Editor's note: Reconsideration denied by Order dated Dec. 20, 1993; Appealed -- sub nom. General Electric Holdings, Inc. v. Babbitt, Civ.No. A4-93-153 (D.ND Nov. 30, 1993), dismissed with prejudice, (settled) (March 15, 1995)

LADD PETROLEUM CORP.

IBLA 91-200 Decided August 27, 1993

Appeal from a decision of the Director, Minerals Management Service, denying appeals from letter-decisions of the Royalty Compliance Division, Royalty Management Program, directing payment of additional royalties for wet gas production from Federal oil and gas lease Nos. 255-030981 and 284-031008. MMS-86-0447-O&G, MMS-87-0162-O&G.

Affirmed.

1. Oil and Gas Leases: Royalties: Natural Gas Liquid Products

MMS may properly require a royalty payor selling unprocessed wet gas at the wellhead pursuant to arm's-length percentage-of-proceeds contracts to value such gas for royalty purposes at an amount equal to one-third of the value of the liquids extracted from the gas and 100 percent of the value of the residue gas where that amount exceeds the gross proceeds accruing to the royalty payor.

2. Oil and Gas Leases: Royalties: Generally

Where the purchaser of residue gas under a contract for the sale of all the residue gas in a field reduces its purchases of that gas but still buys more than 50 percent of the residue gas in the field, MMS may properly value all the residue gas for royalty purposes at the price established in the contract for sale of that gas, even though the gas not taken under the contract is later sold at a lower price.

APPEARANCES: Marla J. Williams, Esq., Denver, Colorado, for Ladd Petroleum Corp.; Peter J. Schaumberg, Esq., Howard W. Chalker, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE KELLY

Ladd Petroleum Corporation (Ladd) has appealed from a December 4, 1990, decision of the Director, Minerals Management Service (MMS), denying its appeals from various orders of the Royalty Compliance Division (RCD), Royalty Management Program, MMS, directing the payment of additional royalties for two Federal onshore oil and gas leases. The appealed

RCD orders included two August 12, 1986, letter-decisions requiring the payment of $121,087.29 in additional royalties for Federal oil and gas lease No. 255-030981 and $114,652.01 in additional royalties for Federal oil and gas lease No. 284-031008, respectively, for the period September 1981 through January 1983 (MMS-86-0447-O&G), and two March 6, 1987, letter-decisions assessing $184,743.63 in additional royalties for lease No. 255- 030981 and $173,980.46 in additional royalties for lease No. 284-031008, respectively, for the period February 1983 through December 1984 (MMS-87- 0162-O&G).

Ladd is the operator and royalty payor for five wells located on Federal oil and gas lease Nos. 255-030981 and 284-031008 in the Scairt Woman Field, McKenzie County, North Dakota. The Duncan Federal 30-22 and 30-24 wells produce natural gas and associated liquid hydrocarbons while the Duncan Federal 30-22A, 30-24A, and 30-34 wells produce crude oil and associated casinghead gas.

During the relevant time period, Ladd sold the gas well gas and the casinghead gas to Koch Hydrocarbon Company (Koch) pursuant to two virtually identical arm's-length percentage-of-proceeds contracts. Both the casinghead gas processing agreement between Ladd and Koch dated June 25, 1980, and amended August 1, 1982, and January 28, 1983 (Tab 8 to Ladd's Apr. 10, 1987, Statement of Reasons (SOR) to the Director, MMS), and the gas well gas processing agreement between Ladd and Koch dated February 23, 1981, and amended April 10, 1981 (Tab 9 to Ladd's Apr. 10, 1987, SOR to the Director, MMS), provided that Ladd sold its gas at the wellhead and that title passed to Koch at that point. Koch then processed the gas at its Grasslands processing plant, located 40 miles from the leases, to recover natural gas liquid products (NGLP), sulphur, and dry residue gas. Pursuant to section 7.1 of both contracts, Koch paid Ladd an amount equal to "seventy-five percent (75%) of the net sales proceeds received for the liquefiable hydrocarbons, residue gas and sulphur saved and sold * * * less the fees attributable thereto." The referenced fees included compression, electrical power (including that used to transport the gas), and treatment costs.

Prior to February 1983 Koch sold all the residue gas processed at its Grasslands processing plant to Montana-Dakota Utilities (MDU) pursuant to a gas purchase contract dated December 20, 1979 (Tab 10 to Ladd's Apr. 10, 1987, SOR to the Director, MMS). Beginning in February 1983, MDU reduced its residue gas purchases and stored the unsold gas. As a result of MDU's action, Koch allocated a proportionate share of the unsold, stored gas to Ladd's account and suspended its obligation to Ladd with respect to that gas. Ladd and Koch ultimately agreed that Koch or its affiliate would purchase Ladd's stored gas at a price less than the MDU contract price.

Ladd valued its gas for royalty purposes at an amount equal to the price it received from Koch under their contracts, i.e., at 75 percent of the sales proceeds of the NGLP, sulphur, and dry gas, less fees for compression, electrical power, and treatment. Ladd continued to use the MDU contract price as the sales proceeds for all the residue gas, even after February 1983.

In 1986, the North Dakota State Auditor, acting pursuant to section 205 of the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. § 1735 (1988), reviewed Ladd's royalty valuation for the period September 1981 through December 1984. The State Auditor recomputed the royalty value of gas production from the leases using the value of 100 percent of the residue gas and one-third of the extracted products, and, by letters dated May 6, 1986, informed Ladd that Ladd had underpaid royalties for lease No. 255-030981 by $305,830.92 and for lease No. 284-013008 by $288,632.47. Ladd responded, arguing that the reasonable value of the gas produced from its leases did not exceed the proceeds it actually received, and asserting that, because the stored gas was sold at a price lower than the MDU contract price, it was entitled to a credit or refund of $75,793.41.

By letter-decisions dated August 12, 1986, RCD upheld the State Auditor's valuation methodology and concluded that Ladd had underpaid royalties on lease No. 255-030981 by $121,087.29 and on lease No. 284-031008 by $114,652.01 for the period September 1981 through January 1983. Ladd appealed these decisions to the Director, MMS. By letter-decisions dated March 6, 1987, RCD again approved the State Auditor's valuation formula and determined that Ladd owed additional royalties for the period February 1983 through December 1984 in the amounts of $184,743.63 for lease No. 255-030981 and $173,980.46 for lease No. 284-031008. Ladd also appealed these decisions to the Director, MMS. In its appeals to the Director, Ladd essentially argued that the valuation method utilized by RCD was arbitrary and capricious because it ignored the existence of actual wellhead sales, the costs of processing the dry gas, the costs of processing NGLP and sulphur in excess of two-thirds of the tailgate value of those products, the costs of transporting the gas from the leases to the Grasslands processing plant, and Koch's inability to sell a substantial portion of the residue gas at the MDU contract price.

In his December 4, 1990, decision, the Director consolidated Ladd's appeals and concluded that Ladd should have valued its gas at an amount equal to the full value of the residue gas plus one-third of the value of the NGLP and sulphur. He observed that under longstanding Federal policy, the royalty value of any liquid manufactured from natural gas produced on Federal leases could reflect a maximum two-thirds allowance for processing costs and that under no circumstances could the aggregate royalty on the residue gas and extracted liquids be less than 100 percent of the value of the residue gas plus one-third of the extracted liquids. Such valuation, he held, comported with Notice to Lessees and Operators of Federal and Indian Onshore Oil and Gas Leases (NTL-5), 42 FR 22610 (May 4, 1977), the Notice to Lessees Numbered 5 Gas Royalty Act (NTL-5 Act), P.L. 100-234, 101 Stat. 1719 (1988), applicable regulations, and longstanding Departmental practice.

The Director rejected Ladd's assertion that because MMS' consistent policy had been to accept the gross proceeds received under the terms of an arm's-length contract for royalty valuation purposes, Ladd's royalty payments based on such gross proceeds should have been allowed. While acknowledging that MMS' general policy included consideration of valid arm's-length contract prices for royalty valuation purposes, the Director indicated that application of this policy was limited by the regulatory provisions of 30 CFR Part 206 (1987), and that valuations inconsistent with the regulations could not be approved.

Ladd's contention that the costs incurred in transporting the wet gas 40 miles from the wellhead to the processing plant should have been separately deductible from the market value of the gas had no relevance to this case, the Director determined, because Ladd had never sought a transportation allowance for those costs. The Director countered Ladd's argument that royalties should have been based on the value of the raw, unprocessed gas at the wellhead by citing the lessee's well settled duty to place the gas in marketable condition and bear all operating expenses associated with bringing the production to market. Due to Ladd's failure to provide any documentary evidence supporting the alleged high costs of processing wet gas with a large hydrogen sulphide content, the Director considered hypothetical Ladd's allegation that extraordinary circumstances warranted a processing allowance higher than two-thirds of the value of the processed liquids. He also found that MMS' valuation methodology did not effectively increase the Government's royalty rate above the statutorily prescribed 12.5 percent.

Finally, the Director rejected Ladd's challenge to MMS' use of the MDU contract price as the value of all of the residue gas, noting that the royalty value of production may exceed the sale price if the sale proceeds do not fairly represent the value of production. He determined that MMS' valuation of the stored residue gas sold by Koch to its affiliate at the MDU contract price fully complied with the regulations requiring that due consideration be given to the highest price paid for a part or a majority of production in a given field. Because he concluded that MMS had properly applied the pertinent regulations and correctly declined to accept the net proceeds from Ladd's percentage-of-proceeds contracts as value for royalty purposes, the Director denied Ladd's appeals.

In its SOR (and response to MMS' answer), Ladd submits that it properly paid royalties based on the proceeds it received pursuant to its arm's-length percentage-of-proceeds contracts with Koch. Ladd challenges MMS' computation of royalty based on the full value of the residue gas and one- third of the value of the processed liquids as arbitrary and capricious both generally and as specifically applied to Ladd's situation. Ladd avers that the use of that net-back formula ignores the existence of actual wellhead sales and deviates from MMS' historical acceptance of such sales as value for royalty purposes. Ladd asserts that royalty accrues on the fair market value of the gas at the lease before it is processed and that the use of a net-back formula, instead of actual wellhead sales as exemplified by its contracts with Koch, is inconsistent with 30 CFR 206.103 (1987) which requires that, in determining royalty value, MMS must give due consideration to the price received by the lessee. The use of a net-back formula, Ladd contends, impermissibly departs from MMS' longstanding policy of adopting gross proceeds under an arm's-length contract as determinative of value for royalty purposes and may not be applied retroactively to gas produced during the period at issue here.

Ladd argues that, even if the use of a net-back formula were otherwise justified, that method as applied to Ladd here is unreasonable because it limits the processing allowance to two-thirds of the value of the extracted liquids, an amount which, Ladd claims, was a reasonable approximation of processing costs at the time it originated but was never intended to exclude the costs of processing dry gas. MMS' automatic restriction of the processing allowance to no more than two-thirds of the value of the liquids precludes consideration of extraordinary circumstances such as the elevated cost of processing a gas stream with high concentrations of hydrogen sulphide, Ladd contends, thus effectively constituting an irrebuttable presumption and thwarting the Secretary's flexibility in determining the reasonable value of unprocessed gas. Ladd insists that MMS should not have disregarded the costs of processing the dry gas in its computation of the processing allowance, disputing MMS' conclusion that Ladd's duty to market the gas obligated Ladd to process the dry gas at no cost to the Government and suggesting that no logical distinction can be made between dry gas and any other product derived through processing.

Ladd objects to MMS' failure to consider the costs of transporting the gas over 40 miles from the leases to the Grasslands processing plant, asserting that the tailgate price of the products from the wet gas was enhanced by transportation as well processing. Ladd avers that, since during the disputed period, no regulation mandated the filing of an application for a transportation allowance, Ladd's failure to file such a request does not justify disregarding its transportation costs. In any event, Ladd suggests, such costs are actually transportation factors included in its sales contracts which reduce its gross proceeds rather than actual transportation costs which it incurs and for which applications are currently required.

Ladd argues that by ignoring the actual proceeds it received from the sale of the gas and determining the value of the gas for royalty purposes on the basis of the full value of the dry gas and one-third of the NGLP and sulphur, MMS has effectively and impermissibly increased the royalty rate above the statutorily established 12.5 percent. The application of the MMS formula to the facts of this case, Ladd claims, results in unconventional and arbitrary meanings being given to common words and creates a royalty obligation that greatly exceeds the obligation Ladd would have under a non-Federal lease containing identical language.

Finally, Ladd contests MMS' valuation of all the residue gas at the MDU contract price. Ladd notes that MDU's curtailment of dry gas purchases from the Grasslands plant to slightly over one-half of its previous volume affected all producers in the field. Although it continued to pay royalty for the stored gas based on the MDU contract price, Ladd insists that the spot market price Koch or its affiliates eventually paid for the stored gas was the best available price for that gas. Ladd reiterates its claimed entitlement to a refund for its overpayment of royalties for the dry gas. 1/

1/ Ladd has requested a hearing on any facts disputed by MMS. We find that no significant facts material to the resolution of this appeal are in dispute and deny Ladd's hearing request.

In its answer, MMS denies that it was required to accept the gross proceeds received by Ladd under its percentage-of-proceeds contracts with Koch as the royalty value for the produced wet gas, stressing that gross proceeds form a floor value for royalty purposes. The royalty value regulations, MMS asserts, require it to compare Ladd's gross proceeds to the value of 100 percent of the dry gas and one-third of the value of the produced liquids, and to compute royalties based on the greater amount. Because it valued Ladd's gas in accordance with the regulations, MMS contends that the Board, which is bound by the Department's duly promulgated regulations, must affirm MMS' royalty valuation.

MMS argues that it correctly valued the stored residue gas sold by Koch to itself or its affiliates at the MDU contract price, averring that the royalty value of production from Federal leases may exceed the sales price if the sales proceeds do not fairly represent the value of production. MMS notes that the regulations explicitly state that royalty value may properly be based on the highest price paid for a part or for the majority of production of similar quality from the same field, and that absent good reason to the contrary, the highest price paid for the major portion of that production constitutes a reasonable royalty value. Ladd's admission that MDU at all times purchased over one-half of the dry gas from the Scairt Woman field, MMS contends, supports MMS' use of the price paid by MDU as the reasonable value of the residue gas sold by Koch to itself. Although Ladd claims that the actual price paid for the stored residue gas equalled or surpassed the prevailing spot market prices for like-quality gas, MMS highlights Ladd's failure to present evidence of the relevant spot market prices or to document any attempts by Koch to sell the gas at a price matching the MDU contract price.

MMS also maintains that Ladd's failure to request a transportation allowance necessarily resulted in MMS' disregard of those costs in computing royalty value. The regulations and NTL-1, 42 FR 4546, 4548 (Jan. 25, 1977), MMS asserts, require that an application be filed and approved before a lessee may deduct transportation costs from value for royalty purposes. MMS avers that it acted in accordance with these authorities by not permitting Ladd to take a transportation allowance for which it did not apply. MMS indicates, however, that it has authorized retroactive allowances, and that if Ladd submits a request for such an allowance, with supporting data, MMS will consider and respond to that request.

[1] Section 17 of the Mineral Leasing Act, as amended, 30 U.S.C. § 226 (1988), requires the payment of royalty based on the "amount or value of production removed or sold from the lease." The statute does not impose any particular method for valuing production removed or sold from a Federal oil and gas lease; rather it authorizes the Secretary of the Interior "to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes" of the Act. 30 U.S.C. § 189 (1988). Thus, the Secretary has the authority and responsibility to establish the reasonable value of production for royalty purposes, as well as considerable discretion in determining that value. See, e.g., Amoco Production Co., 126 IBLA 124, 126 (1993), and cases cited therein; Wexpro Co., 106 IBLA 57, 61 (1988).

During the period at issue here, the regulations at 30 CFR Part 206 (1987) (formerly codified at 30 CFR Part 221 (1982)) governed the determination of royalty value for gas production from Federal onshore oil and gas leases. 2/ The general regulation addressing the value basis for computing royalties, 30 CFR 206.103 (1987), reads:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

The specific regulations governing the royalty on gas, 30 CFR 206.105 (1987) and 30 CFR 206.106 (1987), provide, in relevant part:

> § 206.105 Royalty on gas
>
> The royalty on gas shall be the percentage established by the terms of the lease of the value or amount of gas produced.
>
> (a) Royalty accrues on dry gas, whether produced as such or as residue gas after the extraction of gasoline.

2/ Effective Mar. 1, 1988, the Department substantially revised the regulations relating to gas valuation for royalty purposes. See 53 FR 1230 (Jan. 15, 1988). We note that in that rulemaking the Department specifically examined the question of valuation under percentage-of-proceeds contracts, and the current unprocessed gas regulation, 30 CFR 206.152, explicitly states that the processed gas regulation, 30 CFR 206.153, applies when wet gas is sold under a percentage-of-proceeds contract. The revised regulations operate prospectively only, however, covering gas produced on or after Mar. 1, 1988. See BWAB Inc., 108 IBLA 250, 257 n.2 (1989). References in this decision to gas valuation regulations are to the regulations in effect during the relevant periods in dispute unless otherwise noted.

(b) If the lessee derives revenue on gas from two or more products, a royalty normally will be collected on all such products.

(c) For the purpose of computing royalty, the value of wet gas shall be either the gross proceeds accruing to the lessee from the sale thereof or the aggregate value determined by the Secretary of all commodities, including residue gas, obtained therefrom, whichever is greater.

§ 206.106 Royalty on casing-head or natural gasoline, butane, propane, or other liquid hydrocarbon substances extracted from gas [3/]

A royalty as provided in the lease shall be paid on the value of one-third (or the lessee's portion if greater than one-third) of all casing-head or natural gasoline, butane, propane, or other liquid hydrocarbon substances extracted from the gas produced from the leasehold. The value of the remainder is an allowance for the cost of manufacture, and no royalty thereon
is required. The value shall be so determined that the minimum royalty accruing to the lessor shall be the percentage established by the lease of the amount or value of all extracted hydrocarbon substances accruing to the lessee under an arrangement, by contract or otherwise, for extraction and sale that has been approved by the Associate Director.

* * * * * * *

(b) * * * [N]o allowance shall be made for boosting residue gas, or other expenses incidental to marketing.

The allowance for the cost of manufacture is also known as a processing allowance.

The Board has recently decided two separate appeals contesting the
use of the aggregate value net-back approach to determine the royalty value of wet gas sold at the wellhead pursuant to an arm's-length percentage-of-proceeds contract in those circumstances in which the aggregate value computation resulted in a valuation greater than that obtainable under the

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3/ We note that although sulphur does not appear to be covered by this regulation, MMS authorized a processing allowance for the sulphur extracted from the wet gas produced by Ladd. The propriety of using an allowance for sulphur produced from Federal leases may be considered only in the context of an appeal directly challenging the granting or denial of such an allowance. See Amoco Production Co., 126 IBLA at 125-26 n.2; Exxon Co., U.S.A. (On Reconsideration), 121 IBLA 252A, 252D n.2, 98 I.D. 191, 193 n.2 (1992). MMS' decision to permit a processing allowance for the sulphur has not been challenged here.

gross proceeds method. See Amoco Production Co., supra; Kerr-McGee Corp., 125 IBLA 279 (1993) (Kerr-McGee II). In both cases, the Board rejected challenges to this practice, finding that it was clearly consistent with the regulatory framework and the Department's consistent interpretation of that framework, 4/ and that the NTL-5 Act did not mandate a different result. These decisions control here.

Ladd's contention to the contrary notwithstanding, MMS is not bound to accept the contract price as the reasonable value of gas production. Kerr-McGee II, 125 IBLA at 284, citing Kerr-McGee I, 106 IBLA at 82. See also Amoco Production Co., 126 IBLA at 127. In response to arguments virtually identical to those presented by Ladd, the Board rejected the contention that MMS' longstanding practice has been to accept gross proceeds as royalty value, id. at 127-28, finding, to the contrary, that the law has consistently been that royalty is due on the higher of the gross proceeds or the value calculated under the net-back formula. Id. at 131. The Board further concluded that MMS had not retroactively altered its royalty valuation methodology since no new method had been adopted. Id. In response to the allegation that MMS had made numerous statements indicating that it would accept gross proceeds under an arm's-length contract as a basis for calculating value, the Board held that the fact such proceeds may be acceptable as value in some circumstances did not mean that MMS was bound to accept them in every case. Id. and n.14. Ladd's comparable arguments similarly fail.

None of Ladd's arguments persuades us that MMS' use of the net-back formula in valuing the unprocessed wet gas sold at the wellhead under its percentage-of-proceeds contracts with Koch resulted in an unreasonable royalty value for that gas. Ladd asserts that limiting the processing allowance to the value of two-thirds of the extracted liquids fails to accurately reflect actual processing costs because it ignores the costs of processing the residue gas. The regulations, however, explicitly restrict the processing allowance to no more than two-thirds of the value of the liquids. 30 CFR 206.106 (1987). The Department has consistently interpreted the deduction to be applicable only against the value of the extracted liquids, even where the processor retains portions of both the dry gas and extracted liquids as compensation for processing the gas. See Amoco Production Co., 126 IBLA at 128-29; Kerr-McGee I, 106 IBLA at 78-79 (discussing Jan. 29, 1947, letter from the Director, U.S. Geological Survey, to Acting Secretary Chapman, concerning royalty valuation under percentage-of-proceeds contracts). The Board's endorsement of the use of one-third of the value of the extracted liquids and the full value of the residue gas as the reasonable value for royalty computation purposes when that amount exceeds the gross proceeds received under arm's-length percentage-of-proceeds contracts in Amoco Production Co., Kerr-McGee I, and Kerr-McGee II necessarily includes the recognition that, in accordance with the applicable

4/ The history of the Department's royalty valuation regulations is set forth in Kerr-McGee Corp., 106 IBLA 72, 76-81 (1988) (Kerr-McGee I).

regulations, no processing allowance may be taken to reduce the value of the residue gas. 5/

We find no merit to Ladd's challenge to the limitation of the processing allowance to two-thirds of the value of the extracted liquids on the ground that the rigid application of the restriction precludes consideration of extraordinary circumstances, such as the exceptionally high costs of processing a gas stream with an unusually large hydrogen sulphide content, thus creating an impermissible irrebuttable presumption and violating the mandate of 30 CFR 206.103 (1987) that due consideration be given to all relevant factors in valuing production. Simply sweetening natural gas by removing hydrogen sulphide constitutes treatment of the gas necessary to place the gas in a marketable condition, and the costs associated with such treatment are not deductible from the value of the gas for royalty purposes. See Exxon Co., U.S.A., 121 IBLA at 246-47, 98 I.D. at 415-16. See also 30 CFR 206.106(b) (1987); 43 CFR 3162.7-1(a). Additionally, since under 43 CFR 3103.3-1(c) (1987), the Secretary has the authority to approve a processing allowance exceeding two-thirds of the value of any product, MMS' use of the two-thirds allowance does not create an irrebuttable presumption. The lack of evidence in the record indicating that Ladd has requested Secretarial approval for an increase in its processing allowance further undercuts the validity of its challenge to MMS' limitation of that allowance. See BWAB Inc., 108 IBLA 250, 261 (1989).

Ladd's objection to the Director's failure to consider the costs of transporting the unprocessed gas from the leases to the processing plant because Ladd did not file a request for a transportation allowance fails. MMS has consistently authorized an allowance for such transportation costs

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5/ Ladd's reliance on Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984), cert. denied, 471 U.S. 1005 (1985), as support for its contention that no distinction should be made between residue gas and other products derived from a wet gas stream for purposes of determining a processing allowance is misplaced. That case arose under a private lease not governed by Federal regulations distinguishing between treatment and processing, and turned on the construction of private lease royalty provisions different from those at issue here. See Exxon Co. U.S.A., 121 IBLA 234, 248-49 n.8, 98 I.D. 409, 417 n.8 (1991). See also Beartooth Oil & Gas Co., 122 IBLA 267, 273-74 (1992). Nor does the Board's decision in Exxon Corp., 118 IBLA 221, 98 I.D. 110 (1991), also cited by Ladd, mandate that a processing allowance be granted against the value of the residue gas in this case. In Exxon Corp., since no liquid hydrocarbons were extracted from the sour gas stream during processing, no regulation specifically addressed valuation of that sour gas stream. Id. at 253, 98 I.D. at 126. Thus the Board's reversal of MMS' limitation of Exxon's processing allowance to two-thirds of the value of the liquids produced, which MMS based on an analogy to the wet gas regulation, does not control situations, such as here, where specific regulations govern MMS' royalty valuation.

in appropriate circumstances. See, e.g., Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, 171 (1990); Petro Lewis Corp., 108 IBLA 20, 35, 96 I.D. 127, 135 (1980). Although Ladd correctly states that no regulation effective during the period at issue here explicitly required the filing of an application for a transportation allowance, NTL-1, 42 FR 4546, 4548 (Jan. 25, 1977), specifically stated that the "[d]eduction of transportation charges will not be allowed unless justified in writing and approved by the Supervisor." See Forest Oil Corp., 111 IBLA 284, 288 (1989). We also note that section 3.9.1 of Volume II of the MMS Oil and Gas Payor Handbook (1986) requires that a payor obtain prior written approval from MMS before deducting a transportation allowance. Thus, we find no error in MMS' refusal to permit Ladd to take a transportation allowance for which it did not apply. In any event, MMS has indicated that Ladd can file a request for a retroactive transportation allowance for the period at issue here, with supporting data, which MMS will review. See MMS Answer at 9.

Because we find none of Ladd's challenges to MMS' use of the net-back formula persuasive and conclude that MMS properly applied that formula to value Ladd's unprocessed gas for royalty purposes, we also reject Ladd's contention that the use of that formula unlawfully increases the Government's royalty above the statutorily prescribed rate.

[2] Ladd's final argument contests MMS' use of the MDU contract price as the value of all of the residue gas produced from the leases despite MDU's curtailment of its purchases of such gas and the ultimate sale of the gas not purchased by MDU at prices lower than the contract price. Although, in accordance with 30 CFR 206.103 (1987), the price received by the lessee is one of the factors to be considered in valuing gas for royalty purposes, MMS is not required to accept the actual price at which the gas is sold as the royalty value of the gas if that price falls below the reasonable value of the gas. See Texaco, Inc., 104 IBLA 304, 310 (1988), and cases cited therein. The provisions of 30 CFR 206.103 (1987) also establish that, absent good reason to the contrary, value computed on the basis of the highest price per thousand cubic feet paid or offered at the time of production in a fair and open market for the majority of like-quality gas produced and sold from the same field is deemed to be a reasonable value.

The record clearly demonstrates that MDU continued to purchase more than 50 percent of the residue gas produced from the Scairt Woman field during the period at issue. See, e.g., Mar. 28 and June 3, 1983, letters from Koch to Ladd, Tabs 11 and 12 to Ladd's Apr. 10, 1987, SOR to Director, MMS. Since the MDU contract price governed the majority of residue gas sales in the field during the entire period at issue here, it constitutes a reasonable value of that residue gas. Cf. Amoco Production Co., 112 IBLA 77, 86 (1989) (spot sales prices were not reasonable value of ethane gas where record indicated that the majority of ethane sales were not governed by that price).

Although Ladd asserts that good reason exists for ignoring that contract price and valuing the stored gas at the lower price it actually received for the gas, we find its arguments unpersuasive. Ladd claims that the price Koch or its affiliates paid to itself for the stored gas at

least equalled the spot price for like-quality gas and supports this assertion with the affidavit of one of its employees. Ladd has not, however, presented any evidence that Koch attempted and failed to sell the stored gas at a price equal to the MDU contract price. Because Koch sold the stored gas to itself or its affiliates, there must be independent indicia establishing that the sales price constituted fair market value for the gas. See Transco Exploration Co., 110 IBLA 282, 322, 96 I.D. 367, 389 (1989), appealed filed, No. 90-191-L (Cl. Ct. Mar. 1, 1990). The simple statement that the sales price was not lower than the spot price, absent evidence
that efforts to obtain a higher price were made and proved fruitless, does not sufficiently prove that the sales price and not the MDU contract price should be the basis for the royalty value of the stored residue gas.

When a party challenges an MMS royalty valuation determination, that party must establish that the methodology used is, in fact, erroneous. Exxon Corp., 118 IBLA at 246, 98 I.D. at 122; Davis Exploration, 112 IBLA 254, 259 (1989), and cases cited therein. Because Ladd has failed to meet its burden of demonstrating that MMS' application of the net-back valuation formula and use of the MDU contract price as the value of the residue gas were wrong, we uphold MMS' valuation determination.

To the extent Ladd has raised arguments not specifically addressed herein, they have been considered and rejected.

Accordingly, 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 affirmed.

John H. Kelly
Administrative Judge

I concur:

David L. Hughes
Administrative Judge