INTERIOR BOARD OF LAND APPEALS

Phillips Petroleum Co.

152 IBLA 109 (March 31, 2000)

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PHILLIPS PETROLEUM CO.

IBLA 98-261 Decided March 31, 2000

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 Oklahoma allotted Indian leases in accordance with a major portion analysis on gas production. MMS-97-0085-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 the database used to establish the median value against which gross proceeds received by appellant in arm's-length transactions are compared for major portion analysis. Where all sales, nonarm's-length and arm's-length, are combined to establish the data from which the median value is determined, that value may not establish the baseline majority price for comparison with appellant's arm's-length sales in major portion analysis computations.

APPEARANCES: M. Julia Hook, Esq., Marily Nixon, Esq., Denver, Colorado, and Karen F. Brand, Esq., Bartlesville, Oklahoma, for appellant; Howard W. Chalker, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service and the Bureau of Indian Affairs.

OPINION BY ADMINISTRATIVE JUDGE TERRY

Phillips Petroleum Company (Phillips or appellant) has appealed from the February 10, 1998, decision (February 10 Decision) of the Acting Deputy Commissioner of Indian Affairs (DCIA), Bureau of Indian Affairs, which

denied appellant's appeal of a February 24, 1997, Minerals Management Service (MMS or respondent) order with respect to additional royalties claimed owed in the amount of $11,996.29 as the result of major portion analysis on four leases 1/ for the period December 1, 1988, through December 31, 1990, and in the amount of $6,875.40 for five leases 2/ for the period January 1, 1991, through December 31, 1992. Total additional royalties demanded for the two periods aggregated to $18,871.69.

A brief factual review will prove helpful. The February 24, 1997, MMS order (February 24 Order) of the Chief, Royalty Valuation Section, directed appellant to compare median values calculated by MMS with the values reported by Phillips for gas produced from Phillips' allotted Indian oil and gas leases in Oklahoma for the designated periods, and to pay additional royalties for those gas sales in which the reported values were less than the median value, as calculated by MMS. 3/ Phillips' June 27, 1997, appeal (June 27 Appeal) of the February 24 Order asserted, inter alia, that (1) MMS had performed a totally inadequate major portion analysis and that it should not be upheld, (2) that the MMS February 24 Order improperly attempted to shift the burden of performing a proper major portion analysis onto Phillips, (3) that MMS is barred by the Federal statute of limitations in 28 U.S.C § 2415 (1994) from demanding payment of additional royalties in connection with transactions which took place more than 6 years prior to the date of the MMS demand for payment, and (4) that the order for additional royalty was barred by the equitable doctrines of laches and estoppel. (June 27 Appeal at 5-18.)

In the February 10 Decision here under appeal, the DCIA upheld the February 24 Order in its entirety, rejecting each of appellant's claims, and ordering Phillips to comply with the February 24 Order within 30 days of receipt of the decision. In affirming the Order of the Chief, Royalty Valuation Section, for additional royalties resulting from computations made possible by the major portion analysis, the DCIA stated: "The Appellant's obligation to comply with such orders arises not from the Kauley Agreement, but rather by the terms of its own Allotted Indian leases and the pertinent statutes and regulations." (February 10 Decision at 5.)

In its Statement of Reasons for appeal (SOR), Phillips initially claims that the DCIA's February 10 Decision improperly attempts to shift

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1/ The four leases are No. 607-022576-0, No. 607-027669-0, No. 607-060693-0, and No. 607-060694-0.

2/ The five leases are No. 607-022576-0, No. 607-025402-0, No. 607-027669-0, No. 607-060693-0 and No. 607-060694-0.

3/ In his Aug. 27, 1997, Memorandum to the Chief Appeals Division, Policy and Management Improvement, MMS, the Chief, Royalty Management Program (RMP), stated, in addressing Phillips' appeal of the Feb. 24, 1997, Order: "Our major portion analysis used all gas sales data for the field designated by the Committee--the regulatory agency responsible for such determinations." (Aug. 27, 1997, Memorandum at 5.)

the burden of performing a proper major portion analysis onto appellant. Citing 30 C.F.R. § 206.152(a)(3)(i), appellant states that this regulation first requires the payor to determine the royalty valuation of gas produced from Indian leases and sold pursuant to arm's-length contracts. (SOR at 6.) Then, Phillips states, if MMS chooses to perform a major portion analysis, the payor is to compare the royalty value as established under 30 C.F.R. § 206.152(b) with the value as determined under the major portion analysis, and pay royalties on the basis of the higher of these two values. (SOR at 7, citing 30 C.F.R. § 206.152(a)(3)(i).) In this case, appellant claims, since MMS failed to perform an adequate major portion analysis, Phillips was entitled to calculate and pay royalties based on gross proceeds, and was not required to value the gas production under the benchmark system codified at 30 C.F.R. § 206.152(c)(1)-(3), which applies to sales that are nonarm's-length. Id. Moreover, appellant states, there is no basis for MMS to claim that the exceptions to the standard methodology of royalty payment based on gross proceeds apply here because there is no evidence that the gross proceeds do not reflect the total consideration received by Phillips, and no evidence that the gross proceeds do not reflect the reasonable value of the production because of misconduct of seller or buyer or because of the breach of duty owed by the lessee to the lessor. (SOR at 7-8, citing 30 C.F.R. §§ 206.152(b)(1)(ii) and (iii).)

Appellant next argues that while 30 C.F.R. § 206.152 grants MMS the discretion to perform major portion analysis, any such analysis must be adequately conducted. This did not occur in the analysis of the subject leases, appellant claims. (SOR at 9.) For example, Phillips states, the data used in the calculation of the major portion analysis did not include all like-quality production from leases within the same field or area. Appellant then cites the example of the MMS' January 1986 major portion analysis data that showed the agency's records to be incomplete in that not all sales were included. Id. In that case, appellant states, "the agency's failure to include such prices had a significant impact on the MMS' previously-held position that GPM [Phillips' subsidiary] had underpaid royalties for certain Indian leases located in the two fields for that month." Id., citing GPM Order at Exh. 3 to SOR. Phillips claims that another systemic flaw in the major portion analysis conducted here was the failure to determine whether the natural gas production used in the MMS analysis was in fact of a like-quality to that produced from the leases during the audit periods involved. Id. at 10. In addition, appellant contends, MMS' analysis included gross inconsistencies in the number of records utilized from month to month, resulting in large variations in volumes and prices, as well as the use of identical volumes and prices more than twice in a given month. Id.

Appellant further argues that the MMS cannot rely on the Kauley Settlement Agreement to avoid performing an adequate major portion analysis. Phillips claims that MMS used a special methodology as a result of

this Agreement to perform its major portion analysis in this case, and that this special methodology, set forth in MMS' Field Report concerning the issues on appeal,

> required MMS to use gas sales information from the Oklahoma Tax Commission (OTC) to calculate statistical best estimates of major portion prices (estimated median values) for fields containing Anadarko Area Indian allotted leases and communicate these values to payors with the directive to recalculate and submit any additional royalties.

(SOR at 12, quoting Field Report, Exh. 4 to SOR at 2.) Appellant objects to this special methodology, which differs substantially from the requirements set forth in the regulations at Title 43 C.F.R., because: (1) it was not a party to the Kauley litigation; (2) MMS' trust responsibility cannot and does not require MMS to ignore the applicable laws and regulations; (3) the special methodology provides no guidance to MMS for the use of the concepts "best available data" and "insufficient data," and no guidelines for interpreting and applying these standards in a major portion analysis; and (4) MMS' decision to implement the special major portion methodology constitutes an abrupt departure from prior practice that would create a significant burden on Phillips and, as such, should not be applied retroactively to any of the production at issue in this appeal. (SOR at 13-15.)

Phillips also objects to the use of OTC information on gas sales for analysis purposes because it claims that information is incomplete. (SOR at 15.) Appellant states that it understands that OTC gathers price and volume information but that it does not collect information on Btu content, nor does it make adjustments for Btu content in the information it provides MMS. Id. For this reason, appellant argues, MMS could not make a useful comparison of "like quality" production in the field. Id. Phillips claims the information being used by MMS is incomplete in another way. It states that MMS has failed to include all wells in a particular field because of OTC's removal of well identification data from production information in order to protect proprietary data related to gas sales. Id. at 16.

Phillips similarly argues a number of procedural and equitable bars to the MMS underpayment demands contained within the underlying February 24 Order. First, appellant states that MMS delayed commencement of this enforcement action until more than 8 years after the start of Audit Period 1 and more than 4 years after the end of Audit Period 2. As a result, Phillips claims MMS is time-barred by the applicable statute of limitations, 28 U.S.C. § 2415(a) (1994), from making its demand for additional royalties on account of the pre-February 24, 1991, production from the Audit Period 1 and 2 leases. Id. Second, appellant states that MMS has had in its possession adequate information for performing the critical valuation function since the end of each month of the combined audit periods. Because MMS has so delayed in bringing this

enforcement action, Phillips argues that it is entitled to consider its royalties on account of its share of gas production from the leases for both Audit Periods 1 and 2 as having been properly paid, and that MMS is barred by laches from retroactively asserting that royalties were underpaid on account of such production and for making the demand for additional royalties. Id. at 19-20, citing United States v. Darken, No. 4: CV-89-1681, 1990 U.S. Dist. LEXUS 10904, at 16-17 (M.D. Pa. Aug. 14, 1990); United States v. Eaton Shale Co., 433 F. Supp. 1256, 1272 (D. Colo. 1977).

Finally, appellant urges that MMS should be estopped from bringing this action because if the gross proceeds approach used by Phillips to calculate royalties is now considered an invalid approach, MMS' past endorsement of this method of valuation rises to the level of "affirmative misconduct" resulting in serious injustice. (SOR at 20.) Under such circumstances, appellant argues, the imposition of estoppel against the Government would be consistent with the public interest. Id., citing Watkins v. United States Army, 875 F.2d 699, 707 (9th Cir. 1989)(en banc), cert. denied, 498 U.S. 957 (1990); USA Petroleum Corp. v. United States, 821 F.2d 622, 625 (Fed. Cir. 1987). Phillips claims that MMS' delay in advising it that it must use another valuation methodology prejudices appellant severely because neither MMS nor Phillips now has complete records for these audit periods, making it nearly impossible for appellant "to defend against the MMS' royalty claims and the erroneous assumptions on which those claims are based." (SOR at 21-22.)

In its Answer, MMS argues that Phillips' allegations must be dismissed because respondent properly conducted its major portion analysis. (Answer at 7.) In response to appellant's claims, MMS asserts that under the Kauley Agreement, MMS determines for each field or area by Natural Gas Policy Act (NGPA) category, the statistical best estimate of majority price using the best available data. (Answer at 2.) MMS claims, however, that the gas from these fields did not sell at a price near the NGPA ceiling, but rather sold at a price governed by the spot market. Consequently, respondent states, the relative absence of data regarding NGPA price categories does not affect the like-quality analysis. (Answer at 9.)

In response to appellant's assertion that because the OTC data did not contain the Btu content, a like-quality analysis was not possible. MMS states that the RMP performed an analysis to compare the results obtained by adjusting the prices for Btu content with the results obtained by calculating the price per mcf without adjustment for Btu content, and that analysis showed that adjusting prices for Btu content had little effect on majority price. (Answer at 10, citing Major Portion Analysis Report Anadarko Area Leases.) For this reason, MMS claims, the absence of the Btu data did not affect the validity of MMS' major portion analysis. Id.

MMS responded to Phillips' argument that the major portion analysis is flawed because there was insufficient data on each NGPA category to determine a separate majority price by explaining that the RMP expanded its definition of like-quality production to include all gas sold from the

field to determine a single majority price because the volumes of gas in each NGPA category declined over time. Id. Respondent asserts that the RMP's approach produces a more reasonable approximation of the majority price than would be the case if it had utilized a narrower definition of like-quality and restricted the amount of data and volumes that could be used. Id. at 11. MMS, respondent claims, used all of the records and volumes in a given field to calculate the majority price. Id. Phillips, respondent contends, has not shown that MMS' method does not produce accurate results or comply with the regulations. Id.

MMS likewise argues that the statute of limitations is not a bar to the Board upholding the decision below. (Answer at 4.) Respondent notes that the Board has held on numerous occasions that statutes of limitations do not apply to administrative actions. Id., citing Marathon Oil Co., 119 IBLA 345, 352 (1991); Forest Oil Corp., 111 IBLA 284, 287 (1989), reconsideration denied, April 30, 1990, citing Foote Mineral Co., 34 IBLA 285, 306-08, 85 I.D. 171, 182-83 (1978). Thus, respondent urges, the Board must reject appellant's argument that the statute of limitations bars the Board from upholding MMS' order to pay additional royalties. Id.

In response to appellant's claim that MMS' assessment is barred by laches, respondent states that the doctrine cannot be used to preclude the United States from enforcing a public right or protecting the public interest. (Answer at 12, citing United States v. State of California, 332 U.S. 19, 40 (1947); Santa Fe Minerals, Inc., 145 IBLA 317, 325 (1998); Marathon Oil Co., supra at 345; United States v. Wilson, 38 IBLA 305, 307-08 (1978).) Respondent asserts that the authority of the United States to enforce a public right "is not vitiated or lost by acquiescence of its officers or their laches, neglect of duty, failure to act, or delays in the performance of their duties." Id., quoting 43 C.F.R. § 1810.3(a). In any event, MMS claims, it began its major portion analysis in this case in 1992, thus it did not fail to act or delay in the performance of its duties. Id.

Finally, with respect to appellant's charge that MMS' assessment is barred by the doctrine of estoppel because respondent accepted Phillips' gross proceeds as value, MMS urges that the acceptance of payment prior to audit does not approach the required standard of affirmative misconduct such as represented by a crucial misrepresentation in an official decision and/or concealment of material facts where the party alleging estoppel is ignorant of the true facts. Id. at 13-14. Respondent asserts that Phillips cannot claim ignorance of the true facts when both the lease and the relevant regulations in this case state that the Secretary determines value and that one of the valuation standards is the major portion price. Id. at 14, citing Lease, para. 3(c); 30 C.F.R. § 221.47 (1979); 25 C.F.R. § 172.16 (1978); 30 C.F.R. § 206.152(a)(3) (1995).

[1] As an initial matter, we review the history of calculating royalty based on major portion analysis. 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.

"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.

The record reflects that, in determining the major portion price, MMS established the median price (the value falling in the middle when the data items are arranged in ascending order) by using all sales contained in the OTC data base for the two fields in which the appellant's leases are located within the Anadarko Area. 4/ See February 24, 1995, Letter to Phillips from RMP at 1. MMS claims to have been able to obtain statistically significant measures of the central location of price.

We are satisfied, as we were in Burlington Resources Oil and Gas Co., 151 IBLA 144, 157 (1999), 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

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4/ The appellant's leases subject to the major portion analysis were in the Cement and Watonga-Chikasha Trend Fields within the Anadarko Area. In each case, the appellant's leases comprised a very small fraction of the total leases within the field. See Table 1 to Major Portion Analyses Report Anadarko Area Leases.

location of value for the population examined. We note that appellant likewise did not challenge MMS' methodology, per se, although it did challenge application of that methodology to its leases, since it was not party to the Kauley Settlement Agreement. Our concern, as in Burlington Resources Oil and Gas Co., supra, relates to the population of sales prices examined. In the present case, MMS considered all sales transactions in the OTC databank for the two areas involved in establishing the majority price, despite the requirement in its own regulations that only arm's-length transaction prices shall be considered in the major portion analysis. Moreover, nothing in the Kauley Settlement Agreement indicates that this requirement is waived. MMS claims that the database selected (OTC) for calculation of major portion prices was by agreement of the parties to the Kauley Settlement. Phillips was not a party to that agreement. Even if appellant had been, the agreement did not waive the requirement to segregate out nonarm's-length transactions.

From the data presented in the record in this case, as in Burlington Resources Oil and Gas Co., supra, 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 within the OTC database for the areas encompassed by appellant's leases. In this case, all sales recorded by the OTC for the fields in which the subject leases are located were used in calculating the median. As we noted in Burlington Resources Oil and Gas Co., supra at 158, 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 Tribe, an interest MMS is lawfully obligated to properly represent in a fiduciary capacity. Id. If inclusion of the nonarm's-length sales has resulted in a higher major portion price, as is equally possible, 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 February 24 Order amount represents. As sales by other working interest operators were included in the sales made from the leases in the areas addressed, appellant would certainly not be in a position, itself, to calculate all the nonarm's-length transactions that occurred between 1988 and 1992. Nor does the record reflect whether these other producers have differentiated nonarm's-length sales when reporting sales to the OTC database during this time period.

More importantly, as we also noted in Burlington Resources Oil and as Co., supra at 158, 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, Phillips paid all royalties based on actual sales prices (gross proceeds). 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 submitted by Phillips was that requested by MMS, and could have been enhanced at MMS' will after implementation of the major portion analysis regulations in the Code of Federal Regulations to include a list of nonarm's-length transactions to be compared against the OTC sales figures. 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 calculations based upon major portion analysis are practicable. See 30 C.F.R. §§ 206.152(a)(3)(i), 206.152(a)(3)(ii) (1991). The required sales information was apparently not available nor was the calculation of a median price for a population including only arm's-length transactions using the OTC database in the case of appellant's sales for either the 1988-1991 time frame or 1991-1992 time period. We find that MMS' use of data from all sales, rather than solely arm's-length sales, as required by 30 C.F.R. § 206.152(a)(3), to be inconsistent with the plain language of the regulation. Nor has the language of the Kauley Settlement Agreement relaxed the requirement that only arm's length transactions be used in computing the median value. Quite to the contrary, the issue of arm's- length versus nonarm's-length sales was not even addressed in the 1991 Settlement, thus leaving the regulation cited above intact with regard to the parties. Even had the Kauley Settlement Agreement relaxed the requirement that only arm's-length sales be used, it would not have applied to Phillips, as the Settlement Agreement was extremely specific that its provisions applied only to the parties to the Agreement. 5/

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, as we noted in Burlington Resources Oil and Gas Co., supra at 159, 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 OTC 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.

5/ Paragraph 28 of the Kauley Settlement Agreement states:

"28. The terms of this settlement agreement are to be binding on the parties to this suit only -- i.e., the named plaintiffs, the class represented by the named plaintiffs, and the defendants. Said terms shall not include, affect, or be applicable to any person not a party to this suit."

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 February 10, 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 February 24, 1997, Order.

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James P. Terry
Administrative Judge

I concur:

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Gail M. Frazier
Administrative Judge