against that value." (AAD/ADC decision at 26.)

The third alternative (Method "C") involves calculating Bayless' actual gross proceeds for disposition of his gas, including the total proceeds he received for the sale of all volumes he received at the plant tailgate, including the additional volumes of dry gas he received in place of the liquids after processing. 10/

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8/ The decision ruled that the first benchmark of 30 C.F.R. § 206.152(c) did not apply, because there were no proceeds from a nonarm's-length disposition of wet gas.

9/ The decision also specified the methodology to be used to determine the wet gas value for dual accounting purposes for gas produced from other Indian leases and not sold as unprocessed "wet" gas in the post-Mar. 1, 1988, period, ruling that the benchmarks in 30 C.F.R. § 206.152(c) also applied. Further, it ruled that, for determining the wet gas value for gas produced from other Indian leases during the Jan. 1, 1987-Feb. 29, 1988, period, section III of NTL-1A required that consideration be given to several factors, including "price(s) received by the operator, to the Btu content of the gas, and to other relevant matters." It concluded that section III's dual accounting comparison provision referred only to the "value of the wet gas produced from the lease adjusted for its Btu content," and that the methodology under the 1988 benchmarks was consistent with these requirements.

10/ The decision explains that,

"had Bayless received the liquids, he would have sold them and realized proceeds from that sale, which indisputably would have been part of his gross proceeds. However, in place of the liquids under the 'keep whole' contract, Bayless received additional dry gas, which he then sold, and from which he realized proceeds. Therefore, the proceeds received for the gas received as a substitute for the liquids was correctly included within Bayless' gross proceeds." (AAD/ADC decision at 28.)

The decision also raised a matter not previously in dispute, namely that applicability of 30 C.F.R. §§ 206.103 and 206.152(a)(3)(i) (gas) and 30 C.F.R. § 206.153(a)(3)(i) (residue gas and gas plant products) (as well as subparagraph 3(c) of the Indian lease terms), which provide that, in the absence of good reason to the contrary, the value determined based on a major portion of like-quality production sold from the field or area represents a reasonable value for royalty purposes. (AAD/ADC decision at 29-30.) The decision noted:

"Therefore, RMP should, if possible, perform a major portion analysis and provide the results of that analysis to the Appellant for comparison

[1] We note initially that we do not consider in this opinion where the correct volume measurement points (whether at the wellhead or at the "central delivery point") were at what time. As MMS has observed throughout this and related proceedings, that issue is entrusted solely to BLM. See Robert L. Bayless, 138 IBLA 210, 212 (1997). BLM's rulings on this question, and ours, are matters of record and speak for themselves. For purposes of determining royalty due, MMS should utilize the volumes at the volume measurement points as determined by BLM. In all royalty calculations properly required by MMS, Bayless should also use those volumes. 11/ The AAD/ADC decision is modified to reflect these determinations. 12/

[2] The principal argument raised by Bayless in this appeal is that dual accounting is not required for the Jicarilla Tribal leases because there was no sale of the wet gas at the wellhead, such that MMS improperly requires comparison to a theoretical market that does not exist:

Where gas is produced there are two potential markets, a market at the lease for gas in its unprocessed state and a market at the plant tailgate for the products resulting from processing, such as natural gas liquids and residue gas. When a market actually exists for both processed and unprocessed gas, Bayless does not dispute that dual accounting—comparing the two markets and giving the Indian lessor the benefit of the better market—is required under [Supron, supra.]

However, Bayless argues that the obligation to dual account is triggered only when the lessee has a choice whether to sell the gas before or after processing. (SOR at 8.)

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fn. 10 (continued)

with values derived by the Appellant. In other words, should the Appellant perform a dual accounting value comparison to determine the applicable value of gas production for royalty purposes, it should be aware that MMS reserves the right to determine whether the value computed as a result of that comparison is adequate to conform to the major portion value requirements of the lease and regulations.

"However, the determination of value for royalty purposes may not be considered final until such time that the major portion price comparison is conducted. The major portion price shall be compared with the values otherwise determined in accordance with the regulations at 30 CFR 206.152 and 206.153."

Id. at 30-31. Appellant has not challenged this portion of the decision.

11/ Bayless notes that utilization of volume measurements at the CDP moots the question whether "transportation upstream of the CDP would \* \* \* be a 'deduction' in computing value at the CDP based on residue prices." See SOR at 6 n.9.

Accordingly, we do not comment on this issue.

12/ We note that the AAD/ADC decision indicates that "[a]n upward adjustment of volumes delivered at the plant tailgate must be made \* \* \* as a consequence of the change in the approved original measurement points." (AAD/ADC decision at 28 n.13.) It is not clear that any adjustment must be made.

It is now established that, as a general matter, lessees of Jicarilla Apache Tribal leases must participate in dual accounting, and, moreover, that dual accounting had always been required of those lessees. Amoco Production Co. (On Reconsideration), 143 IBLA 54A, 54E (citing Burlington Resources Oil and Gas Co. v. U.S. Dept of the Interior (USDI), 21 F. Supp. 2d 1, 6 (D.D.C. 1998)). MMS collects royalty on leases of oil and gas owned by the Jicarilla Apache Tribe as trustee for the Tribe. As part of its fiduciary duty to the Tribe, if MMS is faced with two reasonable interpretations of a regulation, it must choose the one that better promotes the Tribe's interests. Supron at 1567. The Department's reasonable interpretation that the regulations require the lessee on an Indian lease to perform dual accounting better promotes the Tribe's interests than its earlier interpretation that dual accounting was not required and is, therefore, properly applied to Tribal leases.

We note that the Court in Burlington rejected the same argument presented to us in the present appeal, that the rationale of Supron had been undercut by a subsequent decision of the Supreme Court, Cotton Petroleum Corp v. New Mexico, 490 U.S. 163 (1989):

Cotton Petroleum did not \* \* \* reject the general proposition that the Secretary of the Interior has a fiduciary duty to the tribes. The Supreme Court merely dismissed the notion that because the Indian Mineral Leasing Act was intended to raise revenues for tribes, it was also intended to insulate the income from otherwise appropriate levies [in the form of State taxes that burdened the Tribe.]

Burlington v. USDI, 21 F. Supp. 2d at 4.

Nevertheless, it remains to determine whether dual accounting, although undeniably applicable to Indian leases as a general matter, should apply to the specific facts here, where the gas was not sold in its unprocessed state. <sup>13/</sup> In reviewing this question, we are mindful of the mandate imposed by our fiduciary duty to the Tribe, to the effect that, if there is more than one reasonable interpretation of a regulation, we must adopt the interpretation that best promotes the Tribe's interests.

The regulation in effect for the period in question here, 25 C.F.R. § 211.13(a) (1996), governing computation of royalty on Tribal leases, provides: "[R]oyalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), whichever is the greater." Section 3(c) of the standard lease form contains substantially similar language. Neither provision states that royalty will be computed by using the greater of the value of the casinghead gas or the component products thereof only if the casinghead gas is sold.

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<sup>13/</sup> As noted above, that fact is disputed by MMS, which asserts that Bayless "admits that it sold wet gas in the field or area during certain months," citing its SOR at 11 and its MMS SOR at 4. (Answer at 4.) It is unnecessary to resolve this factual question in view of our ruling herein.

Section III of NTL-1A required dual accounting by lessees holding Tribal leases:

Unless and until the Supervisor has established that one of the following methods consistently yields the greatest royalty to the Indian lessor, lessees and operators shall compute royalty based on (1) the value of the wet gas produced from the lease adjusted for its Btu content, (2) the value of the separate components after processing and adjustment for the approved manufacturing allowance, and (3) the gross proceeds accruing to the operator. The method that yields the greatest royalty on a monthly basis each month will be reported as royalty due.

42 Fed. Reg. at 18137. NTL-1A remained in effect only until March 1, 1988, but the requirement for dual accounting for Indian leases was retained in the 1988 regulatory revision, which was in effect for the balance of that time. Under 30 C.F.R. § 206.155 (1995),

[t]he requirement for accounting for comparison contained in the terms of leases, particularly Indian leases, will govern as provided in § 206.150(b) of this subpart. <sup>[14/]</sup> When accounting for comparison is required by the lease terms, such accounting for comparison shall be determined in accordance with paragraph (a) of this section.

Paragraph (a) provided the methodology as follows:

[T]he value, for royalty purposes, shall be the greater of (1) the combined value for royalty purposes of the residue gas and gas plant products resulting from processing the gas determined pursuant to § 206.153 of this subpart \* \* \* or (2) the value, for royalty purposes, of the gas prior to processing determined in accordance with § 206.152 of this subpart.

(Emphasis supplied.) From this it is clear that, even when (as here) gas is processed, the value for royalty purposes may be the value of the gas prior to processing. This interpretation is consistent with the language of 30 C.F.R. § 206.152(a)(1), governing valuation standards for unprocessed gas, which notes that it "applies to processed gas that must be valued prior to processing in accordance with § 205.155." It is thus reasonable to interpret these regulations to mean that casinghead gas must be valued (even if processed instead of being sold at the wellhead), and that royalty computed on that value must be paid, if higher than royalty computed on the value of the products of the gas or casinghead gas. Thus, under principles governing interpretation of law in keeping with the Department's Indian trust responsibility, we conclude that dual accounting was properly required here.

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<sup>14/</sup> That section provides that, "[i]f \* \* \* the oil and gas lease subject to the requirements of this subpart are inconsistent with any regulation in this subpart, then the lease \* \* \* shall govern to the extent of that inconsistency." 30 C.F.R. § 206.150(b).

[3] Appellant argues that MMS, in requiring dual accounting, did not properly apply the benchmarks established at 30 C.F.R. § 206.152(c) (for unprocessed gas) and at 30 C.F.R. § 206.153(c) (for processed gas). Bayless concedes that, if dual accounting is required, MMS must look to those benchmarks. (SOR at 11.) However, it asserts that MMS made two errors in doing so.

Bayless argues, first, that

the Contested Decision states that the value of the liquids processed from Bayless's gas should be the gross proceeds received by Northwest Pipeline. Contested Decision p. 17. Where the gas was processed under Bayless's "keep whole" contract, the consideration received by Bayless for the liquids was the Btu equivalent in the form of residue, less the cost of processing. Even if use of the second benchmark is thought to be necessary because Bayless sold the gas at the wellhead prior to processing, the purpose of a proper inquiry under the second benchmark is to determine value at the tailgate, not Northwest Pipeline's gross proceeds.

(SOR at 11.) MMS responds that,

[b]ecause Bayless did not sell the liquids – it traded them for residue gas – MMS valued the liquids under 30 C.F.R. § 206.153(c). The first benchmark considers the proceeds under the non-arm's-length contract. However, Bayless did not receive any proceeds. Therefore, MMS bypassed this benchmark and valued Bayless' gas under the second benchmark. In relevant part it states:

A value determined by consideration of other information relevant in valuing like-quality residue gas or gas plant products, including gross proceeds under arm's-length contracts for like-quality residue gas or gas plant products from the same gas plant or other nearby processing plants.

30 C.F.R. § 206.153(c)(2).

Under the second benchmark, Northwest's proceeds establish value at the tailgate of Ignacio because they are the gross proceeds under arm's-length contracts for like-quality gas plant products from the same gas plant. Therefore, MMS' use of Northwest Pipelines' price in valuing the liquids in this part of the dual accounting calculation is correct.

(Answer at 13-14.) MMS' explanation is persuasive. We find that MMS properly proceeded to value Bayless' production using the second benchmark in these circumstances.

Second, with respect to valuing wet gas, Bayless argues that

the Contested Decision correctly states that the arm's-length price paid at the CDP establishes wet gas value for those months when there were sales at the CDP, but then states that in months when there were no sales from the CDP, a transportation-adjusted version of the so-called Btu method should be employed under the second benchmark. Contested Decision, p. 25, 26. The Btu method, however, is a net-back under the third benchmark and should not be employed if there were other spot sales of similar quality and quantity wet gas in the field or area.

(SOR at 11-12.) MMS responds:

Bayless is incorrect. The second benchmark provides several factors to consider. One of those factors is "other information relevant in valuing like-quality gas." The other information is transportation-adjusted residue gas prices, adjusted for Btu content to reflect the value of the wet gas before processing.

Contrary to Bayless' assertion[,] the Btu adjustment is not a "net-back" method. A net-back method begins with a sales price of a product and subtracts various costs incurred. The Btu adjustment is simply an adjustment in value to reflect thermal energy content.

Once again, we hold that MMS has explained its use of the benchmarks here. Although the benchmarks are not a "perfect fit" to the unusual situation presented here, they provide a reasonable basis for determining value under the various alternative scenarios presented in the dual-accounting process.

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

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David L. Hughes  
Administrative Judge

I concur.

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R.W. Mullen  
Administrative Judge