INTERIOR BOARD OF INDIAN APPEALS

ZCA Gas Gathering, Inc. v. Acting Muskogee Area Director,
Bureau of Indian Affairs

23 IBIA 228 (03/08/1993)

United States Department of the Interior

OFFICE OF HEARINGS AND APPEALS
INTERIOR BOARD OF INDIAN APPEALS
4015 WILSON BOULEVARD
ARLINGTON, VA 22203

ZCA GAS GATHERING, INC.
v.
ACTING MUSKOGEE AREA DIRECTOR, BUREAU OF INDIAN AFFAIRS

IBIA 92-131-A Decided March 8, 1993

Appeal from a decision concerning royalties and the development requirement in an Osage blanket gas lease.

Affirmed in part; vacated and remanded in part.

1. Indians: Mineral Resources: Oil and Gas: Royalties--Regulations: Interpretation

Regulations are interpreted in accordance with traditional principles of statutory construction. Where a Bureau of Indian Affairs regulation contains parallel sections applicable to different classes of persons, and one section is lacking a provision which is included in the other section, the omission is significant to show that a different intent existed.

2. Indians: Mineral Resources: Oil and Gas: Royalties--Oil and Gas Leases: Royalties: Processing Allowance

The regulations in 25 CFR Part 226 do not authorize a gas lessee to deduct allowances from royalties owing to the Osage Tribe.

3. Administrative Procedure: Generally--Bureau of Indian Affairs: Administrative Appeals: Discretionary Decisions

Even in the case of a decision based on the exercise of discretion, the Bureau of Indian Affairs has a responsibility to explain the rationale and factual basis of the decision.

4. Administrative Procedure: Administrative Record--Bureau of Indian Affairs: Administrative Appeals: Generally

When the administrative record in an appeal from a Bureau of Indian Affairs Area Director's decision is inadequate to support the decision, the decision will be vacated and the case remanded for development of an adequate record and issuance of a new decision.

APPEARANCES: Donald S. Smith, Esq., Tulsa, Oklahoma, for appellant; William E. Haney, Esq., Field Solicitor, U.S. Department of the Interior, Pawhuska, Oklahoma, for the Acting Area Director.

OPINION BY ADMINISTRATIVE JUDGE VOGT

Appellant ZCA Gas Gathering, Inc., seeks review of a February 14, 1992, decision of the Acting Muskogee Area Director, Bureau of Indian Affairs (Area Director; BIA), concerning appellant's blanket gas lease, which covers a portion of the Osage mineral reserve. For the reasons discussed below, the Board affirms the Area Director's decision in part, vacates it in part, and remands this matter to the Area Director for further proceedings.

Background

Appellant is present assignee of a gas mining lease, contract No. I-68-IND-3748, which was granted in 1916 by the Osage Tribe (Tribe) to the Indian Territory Illuminating Oil Company. The lease set the royalty rate at "16-2/3 per cent of the value of said gas at the well" (Paragraph 2(a)). It also required the lessee to spend at least $50,000 annually in development of the lease (Paragraph 3(d)). 1/ The lease originally covered approximately 302,240 acres. In 1963, it was substantially reduced in area by agreement between the Tribe and the then lessee, Cities Service Oil Company; it now covers about 105,000 acres. 2/ The lease has

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1/ Paragraph 3(d) provides:

"Lessee further covenants and agrees that he will expend annually not less than fifty thousand ($50,000) dollars in maintaining a production of 20,000,000 cubic feet of available gas per day on the basis of a utilization of not more than 20 per cent of the open flow capacity of any well as hereinbefore set forth, unless the expenditure of a less sum be sufficient to maintain such production. It is understood and agreed, however, that in the event all the gas wells drilled in compliance with the requirements of this lease, but not until after the annual expenditures required during the life of this lease as herein provided for have been made, shall fail to produce the minimum amount of gas as hereinbefore specified, then the per diem payments hereinbefore provided for shall for the succeeding year be reduced to correspond approximately with the amount of available gas actually produced, such sum to be ascertained on the basis of the then determined and current royalty. It is further agreed, however, that should it be shown to the satisfaction of the Secretary of the Interior at any time that the leased premises have been fully prospected and developed, and that the expenditure of additional sums in the drilling of wells could not reasonably be expected to result in the further development of gas, then in such event the further annual expenditures as hereinbefore provided shall not be required."

2/ Appellant and the Area Director disagree as to the exact acreage. Appellant contends that the lease covers 107,604 acres, and the Area Director contends that it covers 105,844.56 acres.

been amended from time to time through adoption of resolutions by the Osage Tribal Council, followed by acceptance by the lessee and approval by the Osage Agency Superintendent, BIA.

On March 16, 1988, the Tribal Council adopted Resolution 27-200, which was accepted by appellant on April 27, 1988, and approved by the Superintendent on May 4, 1988. The lease amendment incorporated in the resolution covers the period March 17, 1988, through March 16, 1993. It provides, in paragraph 1 of the "Resolved" clause:

> A. The requirements contained in [the lease] providing for annual expenditures by [appellant] is waived in consideration of its agreement to promote diligent exploration and development of said lease through economic incentives to others in the manner hereinafter set out, and to carry out or cause to be carried out a program of work to further develop the lease. Said program of work will include geological studies to determine sites for new drilling; the drilling of exploratory wells to determine additional gas and/or oil potential during the term of this modification and amendment; the drilling of development wells as appropriate from the findings of the exploratory wells. Expenditures on the program of work will be not less than $500,000; and
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> B. Pursuant to the Act of June 15, 1950, 64 Stat. 215 [see note 4, infra], * * * for royalties payable by [appellant] to the [Tribe] for gas produced by [appellant] or for gas sold or delivered to [appellant] by gas farmee or oil lessee for the period March 17, 1988, through March 16, 1989, shall be as provided for in the * * * gas purchase contract between [appellant], as Seller, and Faustina Pipeline Company, as Buyer, entered into on the 8th day of September 1985, or any new contract entered into with provision for a higher gas price. The royalty amount will be based on the royalty rate provided for in the lease terms and the income received from the gas. * * *
>
> The royalty payable for the period March 17, 1989, through March 16, 1993, shall be renegotiated annually, * * *
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> *   *   *   *   *   *
>
> G. [Appellant] agrees to carry out the program of work specified in Paragraph 1A hereof. [Appellant] further agrees that development of the lease shall be reviewed by the Superintendent on or about March 17, 1989, and annually thereafter, to determine whether [appellant] is prudently developing the lease under its undertakings of this modification amendment. The Superintendent has the right specified in 25 CFR 226.9(a) to order the termination of portions of the lease not being so prudently developed, such terminated portion not to include any producing or shut in gas wells capable of production and the 160 acres surrounding each such well, and [appellant] shall

> continue to have the right to own and operate the gas pipeline and gathering system on the terminated portion. Provided further that geological studies carried out by [appellant] shall become the property of the [Tribe] with respect to any portion of the lease terminated pursuant to 25 CFR 226.9(a).

By Resolution 27-481, adopted by the Tribal Council on March 21, 1990, accepted by appellant on April 9, 1990, and approved by the Superintendent on April 13, 1990, the royalty price was set for the period March 17, 1990, through March 16, 1991, in accordance with "the terms and conditions set forth in the gas purchase contract between [appellant], as Seller, and Phillips 66 Natural Gas Company, as Buyer." Resolution 27-481 further provided: "The royalty payable for the period March 17, 1991, through March 16, 1993, shall be renegotiated annually."

In January 1991, appellant and the Osage Agency began discussions concerning the royalty price to be set for the period March 17, 1991, through March 16, 1992, and the development requirement in Resolution 27-200. When no agreement had been reached by September 1991, both the Superintendent and the Principal Chief of the Tribe wrote to appellant. The Superintendent's letter stated:

> It is my understanding that you have not been able to agree with the Osage Agency Minerals Branch staff as to a reasonable price to be paid for royalty gas. I also understand that your plant is now using all the gas gathered by your pipeline system, some of which gas was previously sold to Phillips Natural Gas Company.
>
> Given the above facts, I believe that the most reasonable amount to use as a royalty settlement price would be the spot market price for gas each month. Further, I suggest that the price Phillips uses to calculate their payments would serve to set that price. As you are no longer selling gas, your former sales price does not appear to be appropriate for royalty determination, as the use of all this gas in your facility indicates that you place higher value on the gas than if you sold it under the existing contract.
>
> The agreement between yourself and the [Tribe] contains provisions for the Superintendent to determine if further development should be required. Based upon the fact that a total of over 80,000 acres have not been developed, out of a total of 105,844.56 acre lease, and that your company or its predecessors have held the lease since 1916, I feel that it is clear that additional development is required. Therefore, I am ordering your company to diligently develop the remaining undeveloped acreage in this lease. All undeveloped acreage remaining after 60 days from the date of this letter will be released from your blanket lease.

(Superintendent's Sept. 12, 1991, Letter at 1). The letter informed appellant that the Superintendent's decision could be appealed to the

Area Director. The Principal Chief's letter to appellant, also dated September 12, 1991, stated a position virtually identical to that stated in the Superintendent's letter.

Appellant asked the Superintendent to modify his decision. On October 10, 1991, the Superintendent modified his decision in part, stating:

> 1. There is no modification as to the royalty price. This remains set at the Spot Market price as published in “Natural Gas Week” as the Mid-Continent price in the “Delivered to Pipeline” column in the first issue each month. This is the same price as used by Phillips Natural Gas Company, which is how we identified it in our original decision.
>
> 2. The requirement for further development has been modified by reducing the acreage involved to the 10,080 acres specified below, and by postponing the deadline for this development until March 16, 1992. Any of the quarter-sections shown below which do not contain a producing gas well by the deadline will be removed from the Blanket Lease. The affected acreage is shown below:
>
> [List of tracts omitted.]

(Superintendent's Oct. 10, 1991, Decision at 1).

Appellant appealed this decision to the Area Director, who affirmed it on February 14, 1992. Appellant then filed a notice of appeal with the Board.

Both appellant and the Area Director filed briefs before the Board.

Discussion and conclusions

Appellant challenges the Area Director's decision with respect to both the royalty and the development issues. Appellant's objection to the royalty price determination is a relatively narrow one. Appellant states that it does not object to use of the spot market price as the basis for determination of royalties and further states that its "sole objection to the Royalty Ruling * * * is the failure of the Osage Agency to recognize Appellant's right to allocate a proportionate share of reasonable post-production expenses to the royalty payments made to the Osage Tribe" (Appellant's Statement of Reasons before the Area Director at 5). In its brief before the Board, appellant states: "The sole issue [concerning royalties] to be determined upon appeal is whether Appellant can charge the Osage Tribe for its share of compression, treatment and transportation expenses incurred by Appellant beyond the wellhead" (Appellant's Opening Brief at 5-6). In support of its contention that such charges should be allowed, appellant argues that the law governing private oil and gas leasing, and Oklahoma law in particular, recognize the right of a lessee to assign a reasonable share of post-production 3/ expenses to the royalty owner.

Oil and gas leasing of the Osage mineral reserve is governed by Federal law, specifically section 3 of the Act of June 28, 1906, 34 Stat. 539, 543, as amended, 4/ and the regulations in 25 CFR Part 226. Appellant's rights under its lease are also governed, of course, by the terms of the lease.

25 CFR 226.11(b), Royalty on gas, contains separate provisions applicable to (1) oil leases, (2) gas leases, and (3) combination oil and gas leases. Subsection (2) applies to appellant. It provides:

> Gas lease. Lessee shall pay a royalty of not less than 16 2/3 percent of the market value value [sic] of all natural gas and products extracted therefrom produced and sold from his lease. Natural gas used in the reasonable and prudent operation and development of said lease shall be exempted from royalty payment.

As is apparent, this subsection says nothing, one way or the other, about allowances against royalties for post-production expenses. However, the immediately preceding subsection provides:

> (1) Oil lease. All casinghead gas [5/] shall belong to the oil Lessee subject to any rights under existing gas leases. All

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3/ The Board uses the term "post-production" in this decision in the sense appellant uses it. The Board's use of the term is for convenience only and should not be construed as a determination that any particular expenses arise "post-production."

The meaning of the term "post-production" in any given context necessarily depends upon the meaning of the term "production." While "production" may sometimes mean the raw product as it comes from the well, it does not always carry such a meaning. For instance, for purposes of royalty valuation under the Mineral Leasing Act of 1920, 30 U.S.C. § 226 (1988), which governs oil and gas leasing of Federal lands, gas "production" has been defined to mean gas conditioned for market. See, e.g., Mesa Operating Limited Partnership v. U.S. Department of the Interior, 931 F.2d 318, 325 (5th Cir. 1991); California Co. v. Udall, 296 F.2d 384, 387-88 (D.C. Cir. 1961). Under this interpretation, expenses incurred in conditioning gas for market are expenses of production, and royalties must therefore be paid on those expenses. See also 30 CFR 206.152(i); 206.153(i).

4/ As relevant here, section 3 of the 1906 act was amended in 1950 to provide "[t]hat the royalties to be paid to the Osage tribe under any mineral lease so made shall be determined by the Osage Tribal Council, subject to the approval of the Secretary of the Interior." Act of June 15, 1950, 64 Stat. 215. The 1906 act had provided that royalties would be determined by the "President of the United States."

5/ “Casinghead gas” is defined at 25 CFR 226.1(i) as “gas produced from an oil well as a consequence of oil production from the same formation.”

> casinghead gas removed from the lease from which it is produced shall be metered unless otherwise approved by the Superintendent and be subject to a royalty of not less than 16 2/3 percent of the market value of the gas and all products extracted therefrom, less a reasonable allowance for manufacture or processing. [6/] If an oil lessee supplies casinghead gas produced from one lease for operation and/or development of other leases, either his/hers or others, a royalty of not less than 16 2/3 percent shall be paid on the market value of all casinghead gas so used. All casinghead gas not utilized by the oil Lessee may, with the approval of the superintendent, be utilized or sold by the gas Lessee, subject to the prescribed royalty of not less than 16 2/3 percent of the market value. [Emphasis added.]

[1] In light of the inclusion of an allowance provision in subsection 226.11(b)(1), the lack of such a provision in subsection 226.11(b)(2) takes on added weight. Under relevant rules of construction, the two provisions must be read in pari materia. "[W]here a statute with respect to one subject contains a given provision, the omission of such provision from a similar statute is significant to show a different intention existed." Richerson v. Jones, 551 F.2d 918, 928 (3rd Cir. 1977); Cherokee Nation v. Muskogee Area Director, 22 IBIA 240, 245-46 (1992). "[R]egulations are interpreted in accordance with traditional principles of statutory construction." Solano Garbage Co. v. Cheney, 779 F. Supp. 477, 487 (E.D. Cal. 1991); Okie Crude Co. v. Muskogee Area Director, 23 IBIA 174, 180 (1993). In this case, the close proximity of the two dissimilar provisions makes it especially apparent that the drafters did not intend to authorize deduction of allowances from royalties subject to subsection 226.11(b)(2).

Although the Board does not consider the regulation ambiguous in this regard, it observes that any ambiguity would have to be resolved in favor of the Tribe. As the Board stated in Mobil Oil Corp. v. Albuquerque Area Director, 18 IBIA 315, 330, 97 I.D. 215, 223 (1990):

> Both the statutes and the regulations concerning Indian mineral resources are subject to the rule that enactments intended to benefit Indians must be liberally construed in their favor. Jicarilla Apache Tribe v. Andrus, 687 F.2d 1324,

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6/ Neither “manufacture” nor “processing” is defined in Part 226. “Processing” is, however, defined in the Minerals Management Service (MMS) regulations discussed infra. As defined by MMS, “processing” would seem to include appellant’s “treatment,” by which appellant apparently means removal of carbon dioxide (Affidavit of Earl G. Hoff at 2), but would not include “compression,” for which appellant also seeks an allowance. See 30 CFR 206.151.

Accordingly, were appellant subject to subsection 226.11(b)(1) instead of subsection 226.11(b)(2), and were BIA to define “processing” as MMS does, appellant would likely be entitled to deduct at least some of the costs for which it seeks an allowance.

> 1331-32 (10th Cir. 1982). Further, where the mineral leasing regulations may reasonably be interpreted in two ways, the trust responsibility requires that the Secretary choose the alternative which is in the best interests of the Indians. Jicarilla Apache Tribe v. Supron Energy Corp. 728 F.2d 1555, 1566-69 (10th Cir. 1984), dissenting opinion adopted as majority opinion, 782 F.2d 855 (10th Cir.) (en banc), cert. denied, 479 U.S. 970 (1986).

[2] The Board finds that the regulations in Part 226 do not authorize the allowances appellant seeks.

Appellant's lease provides at paragraph 2:

> (a) The lessee hereby agrees to pay or cause to be paid to the Superintendent * * * for the lessor, as royalty, the sum of 16-2/3 per cent of the value of said gas at the well determined as hereinafter provided, after first deducting the gas used for fuel in drilling and operating the lease by either the gas or oil lessee; * * * The basis for measurement of gas sold shall be ten ounces above atmospheric pressure, to which basis all gas shall be reduced by computation no matter at what pressure it may have been actually measured. Beginning March 17, 1916, and until March 16, 1918, the basis on which royalty shall be paid shall be 18 cents per thousand cubic feet, and the basis on which royalties shall be paid for each five-year period thereafter during the full term of this lease shall be the value of said gas at the well which shall be determined by the Secretary of the Interior and approved by the President.
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> (b) It is understood and agreed that should the price basis on which royalty shall be paid be increased for any such five-year period as provided in the foregoing paragraph the lessee shall have thirty days from date of receipt of notice of such modified royalty basis within which to elect either to accept the same or to surrender the lease.

Paragraph 3(b) of the lease provides: "Lessee also covenants and agrees that he will pay the royalty as herein provided on all gas utilized and removed from the leased lands."

Appellant contends that the lease should be interpreted to authorize allowances because it provides that royalties are to be paid on "the value of * * * gas at the well." It is true, as appellant argues, that under the law governing private oil and gas leasing, certain post-production expenses may be shared by the lessor when production is valued at the well. See, e.g., 3 Williams and Meyers, Oil and Gas Law § 645.2 (1992). The Board has stated on a number of occasions, however, that the law governing non-Indian oil and gas leases may not be mechanically applied to Indian leases but, where sought to be so applied, must be analyzed to ensure that it does not conflict with overriding principles of Federal Indian law. E.g., Benson Montin-Greer-Drilling Corp. v. Acting Albuquerque Area Director, 21 IBIA 88, 96, 98 I.D. 419, 424 (1991), aff'd, Benson-Montin-Greer Drilling Corp. v. Lujan, No. CIV-92-210 SC-LFG (D.N.M. Jan. 13, 1993); Mobil Oil Corp., 18 IBIA at 323-31, 97 I.D. at 219-23. Appellant does not attempt to provide such an analysis in this case.

Arguably more relevant here than the law upon which appellant relies is the body of law which has developed in the Department and the Federal courts concerning Federal and Indian (other than Osage) oil and gas leases. See, e.g., Shoshone Indian Tribe v. Hodel, 903 F.2d 784 (10th Cir. 1990); R.E. Yarborough & Co., 122 IBLA 217 (1992); Kerr-McGee Corp., 22 IBLA 124 (1975). 7/ The present regulations governing valuation of gas production for Federal and non-Osage Indian leases were promulgated by MMS in 1988 and are found in 30 CFR Part 206, Subpart D. These regulations provide for certain allowances against royalties. See 30 CFR 206.156-157 (transportation allowance); 30 CFR 206.158-159 (processing allowance).

Osage oil and gas leases are, however, explicitly excluded from the coverage of the MMS regulations. 30 CFR 206.150(a). Moreover, the substantial difference in approach between the MMS regulations and the Osage regulations makes it inappropriate to draw upon the MMS regulations for an analogy here, even though the MMS regulations govern other Indian leases. The allowances authorized in the MMS regulations are only a part of an elaborate MMS valuation procedure, none of which is employed in determining Osage royalties. In this case, valuation for royalty purposes has been a subject of negotiation between the parties, at least in recent years. It appears, therefore, that if the parties had intended to provide for allowances, they could and should have included such a provision in their agreement, as has been done in other Indian oil and gas leases. 8/

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7/ Kerr-McGee Corp., which involved a lease of Navajo tribal land, is the earliest Departmental adjudication of which the Board is aware in which the law concerning allowances, as developed in cases involving Federal leases, was applied to a lease of Indian land. In that case, it was held that the Tribe's royalty interest was chargeable with reasonable transportation costs when there was no market for oil and gas in the field where it was produced. The decision does not discuss the Indian mineral leasing statutes or indicate that any different or additional factors were taken into consideration because the lease at issue was an Indian lease.

It has apparently been the consistent practice of the Department not to differentiate between Federal and non-Osage Indian leases with respect to allowances against royalties. See, e.g., R.E. Yarborough & Co. The present MMS regulations do, however, provide that a provision of a statute, treaty, lease, or settlement agreement will prevail over the regulations to the extent of any inconsistency, 30 CFR 206.150(b), and that "[t]he regulations * * * are intended to ensure that the trust responsibilities of the United States with respect to the administration of Indian oil and gas leases are discharged in accordance with the requirements of the governing mineral leasing laws, treaties, and lease terms." 30 CFR 206.150(d).

8/ For instance, the lease at issue in Shoshone Indian Tribe included a provision authorizing “a reasonable allowance for the cost of manufacture.” 903 F.2d at 787.

No such provision appears either in appellant's original lease or in the much more recently negotiated amendments.

It is also significant that, as far as the record here shows, neither BIA nor appellant has previously interpreted the regulations or the lease to authorize allowances against royalties. Appellant apparently has, until now, paid royalties on the market value of gas sold or used in its refinery, with no allowance for post-production expenses. The Area Director states in his answer brief that neither appellant nor any of its predecessors has previously sought or been allowed such an allowance (Area Director's Brief at 5). Appellant has not refuted this statement, although it had an opportunity to do so by filing a reply brief. Appellant is therefore deemed to have conceded the accuracy of the Area Director's statement.

Appellant does not put forth any reason why its present circumstances warrant an allowance when it had no allowance previously. Indeed, appellant states that its present post-production expenses are "reasonably consistent with monthly post-production costs incurred by Appellant when lease production was being sold on the spot market or under the Phillips contract" (Appellant's opening Brief at 10).

Given the language of Part 226, the rules of construction discussed, the lack of any specific provision for an allowance in appellant's lease, and the apparently consistent past interpretation of the regulations and lease by both BIA and appellant, the Board finds that it was reasonable for the Area Director to decline to authorize an allowance against royalties for post-production expenses. The Board therefore affirms the Area Director's decision insofar as it determined the royalty price for appellant's lease.

Concerning the "development" portion of the Superintendent's and Area Director's decisions, appellant appears to contend that, because it has spent more than the $500,000 required in Resolution 27-200, the Superintendent had no authority to require further development or to remove acreage from the lease. Appellant suggests that, once it had expended the required amount, it had earned "the right to continue to hold all undeveloped acreage under the Lease, without further development, until March 16, 1993" (Appellant's Sept. 27, 1991, Letter to the Superintendent at 5). Appellant seeks rulings from this Board that its obligations under the resolution have been fulfilled and that the lease has been prudently developed by appellant and its predecessors (Appellant's Opening Brief at 5).

The Area Director argues that, under Resolution 27-200, the Superintendent retained his authority under 25 CFR 226.9(a) to order further development and to cancel undeveloped portions of the lease.

25 CFR 226.9(a) provides in relevant part:

> [T]he Superintendent in his discretion may order further development of any leased acreage or separate horizon if, in his opinion, a prudent operator would conduct further development. If Lessee

> refuses to comply, the refusal will be considered a violation of the lease terms and said lease shall be subject to cancellation as to the acreage or horizon the further development of which was ordered.

Resolution 27-200 provides, with respect to the Superintendent's authority in this regard:

> [D]evelopment of the lease shall be reviewed by the Superintendent on or about March 17, 1989, and annually thereafter, to determine whether [appellant] is prudently developing the lease under its undertakings of this modification amendment. The Superintendent has the right specified in 25 CFR 226.9(a) to order the termination of portions of the lease not being so prudently developed.

Although Resolution 27-200 required appellant to spend at least $500,000 on development, it did not guarantee that expenditure of that amount would immunize appellant against cancellation proceedings under the regulations. Appellant's obligation under paragraph 1A of the resolution was to develop the lease, not simply to spend money. Further, the resolution specifically incorporated the regulatory provision concerning cancellation. The Board rejects appellant's argument that its expenditure of $500,000, per se, rendered its actions prudent and exempted it from cancellation proceedings under 25 CFR 226.9(a).

Appellant also objects to the Area Director's apparent interpretation of Resolution 27-200 as requiring that a well be drilled in each quarter section of the lease.

The Area Director's decision states in relevant part:

> In dealing with any question of proper development of a lease, a primary factor to consider is the area developed by each producing well. [Resolution 27-200] specifically states that a producing or shut-in gas well capable of production can hold only 160 acres of the overall lease. It is clear that the 160-acre (quarter section) area should be used as the acreage standard.
>
> [Appellant] has attempted to suggest that over 75 percent of their lease acreage has been developed. * * * Our investigation reveals that this is a false assumption. Of the 662 quarter-section sects comprising this blanket lease, 469 have not been developed for gas. An additional 56 tracts had gas wells at one time, but these have been plugged; therefore, over 82 percent of the available tracts are not developed at the present time. [Appellant's] figures tend to distort the actual facts due to their use of average numbers of wells per section, rather than the 160-acre quarter section tracts mentioned in Resolution 27-200. This Office has reviewed plat maps covering this area which show the place where development has taken place. The true facts are that [appellant] and predecessors to this lease have drilled

> many wells in close proximity to one another at several points in the lease, as there are 48 quarter-sections containing three or more wells, and 14 of these have five or more wells per quarter. Obviously, if the criteria set out in Resolution 27-200 were used, each 160-acre tract requires one well to be developed. Closely spaced wells cannot serve to develop large areas within the lease.

(Area Director's Decision at 3).

Appellant argues that the Area Director erred in his interpretation of Resolution 27-200. It contends that the resolution employed the 160-acre measure as a limitation upon the Superintendent's authority to cancel portions of the lease and that the Area Director inappropriately converted the limitation into an affirmative requirement to drill a well in each quarter section.

The Board agrees that the quoted portion of the Area Director's decision suggests that he may have expanded the significance of the 160-acre measure beyond the apparent intent of the resolution. The Board also agrees with appellant's further argument that the Superintendent was required to determine, prior to ordering further development of the lease, that a prudent operator would conduct further development. This requirement appears in both the regulation and the resolution. No such determination is included in the Superintendent's October 10, 1991, decision. 9/

In his October 10 decision, the Superintendent reduced the area required to be developed from 80,000 acres to 10,080 acres. This reduction clearly lessened the burden imposed on appellant by the September 12 decision. No reason is given in the October 10 decision, however, for the choice of the particular acreage listed. Nor does the administrative record show the reason for the choice.

[3] It is clear that the regulations vest the Superintendent with discretion in ordering further development of a lease. See 25 CFR 226.9(a): "[T]he Superintendent in his discretion may order further development of any leased acreage or separate horizon if, in his opinion, a prudent operator would conduct further development." (Emphasis added.) Where a BIA decision is based on the exercise of discretion, the Board does not substitute its judgment for BIA's. E.g., Honaghaahnii Marketing & Public Relations, Inc. v. Navajo Area Director, 18 IBIA 144, 148 (1990)). The Board does require, however, even in the case of a discretionary decision, that the BIA decisionmaker explain the reason for his/her decision. E.g., Quileute

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9/ Arguably, the Superintendent made such a determination, general in nature though it might have been, in his Sept. 12, 1991, decision. He there stated: "Based upon the fact that a total of over 80,000 acres have not been developed, out of a total of 105,844.56 acre lease, and that your company or its predecessors have held the lease since 1916, 1 feel that it is clear that additional development is required."

Tribe v. Portland Area Director, 23 IBIA 20 (1992). See Bowen v. American Hospital Association, 476 U.S. 610, 626-27 (1986) ("[A]n agency's explanation of the basis for its decision must include 'a rational connection between the facts found and the choice made'"; an agency has a responsibility "to explain the rationale and factual basis for its decision, even though we [the Court] show respect for the agency's judgment in both").

[4] Further, the administrative record must be adequate to support the decision. McPhail v. Acting Muskogee Area Director, 18 IBIA 353 (1990); GMG Oil & Gas Corp. v. Muskogee Area Director, 18 IBIA 187 (1990). As was held in those cases, where the administrative record furnished to the Board does not support the decision appealed, the decision must be vacated and the case remanded for development of an adequate record and issuance of a new decision.

It is apparent that a large portion of the lease has not been developed. Appellant concedes as much. See Appellant's Sept. 27, 1991, Letter to the Superintendent at 3-4. It may well be that parts of the lease ought to be cancelled if they are not developed. But BIA, upon ordering appellant to develop particular acreage, must explain its reasons for choosing that acreage and for concluding that a prudent operator would develop it. 10/

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 CFR 4.1, the Muskogee Area Director's February 14, decision is affirmed in part. With respect to the development requirement, however, the decision is vacated, and this matter is remanded to the Area Director for further proceedings.

//original signed
Anita Vogt
Administrative Judge

I concur:

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Kathryn A. Lynn
Chief Administrative Judge

10/ If BIA imposes a requirement to drill a well in each quarter section, as suggested in the Area Director's decision, it should explain its reasons for concluding that a prudent operator would do so.