

INTERIOR BOARD OF LAND APPEALS

Burlington Resources Oil and Gas Co.

151 IBLA 144 (November 30, 1999)

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BURLINGTON RESOURCES OIL AND GAS CO.

IBLA 98-476

Decided November 30, 1999

Appeal from a decision of the Acting Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, affirming an order directing oil and gas lessee to pay additional royalties for certain Ute tribal and allotted gas leases in accordance with a major portion analysis on gas production. MMS-96-0139-IND.

Reversed.

1. Oil and Gas Leases: Indians: Tribal Lands--Oil and Gas Leases: Royalties: Reasonable Value

"Reasonable value" for the purpose of calculating royalties due to the United States is determined by the highest price paid for the major portion of like quality products produced or sold in arm's-length transactions from the same field or area or the gross proceeds actually received in sales by the lessee, whichever is higher. Nonarm's-length transactions may not be included in base data for major portion analysis.

APPEARANCES: Phillip R. Clark, Esq., and Peter O. Hansen, Esq., Denver, Colorado, for appellant; Stephen L. Simpson, Esq., Office of the Solicitor, Division of Indian Affairs, U.S. Department of the Interior, for the Minerals Management Service and Bureau of Indian Affairs.

OPINION BY ADMINISTRATIVE JUDGE TERRY

Burlington Resources Oil and Gas Company (formerly known as Meridian Oil Inc.) (Burlington or appellant) has appealed from the June 16, 1998, decision of the Acting Deputy Commissioner of Indian Affairs (DCIA), Bureau of Indian Affairs, which granted appellant's appeal with respect to two leases (5190000220 and 5190000250) and denied its appeal with respect to other issues. Principal among the issues for which appellant was not granted relief was the demand to pay additional royalties in the amount of \$767,309.77 for the period January 1987-December 1991.

A brief historical review is necessary. Through an Issue Letter dated June 10, 1993, Burlington was advised by the Chief, Valuation and Standards Division, Minerals Management Service (MMS), that it had potentially underpaid royalties on Southern Ute tribal and allotted leases in

the amount of \$615,015.50 for the period January 1987-December 1991, based on the MMS' calculation of the "major portion" price for the audit period. Subsequent to the Issue Letter, Burlington was advised that the "major portion" prices were being recalculated and that a new Issue Letter would be provided. In a Demand Letter dated January 20, 1996, the Chief of the Valuation and Standards Division of the MMS ordered Burlington to report and pay additional royalties in the amount of \$767,309.77 for the 1987-91 audit period. An appeal of the Demand Letter to the DCIA followed.

In response to appellant's appeal of the Demand Letter, the DCIA, in her June 16, 1998, decision (Decision), addressed each of appellant's contentions. In response to appellant's claim that the MMS calculation of major portion prices was contrary to the applicable regulations, the DCIA determined that MMS, using the best data available, had aggregated and analyzed a statistically significant number of sales and derived an estimate of major portion value that, under the principles of statistical analysis, is considered to be highly accurate. (Decision at 5.) She further concluded, based on her review of the database, the available sales, the methodology used by MMS, and considering the inherent limitations relating to the availability of data, that MMS "has substantially complied with the requirements of the regulations, keeping in mind that the regulations were intended to be flexible so that they could be applied to a variety of circumstances." (Decision at 5-6.)

The DCIA next addressed appellant's assertion that in performing the major portion analysis, MMS failed to distinguish between arm's-length and nonarm's-length contracts as required by 30 C.F.R. §§ 206.152(a)(3)(i), 206.153(a)(i). The DCIA explained that the MMS Royalty Management Program (RMP) acknowledged that the database it used to determine major portion does not distinguish between arm's-length and nonarm's-length contracts. However, she determined, as had the RMP, that appellant would in no way be prejudiced by the inclusion of nonarm's-length contracts in the analysis, as the intent of the regulation was to ensure that the major portion calculation would not be unreasonably biased downward as the result of possibly low nonarm's-length prices. She stated:

The regulation was not intended to prevent the performance of a major portion calculation in situations where there are a large number of sales and there is no way to separate the data for non-arm's-length sales from the data for arm's-length sales. To the extent that the regulatory provision specifying the use of arm's-length prices in the major portion calculation is inconsistent with carrying out the intent of the lease term, then the lease term governs. See 30 CFR 206.150(b) (1988).

(Decision at 6.)

The DCIA addressed directly appellant's contention that MMS' calculations were based solely on sales reported for Southern Ute tribal and allotted lands and not from the entire gas field in which Southern

Ute Indian leases are located. Appellant contends that inclusion of the entire gas field is required. In her decision, the DCIA stated that for purposes of the major portion analysis, the MMS defined the "field" as the five fields within the Reservation boundary of the Southern Ute Indian Reservation, as had the Colorado Oil and Gas Conservation Commission, and MMS simply used the State designations. (Decision at 7.) This designation was consistent, she asserted, with the language in the "Preamble to Revision of Gas Royalty Valuation Regulations" at 53 Fed. Reg. 1230, 1238 (Jan. 15, 1988), which provides: "For royalty computation purposes, the definition of 'area' must remain flexible so that it may be applied to diverse situations. The size of an area may vary with each specific royalty valuation determination for gas." Id. She stated that the MMS definition of the field/area in the instant case was fully consistent with that policy. Id.

In response to appellant's claim that the major portion analysis did not use like-quality (legal, chemical and physical characteristics) lease products in its calculations, the DCIA found otherwise. Responding to appellant's claim that the legal characteristics of products analyzed was flawed because the Auditing and Financial System (AFS) database failed to identify sales of gas that qualified for certain Natural Gas Policy Act (NGPA) regulated price categories and exclude these sales with different legal qualities, the DCIA found that the major portion prices that MMS calculated closely approximated the spot market prices for the area, and that there was no evidence that NGPA-regulated prices materially affected the outcome of its calculations. (Decision at 8, citing Major Portion Analysis at 5.) The DCIA stated that MMS had advised Burlington that it could use the maximum lawful price (MLP) for royalty valuation purposes in lieu of the major portion price in those instances where it could show that it did receive the MLP for production from the subject lease during any sales month. Id. Because appellant had provided no information in its appeal to the Deputy Commissioner of the existence of sales in the field that involved MLP, she found appellant had provided no evidence showing error. Id.

Similarly, with regard to appellant's claim that MMS calculations ignore the like quality requirement concerning physical and chemical characteristics, the DCIA found otherwise. She explained that the two main variables in the physical and chemical makeup of the gas produced from the various formations in the field were carbon dioxide content and British thermal unit (Btu) content, but that both were accounted for in the major portion price. She determined that since the cost of removing carbon dioxide from the gas stream is not an allowable deduction from royalty value, it does not affect royalty value and is not pertinent to the discussion. Id. With respect to Btu content, the DCIA found that RMP adjusts for Btu content by using a \$/MMBtu major portion price. Id.

In adjudicating appellant's claim that in addressing differences in Btu content, MMS based its calculations on assumptions rather than reliable data, the DCIA found that for those sales where an assumed gas

quality was used (when the reported quality of gas was outside the range of 700 Btu/cubic foot to 1,550 Btu/cubic foot) did not have a material effect on the calculated major portion prices. (Decision at 9.) The DCIA determined that the reasonableness of the MMS calculations was shown by the correlation between the published spot prices, a reasonable indicator of the natural gas market, and the estimated median values (major portion prices). Id. She found that the estimated median values and spot prices followed the same pricing trends during the audit period, the spot market prices being consistently higher in 1988, 1989, and 1990, and almost identical in 1987 and 1991. Id.

Appellant also challenged the MMS failure to distinguish between processed and unprocessed gas in its major portion analysis. The RMP calculated a single monthly major portion price for both residue (processed) gas and unprocessed gas. The DCIA found that combining both did not materially affect that analysis because:

1. There was relatively little residue gas reported for the Southern Ute leases; and
2. Differences in physical characteristics between residue and unprocessed gas were accounted for by RMP's calculation of a \$/MMBtu estimated median value.

(Decision at 10.) Moreover, she found that the appellant had neither alleged nor shown that any of its gas was processed (and therefore had a lower Btu content) and/or that it was, or could have been, prejudiced thereby. (Decision at 10.)

Appellant had also alleged that it could not understand how MMS accounted for transportation and processing costs, if at all. The DCIA set out the methodology used by the RMP in her decision, and stated that appellant had been advised by MMS in the audit Issue Letter of June 10, 1993, that the allowance would be calculated as follows:

Where the contract price received by the Appellant was reduced by a transportation factor and royalties were reported net of those costs on Form MMS-2014, the Appellant may provide a schedule of the transportation factors and MMS will adjust the imputed price and royalty liability schedules accordingly.

(Decision at 10.) The DCIA noted in her decision that although appellant had been asked to provide data from arm's-length contracts related to the transportation factor during the audit period, the appellant had not provided MMS with documentation on any leases or sales months that contain transportation factors. (Decision at 11.)

In response to appellant's contention that the price data reported on Form MMS-2014's and used by MMS to determine royalty was not reflective of actual prices offered or paid for gas in the field, the DCIA found that

the factors included, to which appellant objected—dual accounting, gas contract settlement proceeds, settlement of royalty disputes, and use by producers of the major portion price—had not been shown by appellant to have made the prices used in the major portion analysis higher than the prices actually paid for the gas. Id. Indeed, she stated, several factors tended to mitigate any negative consequences that conceivably could have resulted from inclusion of these elements. She found:

With respect to lump sum proceeds, standard MMS practice is to report the settlement as a lump sum payment on a single line attributable to 0.01 mcf of production. This would make its effect too small to materially change the outcome, and indeed the Appellant has provided no evidence that such payments actually did affect the result. Furthermore, many settlement payments result from under reporting of value, in which case the settlement payment should be included in the value reported on Form MMS-2014 and should be used in the major portion analysis.

With respect to gas contract settlement proceeds, the Appellant again has provided no evidence that these were included or that they affected the result. In any case, MMS has maintained that contract settlement payments are part of the lessee's gross proceeds and, in effect, represent part of the price received by the lessee for the gas. Thus, these arguably should be included in the major portion calculation. However, given that the prices reported on the Form MMS-2014 closely track spot prices in the area [reference above], it is unlikely that any such proceeds that may have been included materially affected the result.

With regard to major portion pricing, there is no evidence that any lessee in the area performed a major portion analysis or paid royalties based on major portion prior to the issuance by MMS of the current orders. As for dual accounting, again the Appellant provided no evidence to indicate that any lessees, as a result of performing dual accounting, reported higher values on Form MMS-2014 than they would have reported based on the price they received for their gas, much less that any such reporting had a material affect on the result. As stated above, the fact that the prices reported on Form MMS-2014 closely track spot prices indicates that there was no such effect.

(Decision at 11-12.)

The DCIA addressed directly appellant's claim that it was not provided sufficient information to be able to understand the underlying rationale for MMS' order demanding additional royalty or to be able to verify the accuracy and correctness of MMS' assumptions. She determined

that appellant had been provided the relevant Major Portion Analysis Report, all relevant correspondence between the parties on major portion analysis, the dBASE IV computer program that identified the estimated median values (major portion prices), the dBASE IV computer program that processed and removed adjustments from the AFS database, and the dBASE IV file structure for the files provided on eight attached diskettes that contained the detailed AFS data. (Decision at 12-13.) She determined, after review, that the information and data provided were sufficient to fairly and adequately apprise appellant of the basis for the claim. (Decision at 13.)

The DCIA further determined that appellant's claim that the major portion analysis of the Southern Ute leases is arbitrary and capricious, because it is "unlawfully retroactive" and constitutes "a new and revised position," which is not supported by the facts. She found that the requirement that the Secretary consider the highest price offered or paid for the majority of like-quality gas produced or sold from the same field or area when valuing lease production for royalty purposes is embodied in the terms of the leases themselves. (Decision at 13-14.) With respect to appellant's possible statute of limitations defense (reserved in a footnote in appellant's Statement of Reasons (SOR)), the DCIA held that because the purpose of the appeal was to determine the validity of an MMS order that concerns the underlying obligation for royalty, "the alleged applicability of a statute of limitations does not limit administrative proceedings within the Department of the Interior." (Decision at 14.) She stated that since this proceeding is an administrative appeal, not a court action, the statutory bar is inapplicable. *Id.*, citing BHP Petroleum, Inc., 124 IBLA 185 (1992); Anadarko Petroleum Corp., 122 IBLA 141 (1992).

With respect to appellant's defenses of laches and estoppel (also reserved by appellant in its SOR), the DCIA stated that it is well established that the authority of the United States to enforce a public right or protect a public interest is not vitiated or lost by the neglect of its officers or the delay in their performance of duty. (Decision at 14, citing Alyson A. Allison, 72 IBLA 333 (1983); Warren L. Jacobs, 71 IBLA 385 (1983).) She determined that delays are reasonable in view of the burden upon MMS to perform this audit function for the many leases it must manage. *Id.* She found that royalty payments are always subject to later audit. *Id.*

In addressing appellant's contention that the assessment of late payment interest is contrary to law because late payment was caused by MMS, the DCIA held that under the Federal Oil and Gas Royalty Management Act, 30 U.S.C. § 1721 (1994), and the regulations at 39 C.F.R. §§ 218.54 and 218.150, MMS has the responsibility to make such an assessment in connection with monies due the United States from activities covered by the regulations. (Decision at 15, citing Sun Exploration and Production Co., 104 IBLA 178 (1988).) She determined that the late payment interest referred to by appellant is simply a reimbursement to the lessor of the time value of funds not paid on a timely basis. *Id.*, citing Cities Service Oil and Gas Corp., 104 IBLA 291, 295 (1988).

Appellant had contended with regard to certain of the leases that it was not the lessee and therefore not liable for royalties. MMS determined in its February 20, 1996, order that of the 20 Ute leases considered, appellant was the lessee in 11 and the holder of the operating rights in 7 others. The DCIA found that Burlington had responsibility for additional royalty payments for the 18 leases for which it either had operating rights or was the lessee, as determined by the RMP. (Decision at 16, citing 30 U.S.C. § 187 (1994); 43 C.F.R. § 3106.7-2 (1996); 43 C.F.R. § 3162.1(a) (1996).)

In its 1998 Statement of Reasons (1998 SOR) for appeal of the Deputy Commissioner's decision, Burlington urges that the DCIA decision must be reversed because the MMS' "major portion" calculations violate MMS' own regulations. Citing the pre-1988 regulations and the 1988 regulations, appellant states that a major portion price may only be determined "if data are available to compute a major portion," and then calculations shall be made using "like quality gas sold under arm's-length contracts from the same field for each month." (1998 SOR at 3.) Claiming that the data was not available for the major portion calculations, appellant further argues that the data used contained nonarm's-length sales even though the 1988 regulations require that only arm's-length sales be used in the major portion calculation. (1998 SOR at 4.) Moreover, appellant states, the requirement that only like quality lease products be used to calculate the major portion price was violated as the legal characteristics of the gas were not considered in that NGPA categories of gas were not taken into account in the analysis. Id.

Additionally, appellant claims, prices increased by dual accounting and included within the data used do not reflect a price actually paid or offered for gas and thus under the regulations cannot be included in a major portion calculation. (1998 SOR at 7, citing 30 C.F.R. §§ 206.103 (1987), 206.152, 206.153 (1991).) Equally significant, appellant argues, settlement proceeds, which may or may not be royalty bearing when received by Burlington, may relate to periods prior to the audit period and thus are not appropriately included within the major portion calculation, and, even if they relate to the audit period, may or may not relate to a price paid or offered for gas during that period. Id. Appellant claims that MMS' assertion that settlement payments would have little effect on the MMS calculations because lump sum settlement payments are generally reported on a single line attributable to 0.01 mcf of production is plainly incorrect, and that the inclusion of a high reported value for a corresponding minuscule volume would dramatically skew the estimated major portion price upward. Id.

With regard to the requirement that sales of like quality gas be calculated in the major portion analysis, appellant states that MMS' contention in the Major Portion Analysis Report that "production within the reservation boundary is fairly homogeneous" is not true. Id., citing Major Portion Analysis Report at 2. Appellant asserts that production from Southern Ute lands includes production from multiple conventional

formations (Dakota, Mesa Verde, Pictured Cliffs), as well as from the Fruitland Coal Formation, where the coalbed gas is radically different. Id. Appellant argues that the DCIA determination that differences in carbon dioxide content is irrelevant because removal is not an allowable deduction is without basis, as MMS has failed to analyze whether removal is required to place the gas in marketable condition or is a deductible transportation or processing cost. (1998 SOR at 8.) Further, appellant maintains, MMS' calculations cannot be said to identify "majority price" for a "certain geographical area" as required because MMS' use of 2014 data exclusively does not distinguish between gas sold at the well in the local market and gas sold at the city gate in Los Angeles. Id.

Appellant urges that the decision also fails to accord Burlington credit for transportation allowances in the major portion price determined. Citing 53 Fed. Reg. 1246 (Jan. 15, 1988) for the MMS position that "transportation allowances generally are appropriate for most Indian leases," appellant states that nowhere does MMS justify its disregard of these allowances in its major portion analysis. Id. Moreover, appellant argues, MMS' claim that the calculated major portion prices "are reasonable" is irrelevant to the validity of these prices due to MMS' failure to comply with applicable regulations. (1998 SOR at 8-9.) Burlington urges that the fact that the major portion prices "closely approximate the spot market prices for the area" is irrelevant to prices at the lease, relevant here, as the spot market prices are for sales at the mainline interconnect, downstream from the leases. Appellant claims the Major Portion Analysis Report does not indicate that it made adjustments to the spot market prices to calculate a relevant well head price. (1998 SOR at 9.)

Appellant argues that the DCIA decision erred in finding that where the regulations and the intent of the lease terms differ with regard to use of only arm's-length sales is calculating major portion prices, the lease terms govern and allow consideration of both arm's-length and nonarm's-length sales to be calculated. Id. Appellant states that the provisions of each do not differ, although the lease is general and the regulations specific, and MMS is required to use only arm's-length transactions required by the regulations in its calculations. (1998 SOR at 10.)

With regard to the 1996 Demand Letter, appellant argues that the DCIA erred in approving it because it is contrary to law in holding Burlington liable for the royalty obligations of other producers who are also working interest owners of the leases. Id., citing Mesa Operating Limited Partnership, 125 IBLA 28 (1992), modified in part, 128 IBLA 174 (1994); Phillips Petroleum Co. and Phillips 66, 121 IBLA 278 (1991). Burlington also claims that the Demand Letter is unlawfully retroactive. Appellant states that MMS violated the requirement that a major portion calculation will not be performed if adequate data is not available or if it is impractical to do so. Id., citing 30 C.F.R. § 206.152(a)(1) (1991). That is precisely the case here, appellant claims, because Burlington is being required to pay additional royalties in 1996 based on "approximate"

calculations of major portion going back to 1984 but not made until 1993. Id. Appellant urges that Sun Exploration and Production Co., 112 IBLA 373 (1990), is on point, and that MMS should be precluded from a claim against Burlington based, not on retroactive application of the regulations, but on retroactive application of admitted "departures" from the regulations. (1998 SOR at 11-12.)

Further, appellant claims, the Demand Letter and its approval are deficient for other reasons. Since the demand for additional payment is certainly not the fault of Burlington, assessment of interest on the late payment is not authorized. Citing 49 Fed. Reg. 37336, 37340 (Sept. 21, 1984), appellant claims that interest should be waived for an additional payment "that was not calculated by the MMS until nine years after the fact based on data exclusively within the possession of the MMS and using a methodology that the MMS admits departs from the regulations." (1998 SOR at 13.) Finally, Burlington argues, the MMS has failed, without articulating an adequate basis, to give effect to reversal entries identified by appellant in its March 18, 1996, letter to MMS. Id., citing Field Report at 5.

In its Answer, MMS states that it calculated major portion prices with respect to the Southern Ute leases in this case pursuant to the regulations, just as it has for all Tribes holding gas or oil leases when practicable. Respondent claims that, contrary to appellant's assertion, the MMS major portion calculation for the Southern Ute Reservation did comply with 30 C.F.R. §§ 206.152(a)(3)(i) and 206.153(a)(3)(i) (1991). (Answer at 3.) Respondent notes that the terms of the Southern Ute tribal leases specify:

"Value" for the purposes hereof may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered (whether calculated on the basis of short or actual volume) at the time of production for the major portion of the oil of the same gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and sold from the field where the lease lands are situated.

Id., citing 25 C.F.R. § 211.13 (1995). In meeting the Secretary's trust responsibility, respondent states, MMS used the median value method to establish a reasonable value for royalty purposes. (Answer at 4.) Respondent explains that after reviewing all available databases, MMS found that no usable databases existed that contained 100 percent of the gas sales for the Indian, State and fee leases, nor did any available databases contain reliable information regarding NGPA categories of wells or whether sales were arm's length or nonarm's length on the Reservation. Based on its research, respondent claims, MMS determined its AFS database, which contains information regarding the quality of gas (Btu content) and monthly royalty reports, was the best available database to calculate monthly major portion values for leases on the Southern Ute Reservation. Id.

In addressing appellant's contention that the necessary data was not available for the required major portion calculations and that the calculations that were made did not involve sales of like-quality gas or include only arm's-length sales, respondent states that the "estimated calculations" that were made comply with the regulations. (Answer at 4-5.)

In evaluating the data that was available, respondent argues, MMS used a volume-weighted mean that took into account the volumes of gas at each sales price. (Answer at 5.) Respondent states that MMS was able thereby to obtain statistically significant measures of the central location of price. Id. By using sample sizes in the hundreds of thousands of prices, respondent claims, "MMS was able to establish an interval estimate and to determine the probability of a true population parameter falling within the interval estimate, i.e., the probability that the interval contains the population mean." Id. Then, MMS claims, by calculating intervals for each monthly weighted average median value, it was able to establish a 99 percent confidence level that the sample major portion value represents the population major portion value within plus or minus \$0.006/MMBtu (million Btus). (Answer at 6.)

Respondent urges that the regulations do not restrict major portion calculations to those performed only when the necessary data from the same field is available. MMS claims that it can also obtain a reasonable sample from the area to perform the calculations, and that in this case, it did just that in determining major portion prices for the Southern Utes as part of its fiduciary responsibility to the Tribe. Id. Respondent asserts that the major portion methodology employed is a well-reasoned analysis using the best available data. (Answer at 7.)

Respondent next addresses appellant's contention that MMS did not consider all like-quality gas in the major portion calculation, as required, because NGPA (regulated) categories of natural gas were not differentiated in the Major Portion Analysis Report. This occurred despite the fact that regulated gas is included in one such category created by the NGPA, which also created the MLP for almost all categories of gas, including regulated gas. Appellant's concern relates to the fact that under 30 C.F.R. §§ 206.152(c)(3)(d)(1) and 206.153(c)(3)(d)(1), if the MLP is less than the value determined by major portion calculation, the MMS shall accept the MLP as the value, even if the MLP is higher than the actual sales price within a category. Respondent answers that the inclusion of all available sales data in the major portion calculation has the effect of establishing median values for higher-priced categories under the NGPA at levels equal to or less than those which would have been established utilizing only the sales of a particular category of gas from that field. Id. According to respondent, use of the AFS database allowed MMS to determine the highest price paid or offered while, at the same time, limiting the royalty value at the MLP for any particular NGPA category of gas, thereby limiting the impact on the lessee. (Answer at 8.)

In response to appellant's claim that the gas considered by MMS includes a wide variance of Btu content, whereas the Btu content of appellant's gas is consistently below 1,000 Btus/cf, respondent states that appellant has not shown that MMS' assumptions regarding Btu quality materially affected the estimated median value or prejudiced the appellant in any way. Id. MMS explains that all the prices are calculated on a dollar per Btu basis, then adjusted to an average of 1,000,000 Btus. Under this adjustment, MMS claims, all gas is placed on a level playing field and this ensures MMS' calculations are for like-quality gas. Id.

With respect to appellant's contention that MMS failed to differentiate between unprocessed and processed gas (with lesser Btu content), respondent states that differences in physical characteristics between residue and unprocessed gas were accounted for by MMS' calculation of a \$/MMBtu estimated median value. (Answer at 9.) With regard to appellant's claim that MMS failed to determine whether removal of carbon dioxide was required to place the gas in a marketable condition, respondent asserts that generally, processing costs are a deduction from the value of the natural gas liquids (NGL's) that are extracted by processing, but that MMS did not perform any major portion analysis on NGL's. Id. More significantly, MMS states, the cost of removing carbon dioxide is not an allowable deduction from the value of gas and Burlington would have to increase the royalties it pays to the extent that carbon dioxide treating costs are deducted from the contract price. (Answer at 10.)

In answer to appellant's claim that MMS violated 30 C.F.R. §§ 206.152(a)(3)(ii) and 206.153(a)(3)(ii), by including nonarm's-length contracts in its calculation of major portion price, and that this resulted in higher reported royalty prices, respondent claims that appellant has provided no documentation to show that the data used by MMS contained nonarm's-length contract prices. Moreover, respondent claims, the DCIA determined that the inclusion of nonarm's-length contracts would skew the values down, resulting in a lower portion price for appellant. Id., citing Decision at 6.

Appellant had urged that MMS erred in limiting the subject area of the major portion analysis to the Southern Ute Reservation and not the entire field. Respondent states, as noted by the DCIA in her decision, that the purpose of the MMS calculation was to arrive at a major portion value for all gas leases on the Reservation, so MMS included all five fields on the Reservation in the area it examined. Considering the purpose of the analysis, MMS claims, inclusion of the five fields to form an easily definable area is a reasonable exercise of its discretion. (Answer at 12, citing 53 Fed. Reg. 1230, 1238 (Jan. 15, 1988).)

In response to appellant's contention that the data used by MMS was not reflective of actual prices, respondent claims that appellant has offered no specific evidence in support of this allegation, and moreover, that "the factors speculated upon by Appellant are highly unlikely to have affected the calculations." Id. Respondent notes that lump sum payments

are reported on a single line of the Form MMS-2014 attributable to only 0.01 mcf of production and would therefore not materially affect the major portion calculation. Respondent further states that contract settlement payments would be part of lessee's gross proceeds, in any event, and thus represent part of the price received by the lessee for the gas and would be properly included in the calculations. (Answer at 13.) Similarly, MMS states, dual accounting is a calculation required under the regulations and lease terms and is therefore appropriate to be "used in determining the value of production for royalty purposes." Id., quoting 30 C.F.R. §§ 206.152(a)(3)(i) and 206.153(a)(3)(i) (1991). Finally, respondent argues, there is no evidence that any lessee operating on the Reservation performed a major portion accounting on their own during the subject period. Id.

In answer to appellant's assertion that the major portion analysis did not differentiate between sales with different pricing on the lease and at the city gate in Los Angeles, respondent explained that only BLM can approve the points of royalty settlement for leases on the Reservation, and no approval has been given for settlement at the city gate. (Answer at 14.)

Responding to appellant's assertion that allowances were not made for transportation costs in the major portion recalculation, MMS states that where the contract price was reduced by a transportation factor and royalties were reported net of those costs, appellant could provide a schedule of transportation factors and MMS would adjust accordingly. (Answer at 14, citing MMS Field Report at 9-10.) MMS notes that appellant has not provided it with documentation on any leases or sales months with transportation factors, nor has it alleged the existence of any such factors in this appeal. Id.

In answer to appellant's contention that MMS' reliance on spot market prices at the interconnect, versus wellhead prices paid to appellant, were inaccurate because they would reflect higher prices, respondent observed that published spot prices published by El Paso Natural Gas for sales in the San Juan Basin are one of the best indicators of prevailing market value in the area. Respondent states that a comparison of the spot prices and the major portion prices tended to reinforce the reasonableness of MMS' calculations. (Answer at 15.)

Appellant has contended that the major portion analysis process is based upon uncertainties and inaccuracies. In response thereto, MMS claims that major portion calculations are, by necessity, estimates of the actual market values, but, when checked against those values, are reasonable. (Answer at 16.) Moreover, MMS claims, all lessees are provided full opportunity to check and correct its calculation. Id. In that regard, respondent claims, as a result of reversal entries overlooked by MMS but pointed out by appellant, "MMS recalculated the major portion due on the subject leases to take account of corrections noted by Appellant." (Answer at 15.)

Respondent answers directly appellant's allegation that MMS' current calculation of major portion values "using inadequate data" constitutes a change in interpretation of its regulations that cannot be applied retroactively. (Answer at 17.) MMS states that this was not a new or different interpretation of an existing regulation, as in Sun Exploration and Production Co., supra, but represents "MMS' assumption of the responsibility for performing major portion calculations as specified in the regulations." (Answer at 18.)

Finally, in response to appellant's charge that interest should not be charged for underpayments resulting from the failure to perform calculations based upon information exclusively within MMS' control, and that the claim and the interest thereon are barred by the statute of limitations, respondent states once again that "MMS has the authority to enforce a public right or protect a public interest, which is not lost by acquiescence of its officers or by their laches, neglect of duty, failure to act, or delays in performance of their duties." (Answer at 18, citing Otav Mining Co., 62 IBLA 166, 168 (1982).)

[1] As an initial matter, we review the history of calculating royalty based on major portion analysis. ^{1/} In a December 1991 settlement agreement in Kauley v. Lujan, No. 84-3306T (W.D. Okla. 1991), MMS agreed to determine natural gas values on Indian lands based on the highest price offered at the time of production in arm's-length transactions for the major portion of gas produced from the same field for royalty management purposes. MMS indicates that it has since applied the same commitment to all Tribes, when practicable, performing major portion analysis for all oil and gas leases in an attempt to get the highest royalty for Indian oil and gas as required by the Federal Government's trust responsibility. See Seminole Nation v. United States, 316 U.S. 286, 297 (1942).

The regulations at 30 C.F.R. §§ 206.152(a)(3)(i) (unprocessed gas) and 206.153(a)(3)(i) (processed gas) (1991) contain identical language:

For any Indian leases which provide that the Secretary may consider the highest price paid or offered for a major portion of production (major portion) in determining value of production for royalty purposes, if data are available to compute a major portion, MMS will, where practicable, compare the value determined in accordance with this section with the major portion. The value to be used in determining the value of production for royalty purposes shall be the higher of these two values.

^{1/} IBLA 98-476 represents the first direct challenge before the Board to MMS' major portion analysis process.

"Major portion" is defined in 30 C.F.R. §§ 206.152(a)(3)(ii) (1991) as follows:

For purposes of this paragraph, major portion means the highest price offered at the time of production for the major portion of gas production from the same field. The major portion will be calculated using like-quality gas sold under arm's-length contracts from the same field (or, if necessary to obtain a reasonable sample, from the same area) for each month. [2/]

The record reflects that, in determining the major portion price, MMS used a volume-weighted mean that took into account the volumes of gas at each sales price. By establishing the median (the value falling in the middle when the data items are arranged in ascending order) and the mode (the gas price that occurs with the greatest frequency), MMS claims to have been able to obtain statistically significant measures of the central location of price. (Decision at 4.)

The record reflects that MMS next measured the dispersion of the prices, i.e., their spread or variability. By measuring dispersion, MMS claims, it was able to derive what statisticians refer to as the "standard error of the mean or median," i.e., the standard deviation for the distribution of the sample means or medians. MMS observed that a distribution of sample means or medians that is less spread out (small standard error) is a better estimator of the population mean or median than a distribution of sample means or medians that is widely dispersed and has a larger standard error. Id.

MMS claims that by using a large sample size, it was able to establish an interval estimate and to determine the probability of a true population parameter falling within the interval estimate, i.e., the probability that the interval contains the population mean. By calculating intervals for each monthly weighted average median value, MMS asserts that it was able to establish a high confidence level that the sample major portion value represents the population major portion value.

We are satisfied that the statistical methodology used, a standard process used to determine a statistically significant measure of the central location of a group of values, was capable of finding the central location of value for the population examined. We note that appellant likewise did not challenge MMS' methodology, per se. Our concern relates to the population of sales prices examined. In the present case, MMS states in its decision that it did not separate nonarm's-length transactions and prices from prices obtained in arm's-length transactions in the population considered, despite the requirement in its own regulations that

^{2/} 1987 and 1988 major portion prices were calculated based on the regulations in effect at that time, 30 C.F.R. § 206.103 (1986), which had substantially the same requirements for the major portion analysis.

only arm's-length transaction prices shall be considered in the major portion analysis. MMS claims that the database selected (AFS) for calculation of major portion prices did not include this information. However, the AFS included the largest number of sales, monthly sales reports from producers, and most nearly met the information requirements for the major portion analysis in certain other respects.

From the data presented in the record in this case, we are unable to discern, or even estimate or guess, what percentage of the number of sales, and their values, what range of Btu values, and what volume were nonarm's-length transactions. While MMS would blandly assert that this would work to appellant's advantage, appellant argues otherwise and the Board can visualize those circumstances where nonarm's length transaction prices are set between affiliates at artificial levels, up, as well as down, for tax and profit-indexing purposes. If there are a significant number of sales at lesser value and the major portion is skewed downward, the MMS calculation of major portion prices defeats the interests of the Southern Ute Tribe, an interest MMS is lawfully obligated to properly represent in a fiduciary capacity. If inclusion of the nonarm's-length sales has resulted in a higher major portion price, as appellant alleges, there is no way to determine from MMS' calculations how much in excess of the major portion price for arm's-length transactions authorized by the MMS regulation the Demand Letter amount represents. As sales by other working interest operators were included in the sales made the leases on the Reservation, appellant would certainly not be in a position, itself, to calculate all the nonarm's-length transactions that occurred between 1987-1991, as implied by MMS. Nor does the record reflect whether these other producers have differentiated nonarm's-length sales for MMS-reporting purposes during this time period.

More importantly, the royalty reporting system for Federal oil and gas leases on Indian lands is one controlled completely by MMS. During the audit period in question, Burlington paid all royalties based on actual sales prices. There is no indication within the record that appellant failed in any way to meet the royalty demands of MMS during that time period. The regulations establishing the criteria for major portion analysis were MMS regulations. The information reflected on the MMS Form 2014's was that requested by MMS, and could have been enhanced at MMS' will to include a list of nonarm's-length transactions and sales from regulated wells (NGPA sales). MMS did not do so, and there is no indication that it is doing so now.

The major portion analysis system was first proposed in 1984, although it appears that data to implement the system of major portion pricing was only analyzed after the December 1991 settlement agreement in Kauley v. Lujan, *supra*. It is important to note that major portion analysis is required only if arm's-length sales data is available and if these calculations are practicable. See 30 C.F.R. §§ 206.152(a)(3)(i), 206.152(a)(3)(ii) (1991). The required sales information was not

available nor was the calculation of a median price for a population including only arm's-length transactions using the AFS database in the case of appellant's sales for the 1987-1991 time frame. We find that MMS' use of nonarm's-length sales data required by 30 C.F.R. § 206.152(a)(3) to be inconsistent with the plain language of the regulation.

MMS' position that a major portion price can be established without an adequate database is out of place in the regulatory scheme described above and would negate the very protection for producers and Tribes that the Department intended. Moreover, MMS' interpretation effectively takes away by decision that which it has granted by regulation. Nevertheless, if other existing MMS databases with the necessary information can be merged with the AFS database to meet the regulatory requirements MMS has established, MMS is not precluded from recalculating the major portion price correctly. We do not find it necessary to reach the other contentions of appellant in this case.

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 June 16, 1998, decision of the Acting Deputy Commissioner of Indian Affairs is reversed as to the assessment of additional royalty and interest as set forth in the 1996 Demand Letter.

James P. Terry
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge