

INTERIOR BOARD OF LAND APPEALS

Vastar Resources, Inc.

167 IBLA 17 (September 26, 2005)

Title page added by:
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VASTAR RESOURCES, INC.

IBLA 2001-377

Decided September 26, 2005

Appeal from a value determination issued by the Acting Director, Minerals Management Service, concluding that a gas purchase and sale contract was not an arm's-length contract and that gas disposed of under the contract had to be valued for royalty purposes under the provisions of the applicable Federal and Indian royalty valuation regulations governing gas sold pursuant to non-arm's-length contracts.

Reversed.

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

Under 30 CFR 206.151, a gas purchase and sale contract will be considered an arm's-length contract for royalty valuation purposes where it "has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract." A determination by MMS that a purchase and sale contract entered into by a Federal oil and gas lessee and a marketing company in which it has a 40 percent ownership interest is non-arm's-length because the parties did not have opposing economic interests will be reversed where the lessee (1) has demonstrated that the parties did, in fact, have opposing economic interests and (2) has further shown the inapplicability of any of the exceptions to valuing gas sold under an arm's-length contract based on the gross proceeds accruing to the lessee under the contract.

APPEARANCES: Michael L. Homeyer, Esq., Houston, Texas, and Charles L. Kaiser, Esq., and Charles A. Breer, Esq., Denver, Colorado, for appellant; Howard W.

Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Vastar Resources, Inc. (Vastar), ^{1/} has appealed a July 20, 2001, value determination by the Acting Director, Minerals Management Service (MMS), concluding that Vastar's gas purchase and sale contract with Southern Company Energy Marketing, L.P. (Southern LP) was not an arm's-length contract and, therefore, that gas sold under the contract had to be valued for royalty purposes under the provisions of the applicable Federal and Indian royalty valuation regulations governing gas sold under non-arm's-length contracts.

Vastar is a multi-billion-dollar oil and gas exploration and production concern. It also marketed gas and oil, but in 1997 it "adopted a corporate strategy of selling its gas marketing business and focusing instead on its core oil and gas production business." (SOR at 3, citing SOR Ex. 2, Affidavit of Ronald T. Sponberg (Sponberg Aff.), ¶ 3.) In furtherance of this goal, on August 8, 1997, Vastar entered into a Formation Agreement ^{2/} with Southern Energy, Inc. (Southern Energy) (known at that time as SEI Holdings, Inc.), a wholly-owned subsidiary of Southern Company, ^{3/} which was pursuing the complementary objective of becoming one of the top five

^{1/} On Dec. 31, 2001, Vastar merged into Amoco Production Company, which is now known as BP America Production Company. See Statement of Reasons (SOR) at 1 n.1. For consistency, we will refer to appellant as "Vastar." Additionally, for simplicity, references in this opinion to "Vastar" subsume the wholly-owned affiliates of Vastar Resources, Inc., involved in the formation of the contracts and partnerships at issue in this appeal.

^{2/} The Formation Agreement, which contains confidential and proprietary information, was submitted under seal as document 16 in the certified Administrative Record (AR) filed with the U.S. District Court for the District of Wyoming in Vastar Resources, Inc. v. United States Department of the Interior, No. 00CV1029D, on Feb. 2, 2001. See n. 7, *infra*. A copy of the AR has been included in the case file submitted in this appeal.

^{3/} Southern Energy was subsequently reorganized as Mirant Corp. On Apr. 2, 2001, Mirant was spun off from Southern Company and became a fully independent company. See "Supporting Rationale on the Non-arm's-Length Nature of the Gas Sales Contract Between Vastar Resources, Inc. (Vastar) and Southern Company Energy Marketing L.P. (Southern L.P.)," (Supporting Rationale), attached to the July 20, 2001, value determination, at 2. For simplicity, references in this opinion to "Southern Energy" include all the then wholly-owned affiliates of Southern Company involved in the formation of the pertinent contracts and partnerships.

energy marketers in the United States. See SOR Ex. 3, excerpts from Southern Company 1997 Annual Report.

Under the Formation Agreement, Vastar contributed the assets of its gas and electric energy marketing and trading business, and Southern Energy contributed the assets of its energy trading and marketing business to create Southern LP as a limited partnership to market energy and other energy-related commodities, including electricity, natural gas, and pulp and paper products. See Formation Agreement at 1; SOR at 3; Supporting Rationale at 2. The Formation Agreement also designated Southern Company Energy Marketing General Partnership (Southern GP), which was formed concurrently with the limited partnership, as the general partner of Southern LP. See Formation Agreement at 1; Supporting Rationale at 2-3.

The Formation Agreement provided that, in exchange for their respective asset contributions, Vastar would receive a 39.6 percent interest in Southern LP until July 1, 2001, after which its interest would decrease to 24.75 percent and, conversely, that Southern Energy would acquire a 59.4 percent interest increasing to 74.25 percent on July 1, 2001. ^{4/} The terms of the Agreement further indicated that Vastar would hold a 40 percent interest in Southern GP until July 1, 2001, at which point its interest would fall to 25 percent, conversely with Southern LP owning 60 percent of Southern GP until July 1, 2001, and 75 percent thereafter. See Formation Agreement at 9, 11, 18 § 2.7; SOR at 4; Supporting Rationale at 1; see also SOR Ex. 4, “Guidance and Supporting Rationale On the Arm’s-Length Nature of the Gas Sales Contract Between [Vastar] and [Southern LP],” appended to May 28, 1999, MMS response to Vastar’s Dec. 31, 1997, request for value determination (Guidance) at 1. The Formation Agreement also identified several ancillary agreements into which the parties agreed to enter, including a gas purchase and sale agreement. (Formation Agreement at 48 § 7.6(a).) ^{5/}

Vastar and Southern Energy entered into three separate agreements effective September 1, 1997: The Amended and Restated Limited Partnership Agreement of Southern LP (LP agreement) (AR, Document 19, Ex. B); the Amended and Restated Limited Liability Company Agreement of Southern GP (GP agreement) (AR, Document 19, Ex. C); and the Gas Purchase and Sale Agreement (gas sales contract)

^{4/} Southern GP held the remaining 1 percent interest in Southern LP. See Supporting Rationale at 1.

^{5/} Although the Formation Agreement indicated that the required gas purchase and sale agreement would substantially conform to an attached gas purchase and sale agreement, the referenced agreement is not included with the copy of the Formation Agreement found in the case file. See Formation Agreement at 48 § 7.6(a).

(AR, Document 19, Ex. A; SOR Ex. 5).^{6/} The terms of the LP agreement provided that the ownership interests in Southern LP reflected the capital account contributions of the partners; that income and losses were to be allocated in the same ratios as the ownership interests; and that Vastar was guaranteed minimum yearly earnings, with any remaining earnings apportioned in the same ratio as the ownership interests. See Supporting Rationale at 2.

Under the GP agreement, Southern GP assumed responsibility for all activities of Southern LP, including all management and business affairs, and adopted Southern LP's budget and business plans. It exercised its duties under the direction of a Board of Governors consisting of four representatives selected by Southern Energy and three representatives chosen by Vastar. The agreement further identified three types of voting by the Board necessary for a decision depending on the matter involved: 1. majority; 2. supermajority (80 percent of the vote or 6 Board members); and 3. unanimous. See Supporting Rationale at 2-3; see also GP agreement at 22-26 §§ 7.2 and 7.4.

Pursuant to the terms of the gas sales contract, Southern LP acquired the exclusive right to purchase virtually all of the gas produced, owned, or controlled by Vastar, with minor exceptions, for an initial term of 10 years, with title to the gas passing to Southern LP at delivery points set forth in the contract. (Gas sales contract at 15 §§ 2.1 and 2.2, 43 § 5.1, 52 § 10.1.) The sales price for the gas established in the contract was based on an index price for each delivery point, less transportation costs incurred by Southern Energy. See Supporting Rationale at 3; gas sales contract at 37-43 § 4; see also gas sales contract at 5, 7, and 11. The gas sales contract also included a "special tenet" providing that the price for the gas should reflect the fair market value of spot gas "consistent with what a sophisticated producer and wholesale marketer of gas could receive if permitted to freely market its gas on such basis" (gas sales contract at 63 § 12.6.1(b)) and additional provisions designed to ensure the attainment of that tenet. See, e.g., id. at 63 § 12.6.1 (right to arbitrate over amendment of the contract to ensure attainment of the special tenet); id. at 64 §§ 12.6.2(I), (ii) (use of prices and indices representing the fair market value of the gas); id. at 22-27 §§ 2.3.1, 2.3.2, 2.3.3, and 2.3.5, 31 § 3.1, at 40 § 4.3, at 49 § 7.5, and at 50 § 7.7 (various retained operational and audit rights); id. at 53 § 10.2 (right to test market 10 percent of the committed gas); and id. at 56-65 § 12 (arbitration); see also SOR at 7-10.

Southern Energy purchased all of Vastar's interests in Southern LP and Southern GP effective August 10, 2000, and Southern LP became a wholly-owned

^{6/} All of these agreements contain confidential and propriety information, and our discussion of their contents will be limited to publicly disclosed information.

indirect subsidiary of Southern Energy. The gas sales contract was amended as part of this transaction, but the index pricing and related provisions remained the same. See Supporting Rationale at 2; SOR at 20.

On December 31, 1997, Vastar requested a value determination from MMS to ascertain whether the gas sold by Vastar to Southern LP pursuant to the September 1, 1997, gas sales contract should be valued for royalty purposes as an arm's-length sale. (SOR Ex. 6.) Vastar acknowledged that, in accordance with the definition of "arm's-length contract" under 30 CFR 206.151, MMS' determination of whether an agreement was arm's-length would properly focus on whether the parties were "affiliated," *i.e.* whether one entity "controlled" the other, with a rebuttable presumption of "control" if one entity owned between 10 and 50 percent of the other. MMS' determination would also rest on whether the parties had "opposing economic interests," *i.e.* whether the parties acted in their economic self-interest with respect to the contract at issue. (Dec. 31, 1997, value determination request at 2-3.) Vastar averred that MMS should consider the contract to be arm's-length because it and Southern Energy had opposing economic interests when they negotiated the contract; because it possessed a clear economic incentive to maximize the price of the gas it sold to Southern LP; and because its indirect ownership interest in Southern LP was insufficient to provide it any incentive to discount the price of the gas it sold to Southern LP. Id. at 1.

Specifically, Vastar asserted that it would actually lose money if it reduced the price of the gas sold to the limited partnership. Thus, if Vastar reduced the price of the gas sold to Southern LP by \$1.00 per Mcf, it would, as a member of the Southern limited partnership, gain approximately \$0.396 per Mcf as a direct result of that price reduction. This is because, although the price reduction would reduce the costs to the Southern limited partnership by \$1.00 per Mcf as a whole, Vastar, as the holder of only a 39.60 percent interest in Southern LP, would benefit only to the extent of \$0.396 per Mcf of the expenses saved by that limited partnership. Additionally, Vastar posits that, as a Federal oil and gas lessee, it would also save \$0.125 per Mcf in royalties owed on the reduced valuation basis of the gas, for a total savings to it of \$0.525 per Mcf. However, Vastar as gas producer would, at the same time, lose the full \$1.00 per Mcf in revenue, for a net loss to Vastar of \$0.475 per Mcf for the transaction. Id. at 3.

Vastar also pointed out that, since it knew that its interest in Southern LP would be reduced to 24.75 percent and perhaps to 0 percent by the year 2003 when the contract still had 5 years to run, its benefits through the partnership from any price reduction would diminish in the short run. As a result, it had even less incentive to enter into a contract that did not ensure its ability to obtain the maximum price for its gas for the long term. Id. at 4.

Vastar further contended that its minority ownership interests in Southern LP and Southern GP were insufficient to enable it to control those entities, and that, therefore, those interests did not create an economic incentive to discount the price of the gas sold to Southern LP. *Id.* at 4-5.

The Royalty Valuation Division (RVD), MMS, responded to Vastar's value determination request by letter dated May 28, 1999, expressly stating that its letter, which was characterized as a "guidance," did not constitute either a value determination under 30 CFR 206.153(g) or a decision and therefore was not appealable. (SOR Ex. 4 at 1.) In its "guidance," RVD concluded that, even though Vastar was a minority partner, it had considerable influence and oversight over many of the actions of Southern GP and, effectively, Southern LP and that Vastar therefore had not rebutted the presumption of control evident in its contractual relationship with Southern LP. (Guidance at 6-7.) RVD further found that Vastar had not shown the existence of opposing economic interests, concluding instead that Vastar would benefit by a reduction in price through its ownership interest in Southern LP. RVD dismissed Vastar's claim that it would lose money by accepting lower prices and hypothesized that other foreseeable scenarios existed in which Vastar would take reduced prices knowing that it would share in downstream revenues. RVD posited that Vastar's decision to act in its own economic interest might also be influenced by its entitlement to guaranteed minimum payments based on Southern LP's yearly earnings each year through 2000. *Id.* at 7. Given the potential for price manipulation, RVD determined that the gas sales contract was not arm's-length because Vastar had not met its burden of proving that the contract was arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests. *Id.* at 8. ^{2/}

On February 29, 2000, Vastar submitted a second request for value determination, pointing out asserted flaws in the Guidance. Vastar contended that MMS erred in responding to its first request by issuing the Guidance instead of the value determination required under 30 CFR 206.152(g) and 206.153(g). (Feb. 29, 2000, value determination request at 2.) Vastar also pointed out that the presumption of control when an entity owns between 10 and 50 percent of another relied upon by MMS had effectively been invalidated by the court in National Mining

^{2/} Vastar challenged MMS' May 28, 1999, determination that the gas sales contract was non-arm's-length in Federal Court. See Vastar Resources, Inc. v. Department of the Interior, No. 00-CV-1029D (D. Wyo.). On Mar. 28, 2002, after MMS issued the July 20, 2001, value determination challenged here which specifically provided Vastar the right to appeal to the Board, the District Court dismissed Vastar's appeal, presumably to require Vastar to exhaust its administrative remedies. See SOR at 14 and n. 8.

Ass'n v. U.S. Department of the Interior, 177 F.3d 1, 6-7 (D.C. Cir. 1999) (NMA v. USDI), and that, in any event, it clearly did not control Southern LP under either the discredited presumption or under the new definition of "affiliate" found in MMS' proposed oil royalty valuation regulations. (Feb. 29, 2000, value determination request at 3-6.)

Vastar reiterated its position that it and Southern LP had opposing economic interests. Vastar criticized MMS' attempt to undermine the economic reality of Vastar's assertedly clear incentive to seek the highest price for its gas as pure speculation, counterintuitive, legally and factually flawed, and lacking any basis in the gas sales contract which, in addition to committing all Vastar's gas to Southern LP, also set the price of the gas. Id. at 6-7. Vastar further maintained that MMS' speculations were antithetical to the parties' profit motives, were in conflict with MMS' treatment of other similarly situated lessees, and were unsupported by the cited case law. Id.

In his July 20, 2001, value determination, the Acting Director, MMS, cited both the circumstances surrounding the formation of the gas sales contract and the price variances for three sales months between Southern LP's netback pricing schedules for its sale of production from the offshore Grand Isle Catco Unit and the Inside [the Federal Energy Regulatory Commission's (FERC's)] Gas Market Report prices Southern LP paid to Vastar. Referring to the enclosed Supporting Rationale for further details, he concluded that Vastar's gas sales contract with Southern LP was not arm's-length and that the gas disposed of under the contract accordingly had to be valued for royalty purposes under the provisions of the applicable Federal and Indian gas royalty valuation regulations governing gas not sold pursuant to arm's-length contracts. (July 20, 2001, value determination at 1.)

In the Supporting Rationale, after citing the definition of arm's-length contract found at 30 CFR 206.151, MMS first examined the issue of control when an entity owned or commonly owns between 10 and 50 percent of another entity, by applying the guidance it had developed in light of the Court's decision in NMA v. USDI, supra. MMS concluded that, based on the applicable criteria and the evidence before it, Vastar did not control Southern LP, thus reversing the determination made in the May 28, 1999, Guidance. (Supporting Rationale at 6-8.)

As to opposing economic interests, MMS conceded that, despite its conjecture to the contrary, it had no direct evidence refuting Vastar's claim that it would lose more from selling its working interest at a reduced price than it would gain from its share of Southern LP's profit on the resale of the production. MMS added, however, that this factor was subject to further review and audit, citing its review of Southern LP's netback pricing schedules for the offshore Grand Isle Catco Unit, which

purportedly revealed that Southern LP had received an additional \$0.08453 per MMBtu in September 1998, an additional \$0.04125 per MMBtu in October 1998, and an additional \$0.0982 per MMBtu in May 1999 when it resold the gas. Id. at 8.

MMS, nevertheless, concluded that the gas sales contract was not arm's-length because it was not a contract between parties with opposing economic interests with respect to the contract when viewed "in the totality of the relationship and the way the contracts were formed." Id. at 9. Specifically, MMS pointed out that Vastar and Southern LP entered into the gas sales contract concurrently with the formation of Southern LP and that Vastar was guaranteed a minimum amount of earnings annually through 2002 from Southern LP. MMS considered the gas sales contract and the formation of Southern LP to be inseparable and the compensation Vastar received from the gas sales contract to include not only the stated contract price, but also the additional revenue it received as the effective owner of 40 percent of Southern LP, including 40 percent of the profits Southern LP earned on the margin between the purchase and sales price of the gas produced by Vastar and by other sellers. Id. at 9. MMS added that whether Southern LP purchased from arm's-length sellers at a price similar to that paid to Vastar was irrelevant to the determination of whether the gas sales contract was at arm's-length. MMS further averred that Vastar gained a substantial share of Southern LP's profits from all of its operations in exchange for giving up its right to market all of its gas for 10 years and opined that a prudent gas operator and producer as large as Vastar would not ordinarily commit virtually all of its gas production from all sources to one contract unless the arrangement were a cooperative venture, as this one plainly was. Id.

Even if the contract were arm's-length, MMS found that the gas sales contract would still be treated as non-arm's-length because it had characteristics triggering 30 CFR 206.152(b)(1)(ii) and (iii) and the corresponding provisions in the Indian valuation rules at 30 CFR 206.172(b)(ii) and (iii) (1999), which set forth exceptions to the use of the contract price established in arm's-length contracts for royalty purposes. According to MMS, the gas sales contract did not reflect the total consideration actually transferred from Southern LP to Vastar for the gas and thus fell within 30 CFR 206.152(b)(1)(ii), because Vastar also collected profits on all sales by Southern LP, which represented additional consideration not contained in the gas sales contract. Since it might be impossible to calculate the additional consideration on an MMBtu basis in order to determine the gross proceeds for the gas, MMS concluded that the gas should be valued under 30 CFR 206.152(c) as gas sold under a non-arm's-length contract. (Supporting Rationale at 9-10.)

MMS further found that the gross proceeds reported by Vastar might not represent the reasonable value of the gas because Vastar might have breached its duty to MMS to market the gas for the mutual benefit of the lessee and the lessor by

committing all of its gas to one contract for 10 years, taking some of the consideration for the sale of the gas through the profits of Southern LP, and by failing to account for that consideration to the lessor. That breach, MMS stated, triggered 30 CFR 206.152(b)(1)(iii) and required that the gas be valued either under 30 CFR 206.152(c)(2) or (3) (2000) for Federal leases or under 30 CFR 206.172(c)(2) or (3) (1999) for Indian leases through 1999 and under 30 CFR 206.170 through 206.181 thereafter. (Supporting Rationale at 10.)

On appeal, Vastar contends that its gas sales contract is an arm's-length contract under the applicable regulations because the evidence demonstrates that it and Southern LP had opposing economic interests with respect to the contract. (SOR at 17.) Vastar cites the contentious, protracted, and difficult negotiations led by experienced attorneys aggressively pursuing the interests of their respective clients that ultimately led to the contract and the specific contract provisions demonstrating the arm's-length nature of the contract, such as the special tenet memorializing the sophisticated producer principle, the gas pricing mechanisms based on the rate established by an independent third party reflecting market data designed to represent fair market value, and the detailed operational and arbitration provisions ensuring Vastar's receipt of fair market value prices for the gas. *Id.* at 17-20; *see also* Sponberg Aff., ¶¶ 10-14. Vastar avers that the parties' conduct after it sold its entire interest in Southern LP to Southern Energy in August 2000 further supports the arm's-length nature of the contract because, while they amended other aspects of the contract, it and Southern LP retained the index pricing and related provisions. (SOR at 20.)

Vastar argues that MMS' value determination cannot stand because it is unsupported and contrary to the facts and the law. According to Vastar, not only is MMS' assumption that the existence and terms of the gas sales contract are related to Vastar's ability to collect profits on all of Southern LP's sales completely unsupported, but it is also factually and legally wrong because there is no additional consideration related to the gas sales contract. (SOR at 21-22.) Vastar avers that payments it received for its interest in Southern LP were not connected to its gas sales and thus could not constitute additional consideration, a conclusion allegedly bolstered by uncontroverted testimonial evidence that the gas sales contract was negotiated as a stand-alone contract and by the actual contract terms. *Id.* at 22-23; Sponberg Aff., ¶ 16. Vastar submits that those payments were not payments for the production of gas but represented compensation for the value of the marketing assets it contributed to Southern LP and, as such, were not royalty bearing. *Id.* at 23; Sponberg Aff., ¶ 16.

Vastar further asserts that a long-term contract is not proof that an operator is imprudent or is engaged in conspiratorial conduct to avoid royalties. Vastar points out that MMS cites no authority for its contrary conclusion and that Departmental

regulations and case law acknowledge that Federal lessees can enter into long-term sales contracts. Vastar contends that its long term contract ensures it a market for its gas for 10 years regardless of market conditions and that it has protected itself by guaranteeing that it will receive fair market value for its gas through application of independent, third-party index pricing and the other contract provisions outlined above. Id. at 24-25. Vastar interprets MMS' allusion to a "cooperative venture" as a veiled charge of conspiratorial conduct to avoid royalties, a charge that, according to Vastar, conflicts with the facts of this case and deserves to be summarily reversed. Id. at 25-26. Vastar characterizes MMS' allegations as new theories developed without foundation nearly 4 years after Vastar requested a value determination. Vastar further avers that MMS' apparent skepticism of Vastar's reasons for entering into the contract and MMS' consequent attempt to ignore the uncontroverted facts before it conflict with applicable precedent and must be reversed. Id. at 26.

Vastar maintains that MMS' decision effectively establishes a categorical rule that, if a Federal oil and gas lessee owns any interest in a buyer, then the contract must be non-arm's-length because the seller is receiving additional consideration attributable to its interest in the buyer. This categorical rule, Vastar submits, was specifically rejected in the final valuation regulations issued in 1988, when MMS decided not to adopt the proposed regulatory definition of a non-arm's-length contract as one where a person owned any interest no matter how small in another person, because the proposed definition was too restrictive. (SOR at 27-28, citing 52 FR 4732, 4734, 4744 (Feb. 13, 1987) (proposed regulations) and 52 FR 30776, 30781 (Aug. 17, 1987) (revised proposed regulations).) Vastar adds that such a categorical rule also conflicts with MMS' own case law and with Board precedent recognizing that a contract may be arm's-length notwithstanding one contracting party's ownership interest in another party. (SOR at 29-31.) Vastar asks the Board to reverse MMS' value determination and to find that the gas sales contract is arm's-length for royalty valuation purposes and that Vastar did not receive any additional consideration for the gas due to its minority interest in Southern LP. Id. at 31-32.

In its answer, MMS contends that the gas sales contract was not arm's-length because Vastar and Southern LP did not negotiate the contract in the marketplace and, when the entire arrangement is viewed as a whole, cannot be said to have opposing economic interests. MMS asserts that Vastar's corporate strategy of selling its marketing business severely limited the marketplace in which Vastar was operating by eliminating purchasers willing to pay more for the gas but not interested in buying the marketing business. MMS denies that Vastar's contractual right to receive the short-term index price for virtually all of its gas for a 10-year period ensures the receipt of the same value for the gas that a sophisticated producer free to market the gas on a short term basis would receive for the gas. MMS submits that, to the contrary, if Vastar had offered its gas on the open market to all potential

purchasers, it would have been free to obtain a price that a sophisticated purchaser would receive by marketing its gas on any basis, not simply the short-term index price. MMS therefore maintains that viewing Vastar's corporate goals in conjunction with the gas sale contract demonstrates that the contract was arrived at in a very narrow context that excluded the broad marketplace and thus was not arrived at in the marketplace and is not an arm'-length contract as defined in the applicable regulations. (Answer at 6-7.)

MMS argues that the overall arrangement between Vastar and Southern LP demonstrates that the parties did not have opposing economic interests as to the gas sales contract. According to MMS, Vastar's narrow focus on the four corners of the gas sales contract ignores the contemporaneous agreement forming Southern LP, the 40 percent of the profits from Southern LP's marketing of gas acquired from other companies Vastar receives as part of the overall arrangement, and the minimum floor payments guaranteed for certain years. MMS submits that, when the whole arrangement is viewed in its entirety, Vastar obtained considerable additional benefits beyond those provided in the gas sales agreement which undermine the persuasiveness and completeness of its exclusive concentration on the gas sales contract. (Answer at 8-9.)

MMS contends that Vastar's admission on page 3 of its SOR that Vastar and Southern Energy formed Southern LP in furtherance of their "complementary strategies of exiting and entering the gas marketing business" clearly indicates that Vastar's and Southern LP's interests were mutual rather than opposing. Additionally, MMS posits that a gas sales contract like Vastar's, committing virtually all the gas from all sources for 10 years at an unidentified short-term index price, is not the type of contract a major purchaser would enter into unless its interests were aligned with those of the sole purchaser. (Answer at 9.)

MMS argues that, even if the gas sales contract were an arm's-length contract, Vastar must nevertheless pay royalties under the benchmarks applicable to non-arm's-length contracts because the contract does not reflect the total consideration Vastar received for the gas. MMS cites as omitted consideration both Vastar's receipt of 40 percent of the profits from Southern LP's resale of its gas and sale of gas purchased from other producers and the additional value of Southern LP's marketing services demonstrated by Southern LP's frequent marketing of the gas for a higher price than it had paid Vastar. (Answer at 10-12.) Since the gas sales contract assertedly ignores the value of the marketing services performed by Southern LP as well as Vastar's receipt of 40 percent of the profits from Southern LP's gas marketing, MMS concludes that the contract does not reflect the total consideration flowing to Vastar for its gas. Accordingly, it argues, in accordance with 30 CFR

206.152(b)(1)(ii), Vastar must value the gas under the benchmarks found in 30 CFR 206.152(c). (Answer at 12.)

In its reply brief, Vastar interprets the arguments in MMS' answer as simply another gloss on the previously discredited categorical rule that ownership of any interest in another contracting party renders the contract non-arm's-length because the minority owner receives additional consideration attributable to that ownership interest. See Reply at 2-5. Vastar avers that, in addition to improperly relying on the presumption that the contract is non-arm's-length, MMS continues to ignore evidence of Vastar's and Southern LP's opposing interests, such as the contract provisions evidencing Vastar's intent to maximize its economic return and to prevent Southern LP from overreaching, which provisions would be unnecessary if the parties' interests were not opposing. Vastar adds that MMS disregards the contentious negotiations and the parties' conduct after the contract was in place, while offering no contrary evidence. (Reply at 6-8.) MMS' passing reference to the special tenet and claim that Vastar should have remained free to market its gas on any basis, not just the short-term index price, is unpersuasive, Vastar submits, because MMS has explicitly recognized the fairness and validity of valuing gas based on the Inside FERC index price used by Vastar here. (Reply at 6-7, citing 64 FR 66771, 66772-73 (Nov. 30, 1999).)

Vastar argues that MMS improperly relied on new reasons for claiming that the gas sales contract is non-arm's-length, as well as resurrecting old rejected justifications. Vastar maintains that MMS' novel assertion that the contract is non-arm's-length because it was not entered into in the marketplace fails because it never limited possible gas sales only to entities that would buy its gas marketing business. Vastar points out that Southern Energy, not Vastar, wanted Vastar to sell its gas to Southern LP, that it negotiated the gas sales contract as a stand-alone contract and not as part of the asset sale, and that it insisted on a contract provision assuring its receipt of the same value it would have received if allowed to freely market the gas, all of which demonstrate that there was no connection between the gas sales contract and the asset sale, much less a prerequisite that the gas could only be sold to an entity that would purchase its assets. (Reply at 9, citing *Sponberg Aff.*, ¶¶ 7, 8, 16.)

In any event, Vastar contends that MMS' interpretation of the regulatory reference to "marketplace" does not accord with the rationale for adding that term to the 1988 final valuation regulations, as set out in the preamble. According to Vastar, the marketplace requirement was added, not to ensure some unknown minimum number of potential buyers, but to support "the concept that an arm's-length contract must be between nonaffiliated persons." (SOR at 10, quoting 53 FR 1230, 1239 (Jan. 15, 1988).) Since the term "marketplace" refers to affiliation and MMS determined that Vastar did not control Southern LP, Vastar avers that this case raises

no issue as to whether the contract was entered into in the marketplace. (SOR at 10.)

Vastar submits that MMS' new total consideration claim also fails because, rather than relying on Southern LP to market its gas, it marketed the gas itself by selling it to Southern LP at a price that it took extraordinary measures to ensure would reflect the maximum value possible for that gas. Vastar disputes as unsupported MMS' allegation that it accepted a reduced sales price for the gas. Vastar also denies that it admitted that Southern LP marketed its gas for a higher price than that paid to Vastar, asserting that it has appealed the November 13, 2001, demand letter cited by MMS basing its demand for additional royalties on the value determination at issue here. (SOR at 11-12.) Vastar further notes that the precedent MMS relied on in support of its total consideration theory has been reversed by the U.S. Court of Appeals for the D.C. Circuit. *Id.* at 12, citing Fina Oil & Chemical Company v. Norton, 332 F.3d 672 (D.C. Cir. 2003), *rev'g* Fina Oil & Chemical Company v. Norton, 209 F. Supp. 2d 246 (D.D.C. 2002).

Finally, Vastar disputes MMS' attempt to resuscitate the claim that Vastar somehow had an incentive to lower the price for its gas despite MMS' own admission in the Supporting Rationale that no evidence existed supporting that claim. Vastar points out that, contrary to MMS' assertion, Vastar discussed its 40 percent interest in the profits of Southern LP and the minimum payments it received both in its December 31, 1997, value determination request and in the testimony that those payments were designed to ensure that it received a minimal return on the valuable assets it contributed to forming Southern LP, a value evidenced by its sale of its interest to Southern LP for over \$250 million. (Reply at 12-13, citing SOR at 4, n.4, 21-24, and Ex. 6 and Sponberg Aff., ¶¶ 3, 15, 16.) Vastar submits that MMS has offered no evidence to the contrary and thus has not successfully rebutted Vastar's claim that it was not in its economic interest to sell its gas at a lower price. (Reply at 13-14.)

In a response to Vastar's reply, MMS denies establishing a categorical rule that any ownership interest in another party to a contract makes that contract a non-arm's-length contract. It asserts that it instead focused on the specific facts of this case in determining that the significance of the interest owned and the considerable amount of additional consideration received rendered the gas sales contract non-arm's-length. (Response at 2-3.) MMS repeats that Vastar's continued concentration on only the gas sales contract, rather than the entire contractual arrangement, ignores evidence demonstrating a lack of opposing economic interest between the parties, including the reference to the gas sales contract in the Formation Agreement and other indicia of the interrelationship between the gas sales contract and the formation of Southern LP. *Id.* at 4-5.

According to MMS, none of the contract provisions cited by Vastar proves that the contract was arm's-length because they focus on the spot market price for gas and ignore the additional consideration flowing to Vastar under the Formation Agreement. (Response at 5-6.) MMS concedes that it has recognized index prices as indicators of market value, but submits that this recognition is not relevant to the question of whether the contract is arm's-length. MMS reiterates that Southern LP was able to sell Vastar's gas for more than those prices and avers that a large producer like Vastar could have received a comparable price if it had offered its gas on the open market. Id. at 6-7. Nor, according to MMS, do the contentious negotiations compel a finding that the contract was arm's-length, since Vastar's own statements show that its goal of selling its marketing assets constrained its negotiations, and no evidence exists showing that it attempted to obtain a better price from other potential buyers. Id. at 7-8. Southern LP's instigation of the term requiring Vastar to sell all its gas to Southern LP does not undermine the conclusion that Vastar's corporate goals limited its gas sales options, MMS adds, citing Vastar's failure to address how its corporate strategy of selling its marketing assets did not restrict its possible gas sales to only those entities willing to buy its production as marketing entity. Id. at 8.

Finally, MMS avers that Vastar's attempt to remove the term marketplace from the regulatory definition of arm's-length contract violates basic principles of regulation interpretation. Citing the regulatory history, MMS contends that its addition of the terms "marketplace" and "opposing economic interests" to the definition in response to public comments would have been unnecessary if the affiliation of the parties were the only criteria relevant to the arm's-length determination. (Response at 9-10.) According to MMS, Vastar's construction of the definition of arm's-length contract renders the term marketplace a mere redundancy and conflicts with Board precedent holding that a regulation should be read to give meaning to all of its parts. Id. at 11.

MMS concludes that Vastar's emphasis on the gas sales contract to the exclusion of the overall arrangement misrepresents the total picture and fails to show that the relationship between Vastar and Southern LP was arm's-length. MMS asserts that the record clearly demonstrates that the parties entered into the Formation Agreement and the gas sales contract virtually simultaneously as part of a package designed to further Vastar's and Southern Energy's corporate goals. MMS contends that, under these contracts, Southern LP acquired Vastar's gas marketing assets, Vastar and Southern LP entered into a long-term gas sales contract for the short term price, and Vastar received considerable additional consideration outside the gas sales contract. According to MMS, these factors demonstrate that Vastar's and Southern LP's interests were aligned, not opposing, and support MMS' determination that the

gas sales contract was not arm's-length and that the gas must therefore be valued under the benchmarks. (Response at 11-12.)

In a sur-reply, Vastar avers that, contrary to MMS' insistence that its analysis evaluated both Vastar's ownership of a substantial percentage of Southern LP and its receipt of a considerable amount of additional consideration, the challenged value determination focused solely on the claim that Vastar obtained additional consideration or revenue through its interest in Southern LP attributable to Vastar's gas sales, a claim Vastar characterizes as contrary to the evidence. Vastar asserts that, even if MMS had relied on a substantial percentage rule, that rule would still conflict with the definition of arm's-length contract adopted by the 1988 valuation regulations, which definition expressly recognizes only that agreements may be arm's-length when one entity owns between 10 and 50 percent, i.e., a substantial percentage, of another entity. (Sur-Reply at 1-3.)

Vastar denies that MMS reached its non-arm's-length determination by analyzing the particular facts of this case. Vastar contends that, to the contrary, MMS provided Vastar with the same stock non-arm's-length response it provided several other companies involving totally different agreements and underlying facts. (Sur-Reply at 3-4 and Exs. 12 and 13.) Vastar asserts that, in all these cases, MMS found that the contracting entities did not have opposing economic interests because they were receiving additional consideration due to their interest in the other entity. Those generic rationales, Vastar submits, belie MMS' claim that it analyzed the particular facts here and show that, instead, MMS relied on a categorical rule that whenever one entity owns an interest in another, it is receiving additional consideration, and the agreement is accordingly non-arm's-length. Id. at 5.

Vastar maintains that MMS fails in its attempt to undermine the significance of the contract provisions cited by Vastar as indicia of the arm's-length nature of the gas sales contract because they deal with the monthly spot price received under a short term contract and are not all immediately effective. (Sur-Reply at 5.) Vastar reiterates that the contract terms clearly demonstrate that its and Southern LP's economic interests were opposed. Vastar adds that MMS has neither mentioned nor challenged the testimony and other evidence showing that the negotiated provisions were intended to protect Vastar's economic provisions and avers that parties with identical economic interests entering into sweetheart deals neither need nor insert such provisions in their contracts. Id. at 6. The varying effective dates of some of the provisions do not detract from their import as indicators of opposing economic interests, Vastar explains, because the delayed effective date of some of the provisions simply reflected Vastar's greater comfort with the assumptions underlying the contract for the short term and lesser comfort with those assumptions for the long term. Id. at 6-7.

Vastar also disputes MMS' contention that the gas sales contract's utilization of short-term spot prices demonstrates that the parties did not have opposing interests. Vastar points out that MMS has offered no evidence supporting that presumption generally or showing that in these particular circumstances the price for gas sold under long term contracts was higher than the short-term spot price. According to Vastar, the uncontroverted evidence reveals that the parties fought hard over how best to obtain a proxy for fair market value that would hold up over the term of the agreement and ultimately determined that index prices established by independent third parties best reflected that value. Vastar submits that, under the resulting contract, Vastar received the benefit of knowing it had a long term purchaser, Southern LP received the benefit of knowing it had a long term source of supply, and neither party would suffer from incorrectly guessing future fluctuations in gas prices. (Sur-Reply at 7-8.) Vastar further maintains that, MMS' assertion to the contrary notwithstanding, price is a key factor clearly relevant to whether a contract is arm's length and that MMS' approval of the spot price as indicative of the value of production in both the Indian gas and Federal oil valuation regulations supports Vastar's claim that the use of the Inside FERC price in the gas sales contract demonstrates that the contract was arm's-length. Id. at 8-9.

Vastar objects to MMS' dismissal of the evidence showing the hard fought and contentious negotiations as insufficient to demonstrate the existence of opposing economic interests based on its assumption that the lack of evidence in the record documenting any Vastar attempts to obtain a better price means that negotiations were constrained. Vastar submits that MMS had the obligation to, but did not, provide any evidence supporting its claim that Vastar should have been able to negotiate a higher price. Absent such proof, Vastar asserts that, as the courts have made clear, MMS cannot ignore the evidence before it and simply increase the royalty payments due. (Sur-Reply at 10.)

Finally, Vastar contends that its interest in Southern LP neither proves that its economic interests were not opposed to those of Southern LP nor constitutes additional consideration for the sale of the gas. Vastar points out that MMS' expansive interpretation of total consideration to include Vastar's profits from its interest in Southern LP conflicts with language in the preamble to the final 1988 valuation regulations explaining that the phrase "total consideration" had been removed from the definition of arm's-length contract because that issue did not reflect the affiliation of the parties, but was a gross proceeds matter. (Sur-Reply at 11, citing 53 FR 1230, 1239 (Jan. 15, 1988).) Vastar repeats that the terms of the gas sales contract were negotiated as a stand alone agreement and do not attribute any profits flowing from Vastar's interest in Southern LP to gas sold under the contract. (Sur-Reply at 11; Sponberg Aff., ¶ 16.) The fact that the gas sales contract is listed as an ancillary contract in the Formation Agreement does not support MMS'

claim that these profits must be attributed to the gas, Vastar submits, because the gas sales contract was only one of more than a dozen ancillary agreements and its inclusion in that list does not suggest that the terms of the gas sales contract were not negotiated separately or that Vastar will somehow receive additional value for the gas. Id. at 11-12 n.5. Vastar maintains that the uncontroverted evidence here clearly shows that any profits on Vastar's interest in Southern LP represented a return on its investment of the assets it contributed to Southern LP, rather than additional value for the gas. Id. at 11-12.

[1] Resolution of this appeal centers on whether the gas sales contract between Vastar and Southern LP qualifies as an arm's-length agreement under the royalty valuation regulations. If it does, then our inquiry shifts to whether an exception to the utilization of the gross proceeds accruing to the lessee under the contract as the value for royalty purposes applies. We find that the gas sales contract is an arm's-length contract and that none of the exceptions applies, and, accordingly, we reverse MMS' value determination.

The Federal gas royalty valuation regulations define "arm's-length contract" as

a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. For purposes of this subpart, based on the instruments of ownership of the voting securities of an entity, or based on other forms of ownership:

- (a) Ownership in excess of 50 percent constitutes control;
- (b) Ownership of 10 through 50 percent creates a presumption of control; ^[8/]
- (c) Ownership of less than 10 percent creates a presumption of noncontrol which MMS may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates.

^{8/} MMS acknowledges that the U.S. Court of Appeals in NMA v. DOI, supra, invalidated the presumption of control where one entity owns or commonly owns between 10 and 50 percent of another, and states that it now follows the Aug. 21, 2000, non-regulatory guidance for determining control on a case-by-case basis where the lessee's ownership interest falls between 10 and 50 percent. See Supporting Rationale at 4.

* * * The MMS may require a lessee to certify ownership control. To be considered arm's-length for any production month, a contract must meet the requirements of this definition for that production month as well when the contract was executed.

30 CFR 206.151; see also 30 CFR 206.171 (Indian gas royalty valuation regulations).^{9/}

Pursuant to 30 CFR 206.152(b)(1)(i), “[t]he value of gas sold under an arm's-length contract is the gross proceeds accruing to the lessee except as provided in paragraphs (b)(1)(ii), (iii), and (iv) of this section.” See also 30 CFR 206.172(b)(1)(I) (1999) (comparable provision for Indian gas produced before Jan. 1, 2000) and 30 CFR 206.174(b)(1) (comparable provision for Indian gas produced beginning Jan. 1, 2000).^{10/} The exceptions relevant to the Federal gas at issue in this appeal, 30 CFR 206.152(b)(ii) and (iii), provide:

(ii) In conducting reviews and audits, MMS will examine whether the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the gas. If the contract does not reflect the total consideration, then MMS may require that the gas sold pursuant to the contract be valued in accordance with paragraph (c) of this section. Value may not be less than the gross proceeds accruing to the lessee, including the additional consideration.

(iii) If the MMS determines that the gross proceeds accruing to the lessee pursuant to an arm's-length contract do not reflect the reasonable value of the production because of misconduct by or between the contracting parties, or because the lessee otherwise has

^{9/} The regulations continue to provide that lessee has the burden of demonstrating that its contract is arm's-length. 30 CFR 206.152(b)(1)(i); 30 CFR 206.172(b)(1)(i) (1999); 30 CFR 206.174(b)(1)(i). However, if there is no presumption that a contract is non-arm's-length, it would seem that the burden must rest with MMS to show that it is, as an initial matter. It is unnecessary to resolve that question in the present case, as, regardless of who had burden of proof, the record amply shows that this contract was arm's-length.

^{10/} Under the valuation regulations for Indian gas produced beginning Jan. 1, 2000, gas production from Indian leases located in an index zone sold under an arm's-length dedicated contract is valued at “the higher of the index-based value under [30 CFR 206.172(d)] or the value of that production determined under [30 CFR 206.174(b)].” 30 CFR 206.172(b)(3).

breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the gas production be valued pursuant to paragraph (c)(2) or (c)(3) of this section * * * . [Emphasis added.]

See also 30 CFR 206.172(b)(1)(ii), (iii) (1999) (comparable provisions for Indian gas produced before Jan. 1, 2000) and 30 CFR 206.174(b)(1)(ii), (iii) (comparable provisions for Indian gas produced beginning Jan. 1, 2000). The referenced sections of 30 CFR 206.152(c) address the value of gas not sold pursuant to an arm's-length contract and set out in the order of preference the various methods or benchmarks for determining the reasonable value of the gas for royalty purposes. See also 30 CFR 206.172(c) (1999) (comparable provisions for Indian gas produced before Jan. 1, 2000) and 30 CFR 206.174(c) (comparable provisions for Indian gas produced beginning Jan. 1, 2000).

In this case, MMS concedes that Vastar does not control Southern LP. See Supporting Rationale at 6-8. The arm's-length nature of the gas sales contract therefore turns on whether the parties had "opposing economic interests" in that contract. ^{11/} Vastar focuses on the contentious negotiations leading to the execution of the contract, the terms of the contract, and the parties' subsequent conduct as evincing the parties' opposing economic interests regarding the gas sales contract. MMS, on the other hand, concentrates on the entire arrangement among Vastar, Southern Energy, and Southern LP as indicative of the parties' complementary economic interests. For the following reasons, we find that Vastar has shown that the gas sales contract is an arm's-length contract and reverse the value determination's contrary conclusion.

The key question here is whether Vastar and Southern LP had opposing economic interests with respect to the gas sales contract. The focus is on the parties' economic interests in the specific contract at issue, and the fact that the parties may have common interests elsewhere does not necessarily negate their ability to have opposing economic interests with respect to the contract under review. See 53 FR

^{11/} Although MMS argues for the first time on appeal that the gas sales contract was not arrived at "in the marketplace," neither the value determination nor the Supporting Rationale even addresses, much less relies on, this factor. MMS' contention appears to rest on the assumption that Vastar's adoption of a corporate strategy of selling its gas marketing business necessarily limited the potential purchasers of its gas to only those entities also willing to buy its gas marketing business. Vastar vehemently denies that allegation, and the record contains no evidence supporting MMS' supposition. We therefore find no merit in MMS' marketplace argument.

1230, 1239 (Jan. 15, 1988) (“[A]lthough the parties may have common interests elsewhere, their interests must be opposing with respect to the contract in issue.”). The overall relationship among the parties stressed by MMS, therefore, does not automatically establish that the parties did not have opposing economic interests in the gas sales contract.

Vastar has presented uncontroverted evidence demonstrating the parties’ opposing economic interests and the arm’s-length nature of the gas sales contract. This evidence includes the contentious nature of the protracted and difficult negotiations leading to the consummation of the contract; the specific contract provisions ensuring Vastar’s attainment of its economic interests such as the special tenet memorializing the sophisticated producer principle, the gas pricing mechanisms utilizing rates established by an independent third party based on market data reflecting fair market value, and the detailed operational and arbitration provisions ensuring Vastar’s receipt of fair market value prices for the gas; and the parties’ retention of the index pricing and related contract provisions when they amended other aspects of the contract after Vastar’s August 2000 sale of its entire interest in Southern LP to Southern Energy.

None of MMS’ challenges to the persuasiveness of these factors convinces us that the parties’ economic interests were not in opposition. Although MMS contends that the 10-year term of the contract undermines Vastar’s claim that the parties had opposing economic interests, it offers no regulatory or precedential basis for presuming that only parties with compatible economic interests enter into long-term contracts. Nor do we find convincing MMS’ assertion that the contract’s adoption of short-term spot prices demonstrates the parties’ lack of opposing economic interests, especially since MMS itself has approved the use of spot prices as the reasonable value of production (see 64 FR 66771, 66772-73 (Nov. 30, 1999), listing Inside FERC’s Gas Market Report as an MMS-approved publication for Indian gas royalty index zones), and, as Vastar points out, the use of the spot price over the length of the contract eliminates the risk of incorrectly guessing future price fluctuations inherent in long-term fixed price contracts. See Northern Indiana Public Service Co. v. Carbon County Coal Co., 799 F.2d 265, 275 (7th Cir. 1986) (normal risk of a fixed price contract is that the market price will change; if it rises, the buyer gains at the expense of the seller, and if it falls, the seller gains at the expense of the buyer). In the absence of any evidence that the spot index price utilized in the gas sales contract does not represent the fair market value of Vastar’s gas, we have no basis for questioning Vastar’s averment that the use of that price evidences, rather than undercuts, the opposing nature of the parties’ economic interests.

Given the lack of evidence to the contrary, we also accept Vastar’s explanation that the delayed effective date of some of the contract provisions (rather than

undermining their significance in showing the parties' opposing economic interests) simply reflects Vastar's greater short-term and lesser long-term comfort with the assumptions underlying the contract. Accordingly, we conclude that Vastar has met its burden of showing that, under the facts of this case, the gas sales contract qualifies as an arm's-length contract.

MMS contends that, regardless of whether the gas sales contract is arm's-length, the gas must be valued in accordance with 30 CFR 206.152(c) (setting out the benchmark values applicable for non-arm's-length sales) because the contract does not reflect the total consideration flowing to Vastar for the gas, specifically, the 40 percent of the profits it receives from Southern LP's gas sales. Vastar answers that the uncontroverted evidence establishes that its 40-percent share of Southern LP's profits represents a return on its investment in the assets it contributed to Southern LP, not additional consideration for the gas it sells to Southern LP. (Sponberg Aff., ¶ 16.)

MMS also asserts that the contract price does not include the value of Southern LP's marketing services. Vastar avers that it met its obligation to market the gas at no cost to the United States, not by relying on Southern LP to market its gas as MMS claims, but instead selling the gas itself to Southern LP at a price reflecting the maximum possible value for the gas. Further, Vastar denies that Southern LP resold its gas for a higher price than that paid to it.

Neither of these issues was adjudicated in the decision under appeal. ^{12/} MMS stated simply that "Vastar may have breached its duty to MMS to market the production," noting that "[i]f MMS makes such a determination, Vastar will have the opportunity as provided by the regulations to provide written information justifying its value," but that "such a specific is not necessary at this time because of the analysis regarding both opposing economic interests and total consideration set forth above." (Supporting Rationale at 10.) In the absence of an initial decision by MMS on these issues, we will not consider them in the context of the present appeal. It having been established that production disposed under the sale agreement should not be valued under the non-arm's length provisions of the regulations, it now remains for MMS to develop a record and determine "whether the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the gas" within the meaning of 30 CFR 206.152(b)(1)(ii), or whether "the gross proceeds accruing to the lessee pursuant to an arm's-length contract do not

^{12/} MMS referred only to Vastar's allegedly "taking some of the consideration for the sale of Federal and Indian gas through the profits of Southern L.P., and not accounting for that consideration to the lessor." (Supporting Rationale at 10). We find no reference to failure to account for marketing costs.

reflect the reasonable value of the production” within the meaning of 30 CFR 206.152(b)(1)(iii).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed.

David L. Hughes
Administrative Judge

I concur:

C. Randall Grant, Jr.
Administrative Judge